

## **General Communication with Tax Authorities in friendly or unfriendly ways**

**Tax Commission – of course...!**

**Prague, 2014 – Working Session 9**

### **National Report of Germany**

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19 March 2014

## **1. Introduction**

Tax authorities – surely each one of us had the pleasure to deal with one: as taxpayer at least with the tax authority of the country you are resident of, as a lawyer helping others in tax matters you might have had the chance to deal with the tax authorities of other countries as well. If the latter is the case you might have seen some differences in the behaviour of the different tax authorities. You might have realized that the tax authorities in some or even the majority of the countries do treat the taxpayers not as their customers or clients but rather as subordinates. In such cases the communications tends to be rather hierarchical and often results in administrative proceedings against the tax authorities with more or less success.

Other countries have realized that treating the taxpayer in ways like we know from the tale of Robin Hood and the Sheriff of Nottingham only results in the tax payers trying to circumvent their tax obligations. Some countries, thus, have not only reduced the taxes in their countries. They also made their tax authorities treat the taxpayers as their clients e.g. in offering the taxpayers the possibilities for tax rulings and trying to take a more tailored approach towards their taxpayers .

These – sometimes very significant – differences are what we are focusing on in this year's tax report: We want to show that there are big distinctions in the behaviour of and the dealing with the tax authorities in different countries both in the stage of an advance agreement on a tax position as well as in an objection or litigation phase. For this reason AIJA members from several countries around the globe were so kind to volunteer as national reporters for this report which is crucial for such a comparative topic.

The General Reporters would like to thank you all in advance for your contributions and are already very interested in the results of this year's annual congress session of the AIJA Tax Commission.

## 2. Questionnaire

*Note:* General assumption is discussions with the tax authorities regarding (corporate) income tax or indirect taxes. If a difference would apply in the treatment between either of these, please indicate in your report. Also, if there are different levels of tax authorities for different taxes or issues, please mark that in your report.

### 2.1 Communication general

How does the General Communication with the Tax Authorities take place?

- a. Is a direct contact in between the tax payer and the Tax Authorities possible/common/advisable?

Yes, a direct contact is possible, common for individuals and companies with tax departments and in some cases advisable even if a tax counsel is involved. If a tax payer has hired a tax counsel, the latter is usually communicating with the Tax Authorities.

- b. If not, does the communication only take place via tax counsels?

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- c. How can the communication regarding special matters be described?

The good thing is that the revenue officers usually understand legal queries because they are well educated (bachelor's degree in tax and finance, law degree especially in higher sections of tax authorities). Revenue is training more and more experts especially for international issues such as transfer prices. On the other hand, tax authorities and tax counsels are thus on a level playing field. So be prepared and do not try to trick them.

- d. Does it take place only in a written form or are meetings possible?

There are no statutory restrictions as to the way of communication. So it often depends on the preference of the revenue officer or the conventions in the respective tax office. However, if the tax payer is planning new projects or when uncertainties occur as to the application of (recently introduced) legal provisions, there is a certain tendency to (i) call the official in charge and explain your request, (ii) send a summary in writing, (iii) meet with the person in charge. The bigger the case, the more people will be involved, i.e. the boss of the person in charge, the head of the department, the head of the tax office, sometimes even the ministry of finance of the respective federal state.

- e. Can the behaviour of the Tax Authorities in your country be described as all dominant, cooperative, customer-oriented or otherwise?

Again, a lot depends on the personality of the tax officers involved.

There are very unpleasant developments due to which Revenue is acting more dominant and aggressive.

