

Reform of Germany's tax audit rules underway

Draft bill on reform of tax audit rules and implementation of DAC7 has been published by German Ministry of Finance in July 2022. Now, the official Draft Bill from the German Federal Government has been published as well.

In brief

On 12 July 2022, the German Ministry of Finance has published a preliminary draft ministerial bill (*Referentenentwurf*, "**Ministerial Bill**") that, *inter alia*, provides for a reform of the tax audit and bookkeeping rules in the German General Tax Code (*Abgabenordnung*) and the German Act on cross-border administrative cooperation within the EU (*EU-Amtshilfegesetz*) for tax audits. The draft has been resolved by the Federal Cabinet on 24 August 2022 and on 29 August 2022 the official Government's Draft Bill (*Regierungsentwurf*, "**Government Draft Bill**") has been published.

At this stage, the Draft Bill has not been passed by the legislative bodies yet, and is therefore still subject to further amendments. The Draft Bill was published as part of an overarching legislative package that also contains the draft bill for the implementation of the **DAC7 Directive**, so that a joint implementation is expected before the end of this year.

The declared **aim** of the reform is to modernize lengthy tax audit procedures and to clarify the set of obligations applicable to both the tax administration and the taxpayer, and also to improve the level of cooperation between taxpayer and tax administration. Rules on the acceleration of tax audits are certainly welcome. However, the Draft Bill also extends the cooperation obligations of the taxpayers and even provides for a **new type of cooperation request** that does not require any reasoning by the tax authorities and can result in severe monetary penalties in case taxpayers are not fulfilling the requests in time. The overall disappointing Draft Bill does not live up to the promise made in the relevant explanations to the effect that taxpayers and tax auditors are supposed to have equal obligations.

It is currently envisaged that the new rules on tax audits are to enter into force for taxation periods starting after 31 December **2024**.

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Key takeaways

- The opening of a tax audit usually suspends the **statutory limitation period**. The Draft Bill now only allows a **maximum suspension of five years**. After the end of the five-year suspension, the assessment of taxes would become statute-barred.
- In addition to the general cooperation obligations incumbent on taxpayers in a tax audit, the Draft Bill provides for the possibility for tax auditors to issue a formal written **qualified request for cooperation** (*qualifiziertes Mitwirkungsverlangen*). Such qualified request for cooperation does not require reasoning, and unresponsiveness within a month can be sanctioned with a penalty of a maximum of EUR 10,000 (EUR 100 x a maximum of 100 days). This new type of penalty may be accompanied by a **surcharge** in the amount of a maximum of EUR 1,000,000 (maximum of EUR 10,000 x maximum of 100 days) for particularly unresponsive tax payers or for taxpayers with high turnover or taxpayers that are part of a big group that may not be threatened by the original penalty.

In depth

Reform of rules on tax audits:

