

MOF decree emphasizes importance of tax compliance management system

The existence of a Tax CMS can affect whether a taxpayer can be charged for willful or grossly negligent failure to comply

Germany's Ministry of Finance issued a final decree on 23 May 2016 on the procedure for amending a tax return under section 153 of the General Tax Code (AO); a first draft of the decree was published in July 2015. The final decree contains general guidance about the conditions that must be fulfilled to use provision, as well as the criteria for distinguishing between a simple amendment procedure and a voluntary self-disclosure procedure (VSP).

Section 153 AO provides that, where a taxpayer realizes that the tax return submitted is incorrect or incomplete and that this can lead to, or already has led to, an understatement of tax, the taxpayer is required to notify the tax authorities and make the necessary amendments to the return without undue delay.

Where the underlying reason for the incorrect/incomplete return is due to a willful act or gross negligence, the taxpayer may be subject to criminal prosecution or administrative charges. If the taxpayer notifies the tax authorities of the deficiency, the authorities must determine whether the act was willful or grossly negligent and whether the taxpayer's reporting can be considered a notification based on section 153 AO or a filing in a VSP. The requirements to enter into a VSP recently have been tightened and if these requirements are not met, there is a high potential for criminal prosecution or administrative charges.

The MOF decree provides useful guidance for taxpayers and the tax administration about the requirements relating to a notification/amendment procedure based on section 153 AO.

The decree states that the existence of a tax compliance management system (Tax CMS) can be an indication that an incorrect/incomplete return was not filed deliberately or as a result of gross negligence. A Tax CMS, therefore, can be a critical factor for corporate taxpayers needing to demonstrate that a subsequent amendment of a tax return is not based on a deliberate or negligent act and should help minimize risks for the taxpayer.

The decree does not set out any requirements for the format or contents of a Tax CMS; thus, it will be up to the taxpayer to ensure that its tax department is efficiently organized and that effective internal control measures are in place to ensure that tax returns are complete and prepared based on the best information available. The taxpayer also would need to show that if a mistake is discovered, it is reported immediately and an amended return is filed.

The decree highlights the importance of having well-defined internal control systems in place in a company's tax department and this includes having an organized tax department and the efficient management of procedures to collect the data needed for the preparation of the tax return and that is located outside of the tax department (so-called "interface management procedures").

The existence of an efficient and functioning Tax CMS should be documented in a certification procedure by a public accountant or certified tax advisor. The decree, however, is silent about the requirements and conditions for such a certification procedure.

The German Institute of Public Accountants is currently finalizing a policy paper on the requirements for a Tax CMS (the Tax CMS requirements will be based on the already published so-called IDW PS 980 standard for general CMS); the paper should be published in the near future.

Taxpayers should establish a Tax CMS as soon as possible to minimize significant risks resulting from amendments of tax returns that have been filed. Evidence that the tax department is well organized and that its actions are in compliance with current tax law will become significantly more important in the future. Taking into account the risk potential, affected taxpayers may wish to initially consider focusing on transaction taxes (e.g. VAT,

withholding tax and customs duties) as a starting point for implementing a Tax CMS.

It also is likely that, in future, corporate taxpayers in Germany will be ranked by the tax authorities based on their risk profile, as already is the case in other countries, and that tax audits may be initiated based on a company's ranking. The quality and the effectiveness of a Tax CMS can be an important factor in the ranking of a taxpayer. Companies that have implemented a top-notch and certified Tax CMS should be able to lower their tax risks, but also benefit from a contemporaneous and less painful tax audit procedure.

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