- Revenue's self-image has been changing over the last decades: Revenue does not necessarily accept the separation of powers. Revenue is bound to legality and has to apply the law whereas the Parliament makes the law and the fiscal courts interpret the law. However, Revenue does not necessarily respect this system if Revenue feels that certain rules or the application of the rules are too much in favor of the taxpayer.
- At the beginning of an audit, the tax auditors usually have a very precise idea how much more taxes they want to collect. There are even target agreements for the auditors! The final audit conference has become something between a bazaar and blackmailing. Tax auditors feel comfortable because they do not necessarily feel bound to statutory law and they know that a lawsuit takes at least 2 to 4 years at the first level of jurisdiction and another 2 to 5 years at the second (and highest) level. There are cases when Revenue uses criminal law to enforce a favorable resolution of controversial questions. E.g. Revenue claims that accruals were too high and the tax payer thus committed tax evasion.
- The discussion on tax evasion has become quite aggressive (BEPS, black money in Switzerland etc.).

## 2.2 Agreements between tax payers and tax authority

- a. Is there the possibility of a tax ruling and, if so, which costs can be expected?

Tax rulings have existed for decades and are codified in the *General Tax Code*. Please note that a tax ruling is never an agreement on legal consequences and effects. E.g. it is not allowed to negotiate the tax rate. The ruling fixes the application of the law on determined facts.

- Advance ruling<sup>1</sup>: The tax payer describes his or her plans and asks Revenue for a legal opinion (e.g. for transactions, restructurings, donations); he or she has to prove that the issue has substantial tax consequences and thus his or her legal interest. Since 2007, the advance ruling is subject to fees. The fee depends on the value, i.e. the amount of

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<sup>1</sup> *Verbindliche Auskunft* (Sec.89 GTC).

taxes to be expected. The maximum fee is about € 110.000 (value € 30.000.000). A tax payer usually applies for a ruling to make sure that certain tax exemptions apply such as tax exemptions for certain kinds of restructurings. On the other hand, Revenue does not grant rulings if the main purpose of the ruling is tax avoidance (e.g. tax shelter schemes).<sup>2</sup> We will see how Revenue will handle these cases if the discussion on tax avoidance gets more and more aggressive.

- Ruling after an audit<sup>3</sup>: Tax payer may file a motion for a ruling after an audit. Revenue consents to treat an ongoing situation in the future in the same way as in the past.
- Ruling on Wage Tax<sup>4</sup>: An employee as well as an employer may ask Revenue if and to which extent the employer has to retain wage tax.
- Agreement on Facts and Circumstances<sup>5</sup>: The general rule is that Revenue has to ascertain all facts and circumstances that are tax relevant. The taxpayer has to assist in this process by filing tax returns and presenting documentation. However, in complicated cases or when the case dates back many years (10 years and more can easily happen), Revenue and taxpayer may agree on a certain description of the facts and circumstances. The description is binding.

b. What is the average time frame to get a tax ruling done?

One to six months for advance rulings, less for other rulings.

The tax payer usually files his or her motion for the ruling after discussing the concept with Revenue. Sometimes Revenue does not follow the argument of the tax payer in all details and therefore may ask the tax payer for an additional statement or a different solution.

c. Are these consultations binding and, if so, which possible remedies do exist?

The consultations before filing the motion are not binding. Only the written ruling is binding.

d. Once a tax ruling between all the parties concerned has been achieved, can one rely on it?

Yes.

e. What is the exact legal status of a tax ruling?

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<sup>2</sup> AEO Sec. 89 3.5.4.

<sup>3</sup> *Verbindliche Zusage* (Sec. 204 GTC).

<sup>4</sup> *Anrufungsauskunft* (Sec. 42e Income Tax Code).

<sup>5</sup> Decree by the Federal Ministry of Finance, 30<sup>th</sup> July 2008, IV A 3 – S 0223/07/10002, BStBl. I S. 831.

The ruling is an administrative act (*Verwaltungsakt*), it has the same legal status as a tax return. So the tax office cannot easily declare it nil and void. However, if the taxpayer has presented false and/or incomplete information, the ruling can be declared void. If the applicable law changes, the ruling can be declared invalid for the future.

- f. Is it common in order to get a tax ruling that the tax payer has to give up certain rights or explicitly agree to e.g. information exchange?