- Online video conferences for meetings and discussions should be possible in the future (Sec. 87 AO). The same applies to closing tax audit meetings (Sec. 201 AO).
- Upon application, individual separable findings may already be assessed during the audit by way of a partial final assessment if there is a justified interest (Sec. 180 (1a) AO).
- Under the Draft Bill, **transfer pricing documentation** would no longer only have to be provided upon request of the tax auditors but **automatically** upon commencement of any tax audit (Sec. 90 AO). In addition, the Draft Bill provides for a 30-day deadline for submitting transfer pricing documentation. The currently applicable provisions, in contrast, make a distinction between ordinary documentation (that has to be provided within 60 days upon request) and documentation on extraordinary business transactions (that has to be provided within 30 days upon request). This new rule is not a simplification but an **additional burden** for taxpayers. In particular in cases where the taxpayer is subject to tax audits without unaudited periods and has conducted a number of similar routine transactions, the documentation is not always requested by the tax auditors because it would not provide any additional insight for the tax auditors.
- The **obligation to inform the tax office and correct past tax returns in case of errors** (Sec. 153 AO) is extended to cases where the tax auditor made findings for the audit period and the fact pattern also applies to post-audit periods. This new extension of the correction obligation aims at accelerating (subsequent) tax audits. In the past, some tax auditors accepted these corrections as findings for the subsequent tax audit. Thus, the new rule constitutes an additional burden for the taxpayer that, if violated, can result in criminal sanctions.
- The initiation of a tax audit usually **suspends the statutory limitation period** (Sec. 171 AO). Provided that the tax auditor starts to perform actual audit measures in the first 6 months, the suspension can, in principle, be indefinite. This can lead to never-ending tax audits that can tie up extensive capacities on the taxpayers' side. The Draft Bill now only allows for a maximum suspension of **5 years** for tax audits. After such period, the assessment of taxes would be statute-barred.
 - The suspension, however, does not apply in case the tax audit has been put on hold upon the taxpayer's request or if criminal proceedings have been opened. Also, in case the tax office has requested cross-border administrative cooperation from another foreign tax office, the deadline is extended by another year (the Ministerial Bill had foreseen a 2-year extension) (but only if the taxpayer has been made aware of this prior to the end of the 5-year deadline). Consequently, tax auditors may use the instrument of cross-border administrative cooperation as means to extend the tax audit period.
 - Further, if a **cooperation delay penalty** (see below) has been imposed due to a delay in cooperation, the maximum duration period of 5 years is to be extended by the duration of the delay (at least by one year). Based on the wording of the law, this would even apply if the taxpayer successfully appealed against the penalty. Again, tax auditors struggling with the maximum period may use this type of penalty as means to lengthen the tax audit period. The original Ministerial Bill was tightened even further: even if it is **impossible** for the taxpayer to comply with the cooperation request, the minimum extension by one year shall apply unless the taxpayer points out the impossibility **immediately**.
- The Draft Bill enables the tax auditors to **request bookkeeping records right at the beginning** when issuing the audit order, and to establish audit focus points on that basis (Sec. 197 AO). This new rule is aimed at accelerating the audit procedure. Fortunately, the Government Draft Bill also provides for a faster initiation of a tax audit. In the future, a tax audit must begin within one year of the end of the year in which the tax assessment notice was issued. If the authority is responsible for the delayed start of the audit, the 5-year suspension will automatically start at the end of the year following the year in which the tax assessment had been issued.
- Further, taxpayer and tax auditor can **agree to discuss audit findings and their potential tax impact on a regular basis** or they can agree on a **basic framework** of the cooperation in the tax audit. If this framework is being followed by the taxpayer, no qualified cooperation request (see

below) shall be made. It remains unclear, however, whether any delay in response may cause a violation of the framework agreement.

- The tax administration may issue a formal written or electronic **qualified request for cooperation** (*qualifiziertes Mitwirkungsverlangen*). Such qualified request for cooperation does **not require reasoning** (In the Government Draft Bill, the only improvement is that the taxpayer must at least be made aware of the possibility of such a request in advance). Unresponsiveness within a month can be sanctioned with a penalty of **EUR 10,000** (EUR 100 x a maximum of 100 days). This new type of penalty may be accompanied by a **surcharge** in a maximum amount of **EUR 1,000,000** for particularly unresponsive tax payers or for taxpayers generating a high turnover or that are subject to a big group that may not be threatened by the original penalty (maximum of EUR 10,000 x maximum of 100 days).
 - The penalty shall not be assessed where the taxpayer provides plausible arguments that the delay is **excusable**. Given that the qualified request made by the tax office does not need to include a reasoning, it will generally be harder for the taxpayer to understand the background of a specific request. To avoid the issuance of a qualified request, taxpayers should aim to agree on a **framework agreement** with the tax auditor at the beginning of a tax audit.
 - The **surcharge** to the penalty may be assessed if a penalty has already been assessed once in the past 5 years and if it cannot reasonably be expected that the taxpayer will respond to the cooperation request; or if it has to be assumed that a taxpayer will not be threatened by the penalty, simply because of its economic outperformance (revenue of a minimum of EUR 12 million; or if the taxpayer is part of a group whose consolidated sales revenues reported in the consolidated financial statements amounted to at least EUR 120 million in one of the calendar years covered by the external audit).
 - If this type of penalty is assessed, the suspension of the statute of limitation will be **extended** for the duration of the delay but **at least by one year (even if fulfilling the cooperation is factually impossible (!))**. If the qualified cooperation request or the assessment of the penalty or surcharge is appealed, the statute limitation period will not end before the expiry of one year after the decision on the appeal.
 - This new type of penalty **replaces** the possibility of the assessment of a (simple) fine for delay (*Verzögerungsgeld*) in the event of delayed responses during tax audits which currently can be between EUR 2,500 and EUR 250,000, provided that the deadline was reasonable.