In some areas, it is common to waive rights:

- Advanced Pricing Agreements (*APAs*): Taxpayer waves his right to object to any tax returns based on the APA.<sup>6</sup>
- Structures to avoid exit taxation.<sup>7</sup> (These structures are subject to review due to recent rulings by the Federal Fiscal Court.)

The exchange of information is not subject to rulings.

- g. Is a tax ruling a public document or will it be treated confidentially by the tax authority? Does the taxpayer have an obligation to keep it confidential?

The ruling is subject to tax confidentiality (*Steuergeheimnis*). The taxpayer does not have to keep it confidential. However, we advise the taxpayer to do so because rulings may contain hints on (of course statutory) tax advantages – bad publicity for Revenue in times of BEPS.

### 2.3 Remedies against decisions of the Tax Authorities

- a. Is it common that one has to litigate if a decision has been made by the Tax Authorities and which remedies do exist?

A tax assessment is an administrative act (*Verwaltungsakt*) with very formal remedies. The taxpayer has to file a protest/an objection within one month.<sup>8</sup> If the objection is not successful, the taxpayer has to file a lawsuit to the fiscal court within another month (see b.).

Other decisions by the tax authorities such as not extending a term of payment or assessments of value upon which a tax assessment is based are administrative acts as well.

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<sup>6</sup> Decree by the Federal Ministry of Finance, dated Oct. 5<sup>th</sup>, 2006, BStBl. I 2006 p. 594, Sec. 6.4.

<sup>7</sup> Sec. 6 Foreign Transaction Tax Act.

<sup>8</sup> Sec. 355 GTC.

- b. Is there the possibility of addressing a court or is this an administrative procedure?

The taxpayer has to wait for the ruling on an objection before he can address a court.

There is one exemption: If the tax office does not issue an administrative act or a ruling on an objection in due course, the taxpayer can file an action for failure to act.

- c. Which costs are to be expected in such a case?

The *administrative procedure* is exempt from charges. The taxpayer has to bear the costs for his advisor even if his objection is successful.

The *lawsuit* is subject to charges that depend on the value of the case, i.e. as a rule of thumb the amount of taxes at stake.

- Court of first instance: up to € 440.000 (value  $\geq$  € 30.000.000)
- Court of second instance: up to € 550.000 (value  $\geq$  € 30.000.000)

In addition, the taxpayer has to bear the costs for his or her advisor.

However, if the taxpayer is *fully or partially* successful, he or she is entitled to a *full or partial* reimbursement:

- Court fees.
- Costs for his advisor during the lawsuit. Please note that the costs are limited to the statutory fees for lawyers<sup>9</sup> (maximum of about € 229.000 in first instance, € 275.000 in second instance with a value  $\geq$  € 30.000.000).
- The court may decide that hiring a lawyer for the administrative proceedings was necessary (which is usually the case). Taxpayer is entitled for a reimbursement according to the statutory fees.
- The ratio of the reimbursement depends on the extent to which the taxpayer has been successful, i.e. 100% success  $\rightarrow$  100 % reimbursement.

- d. Is it compulsory to have a lawyer in case of any remedy?

Only in lawsuits at the Federal Fiscal Court.<sup>10</sup>

- e. What timeframe can be expected in case of a remedy/litigation?

- Administrative procedure: 3 months to one year.
- Lawsuit, first instance: 2 to 4 years.

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<sup>9</sup> Act on the fees of lawyers (*Rechtsanwaltsvergütungsgesetz – RVG*).

<sup>10</sup> Sec. 62 Par. 4 Tax Court Code.

- Lawsuit, second (and highest) instance: 2 to 5 years.
  - If the fiscal court decides to have to file a preliminary ruling procedure with the *German Constitutional Court* or the *European Court of Justice*, please add another year.
- f. Is it possible to postpone the payment of the tax debt as assessed by the tax authority until the end of a pending litigation with the tax authority? Will the tax authorities require guarantees for the postponement (Bank guarantees, mortgages etc.)?

Yes, it is possible. Taxpayer has to file a motion. The motion is successful if it is doubtful whether the tax assessment is correct or if the execution would constitute an undue hardship.<sup>11</sup>

Revenue may ask for guarantees such as bank guarantees and mortgages, usually if a large amount of taxes is at stake.<sup>12</sup>

Please note that the postponement is subject to a 6 % p.a. interest rate for the amount of taxes that is finally due. On the other hand, the taxpayer may be entitled to a 6 % interest (minus income taxes) on overpaid taxes.

- g. Is it possible that the tax authorities submit a report to the public prosecutor to investigate on possible criminal tax offences and under what circumstances?

Yes, and that happens quite often. There are no further requirements such as the approval by a higher tax authority or a court.

- h. Is it possible to include a clause in an agreement to automatically amend this agreement in accordance with the outcome of a discussion or litigation with the tax authority (e.g. if an “at arms length payment” is not accepted as such by the tax authority or if interests are held to be dividends or a loan is seen to be a gift)?

Yes, tax clauses are being used, but the legal status is still not clear. There are no statutory rules and the courts have not established a conclusive case law as yet.

- Tax clauses are often used as a condition (e.g. restructuring under the condition of tax neutrality, donation under the condition that the donee does/omits certain things). A contract becomes invalid or a party has the right to terminate the contract if a certain condition becomes applicable, i.e. the transaction is subject to tax. The termination of the contract can be seen as retroactive event and therefore may be binding for tax purposes. Please note that in general, tax law is not open for retroactive actions. Therefore, it is crucial to

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<sup>11</sup> Sec. 361 Par. 1 General Tax Code.

<sup>12</sup> Sec. 361 Par. 2 Phrase 5 General Tax Code.



have a clear clause in the contract to have at least the chance to reach an effective tax clause.

- Tax clauses may work for some non-recurring events, but not for periodic events. E.g. German company A grants a loan to the foreign affiliated company B at 2% interest in year 01. In year 04, Revenue finds out that the appropriate interest rate would have been 4%. The loan agreement adjusts the interest rate retroactively – but only for civil law purposes not for tax law. The income in year 01, 02, and 03 will be adjusted.

## 2.4 Sanctions

- a. What is the statute of limitations for tax related matters?

The statute of limitation is

- One year for consumption taxes (e.g. tobacco tax, energy tax) and customs – if not otherwise stated by European Law,
- Four years for other taxes,
- Five years in case of careless tax evasion,
- Ten years in case of tax evasion.

The limitation period begins

- At the end of the year in which the tax arises,
- OR if the taxpayer has to file a tax return at the end of the year when the taxpayer filed the return, however not later than the end of the fourth year after the tax arises.

- b. What is the typical sanction/amount of fines in your jurisdiction? Is there a different fine level for direct or indirect taxes?

There are different sanctions:

- Assessment Procedure
  - Interest for late payment: 6% p.a.
  - Interest in case of tax evasion: 6% p.a.
- Criminal Procedure (on top of interest)
  - Fines,
  - Imprisonment depending on the amount of evaded taxes up to 5 years, in particularly serious cases up to ten years. (> € 1 Mio. in general means imprisonment)

There is no different fine level for direct and indirect taxes.

- c. Is it possible for a taxpayer to prevent tax penalties to be imposed should he/she be able to prove her good faith or reasonable interpretation of the law?

The interest for late payment during the assessment procedure is not reduced. However, in case of good faith or reasonable interpretation of the law, the taxpayer does not commit tax evasion (or only the mild form of careless tax evasion) so there are no additional criminal fines due.

- d. Is it possible to regularize your tax situation with reduced or no fines/sanctions?