Reform of rules on cross-border administrative cooperation within the European Union:

- General: The German Act on administrative cooperation between the EU governmental bodies (*EU-Amtshilfegesetz*) contains rules for an automatic exchange of information, for joint audits and for information requests made by one EU governmental body to another.
- End of fishing expeditions in sight? Information requests that are aimed at identifying unknown facts and/or persons can sometimes be vague and very broad. The line between an admissible information request and an inadmissible fishing expedition is typically where investigations are conducted as a "shot in the dark". The Draft Bill now seeks to clearly define that line and contains a legal definition of the circumstances under which a tax office might argue that the facts are expected to be of significant relevance for the taxation in its jurisdiction (*voraussichtliche Erheblichkeit*). The tax administration requesting the data must include detailed reasoning in its information request. By levelling up the formal standard, the requesting authority is forced to specify their information requests instead of just sending out a vague information request. This new formality is, therefore, a pleasant and long overdue update.
- The Draft Bill also sets a higher formal standard for **group information requests**. The requesting authority will be obliged to provide details on the group and elaborate why information is needed and how the requested pieces of information will lead to an impact on the domestic taxation of the requesting authority. It is to be expected that the need to answer these questions prior to issuing the information request will lead to more justifiable information requests and possibly lessen the need to defend against unjustified group information requests.

- License fees to be covered by automatic information exchange: The Draft Bill aims at including license fees in the automatic information exchange system.
- Clarification on procedural rights of non-German tax officers in Germany: Further, the Draft Bill stipulates the rules applicable to tax officers from other EU jurisdictions and specifies which rights and competencies they are to have in Germany (ranging from having the right to be present to having interrogation rights).

Reform of German bookkeeping rules:

The Draft Bill also contains some updates regarding the general bookkeeping rules in Germany:

- Once a permit to relocate the electronic bookkeeping to a non-EU country has been revoked, the tax office could request the bookkeeping to be relocated back to Germany. The Draft Bill clarifies that it will be **sufficient to relocate the bookkeeping to an EU jurisdiction**. This will allow international group companies more flexibility in choosing where to locate their bookkeeping in the EU. The Government Draft Bill now also clarifies that upon request, the bookkeeping may be taken out of Germany to more than one non-EU country.
- A new rule stipulates that a new **electronic interface** could be established by way of a legislative decree in order to facilitate the upload of data and to standardize the **export of data**. This new electronic interface may put an end to discussions about the right IT software to be used between tax administration and taxpayers. However, the new rule will likely result in additional burdens for taxpayers that have to change their systems and implement the new interface. The legislative decree could potentially prescribe the mandatory use of such an electronic interface.
- The taxpayer's **bookkeeping evidential value** (*Beweiskraft*) will be limited if required interfaces are not implemented or if data is not provided in the prescribed electronic format. According to the Draft Bill, the tax office is allowed to reject the bookkeeping if the data has not been provided by electronic means. So far, that has only been possible if the tax office has reason to believe that the data is incorrect. If the bookkeeping is rejected, the tax office is entitled to **estimate** the income of the taxpayer.
- **New administrative offence (Sec. 379 AO):** Non-compliance with German rules on **storing records** (Sec. 147 and 147a AO) or **failure to provide remote data access** (Sec. 147(6) AO) will now qualify as an administrative offence. The Government Draft Bill even provides for a further tightening: in cases where data is held by third parties, the authorities will be permitted to **prescribe the data format** in the future. Violations of this will be punishable by monetary administrative fines in the future.

Non-compliance with the retention obligations may result in a maximum penalty of **EUR 5,000**, while not providing remote data access or not fulfilling the data format preferred by the tax office may result in a maximum penalty of **EUR 25,000**. In addition, the failure to provide remote data access continues to be sanctionable by means of a **standard fee for delay** (*Verzögerungsgeld*) in the range of EUR 2,500 to EUR 250,000.

DAC7:

- The legislative package also includes the draft bill for the implementation of the DAC7 Directive, which must be implemented by the end of the year.
- The new reporting obligations will be included in the so-called **Plattformen-Steuertransparenzgesetz ("PStTG")**.
- Non-compliance with the new rules, which are to apply from 2023 onwards, can range from fines to (partial) blocking of the platform.