In cases of tax evasion, a taxpayer can file a corrected return to obtain exemption from punishment (criminal procedure). The corrected return must be filed (i) before Revenue or the Public Prosecutor discovers the tax evasion and (ii) the return must be complete for ten years (ALL facts and circumstances to be declared. Revenue must be able to compute the exact amount of taxes based on the corrected tax return).

Please do it better than Mr. Uli Hoeness, the president of the famous football club Bayern Munich. He filed his corrected return only hours before Revenue found out that a bank account in Switzerland belonged to Mr. Hoeness (great timing!). But he did not file ten years and the documentation showed only € 3,5 Mio. of evaded taxes – instead of about € 28 Mio. (very, very bad!).

There is no negotiation whatsoever on the amount of taxes and the interest for late payment and tax evasion (assessment procedure).

- e. May tax advisors/tax lawyers be held responsible by the tax authority for their advice to taxpayers?

Tax advisors and tax lawyers are not liable for the taxes that the taxpayer fails to pay (e.g. in case of tax evasion).

However, the advisors can commit tax evasion in favor of the client if he files wrong or incomplete tax returns (when acting as representative of the client) or does not clear up all facts and circumstances despite his statutory duties. The advisors can also be guilty of abetment in tax evasion when knowingly filing a wrong tax return.

We have seen a trend that Revenue passes even minor files of wrong tax returns to the Public Prosecutor. The weirdest case I have ever seen: A tax advisor claimed an exemption for child care expenses although the taxpayer's employer had reimbursed the taxpayer for the said expenses (tax free reimbursement). Definitely a mistake, but one the tax advisor did not make intentionally. In the end, Revenue undervalued the income tax by € 800 and the tax advisor had to fight for months to get rid of the Prosecutor.

## 2.5 Tax information exchange

- a. Does a tax information exchange on the EU level or OECD level happen and how does it take place?

There are three fundamentals for the exchange of information:

- DTAs: All DTAs that Germany concluded recently contain clauses on the exchange of information. Older treaties will be amended accordingly.
- TIEAs: e.g. with Bermuda, Finland, France, Liechtenstein, Monaco, San Marino, U.S.A.
- EU Council Directive on Administrative Cooperation in the Field of Taxation (2011/16/EU), 15 February 2011.

The local tax office prepares the application and forwards it to the Federal Central Tax Office.<sup>13</sup> The Federal Central Tax Office sends the requests to foreign tax administrations and receives the answers. The local tax offices are usually not involved in the process but only receive the results.

- b. Does your country enter into tax treaties that oblige to exchange information spontaneously, automatically and/or upon request?

Yes, German DTAs know all three kinds of exchange of information.

- The exchange upon request is most common.
- A spontaneous exchange of information must be expressly stated, otherwise it is unlawful. It is admitted by the aforementioned council directive for EU member states.
- The automatic exchange of information is not that common (at the moment 8 countries).

For more details, see the Decree by the Federal Ministry of Finance on the exchange of information.<sup>14</sup>

- c. Is the tax payer notified in case information is exchanged with foreign tax authorities?

Yes, at least if he is a German party. He must be notified two weeks before Revenue sends out its request.

- d. Can the tax payer object against an exchange of information?

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<sup>13</sup> *BMF* 25 Mai 2012, IV B 6 – S 1320/07/10004 :006, BStBl. I S. 599, Sec. 1.5.1.

<sup>14</sup> *BMF* 25 Mai 2012, IV B 6 – S 1320/07/10004 :006, BStBl. I S. 599.

Yes. He can object. The tax office checks the objection. If the tax office holds the objection without merit, it passes the file to the Federal Central Tax Office. If the Federal Central Tax Office does not grant the appeal, the party can file a motion and/or a motion for preliminary injunction at the fiscal court.<sup>15</sup>

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<sup>15</sup> *BMF* 25 Mai 2012, IV B 6 – S 1320/07/10004 :006, BStBl. I S. 599, Sec. 3.2.