



VAT NEWSLETTER

## Tax compliance management: Germany is taking it seriously

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### 1 Background

Tax compliance management is a complex subject. Every company understands it differently. Some deal intensively with the topic, others do nothing and simply wait for enlightenment. Is the “aha” moment now approaching courtesy of a new law that came into force on 01.01.2023?

We are talking about the act on the implementation of the DAC7 Directive and the modernisation of tax procedural law, which is intended in particular to speed up external audits. The idea is a good one: tax auditors and taxable persons are to be held equally responsible. In doing so, a trusting tax partnership is to be established. If taxable persons cooperate better in the future, they will be treated more generously by the tax authorities: tax audit orders will then be issued more promptly and audits completed earlier. It should also be possible to communicate the focus of the tax audit in advance and to hold interim discussions. This is all very sensible and purposeful and is the hallmark of a modern state. In customs law, simplification of regulations has been a familiar development for quite some time, namely in the form of the Authorised Economic Operator, short “AEO C” (AEO Customs).

At the last minute, further audit simplifications were included in a new sec. 38 of Art. 97 of the Introductory Act to the German Fiscal Code. According to this, tax authorities can promise specific audit simplifications for future tax audits if the current audit of the internal control system (ICS) has confirmed its effectiveness in complying with tax regulations. However, the legislator still remains somewhat hesitant at this point. The first experiences are to be evaluated by 2029 and then the idea is to go on from there. It may well be that the fast-moving practice will outpace the legislator.



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## 2 What is tax compliance management?

There is no legal definition of tax compliance management systems (Tax CMS) in Germany. The Institute of Public Auditors in Germany (IDW) defines a Tax CMS as the totality of all documented measures that a company takes in order to fulfil its tax obligations. If the legal representative maintains a functioning Tax CMS, it can effectively exculpate itself from the accusation of having made an organizational fault. The Federal Ministry of Finance has stated in the Administrative Guidelines regarding sec. 153 of the German Fiscal Code, that the implementation of an internal control system, which serves the fulfilment of tax obligations, may be considered as an indication against the existence of intent or recklessness with regard to tax evasion. However, the Federal Ministry of Finance has not yet explained, in this context, which minimum internal control requirements must be evident so as to arrive at a position where an act of tax evasion cannot be regarded as recklessly accepted. The legislator has also missed the opportunity to describe, in detail, and from its point of view, an effective ICS. One small progressive step has, however, been taken in that the legislator has provided a legal definition of a tax control system: This includes all internal measures that ensure that the tax bases are correctly recorded and taken into account and that the taxes due on them are paid in full and on time. The tax control system must (also) continuously map the tax risks.

This means that it is the responsibility of the practice – probably in interaction between tax authorities and companies – to “establish” these control systems. In its “Praxishinweis 1/2016”, the IDW published details of how such a TAX CMS should be structured and correctly pointed out that Tax CMS can vary, quite significantly. As the implementation, certification and also the audit of Tax CMS for our clients have shown, the following minimum requirements must be ensured: a documented description of the tax function, clear tax processes, sufficient structuring of the tax ICS, consisting of a management and a control system. The ICS must be based on a tax risk management system.

In this context, *less is more*: only a Tax CMS that is seriously “lived” deserves its name. This is also what the legislator means by stating that “the tax control system must map the tax risks on an ongoing basis”. Controls must not only take place once a year in the obligatory system review. Rather, controls must be carried out regularly, in the case of VAT monthly, preferably on an ongoing basis. Digital tools, such as our KMLZ TCMS Assistant or our TAX-ray applications, can help. Existing data in the ERP system can be systematically evaluated and the processes in the tax determination logic can be fully identified. Entire tax processes can be quickly visualised, and any weaknesses uncovered. The audit intensity can be narrowed down or extended. Our TAX-ray@Celonis even automatically checks processes in the ERP system for their tax risk, sometimes even before the supplies are rendered or invoiced, basically a real-time Tax CMS. The documentation of these controls goes without saying.

## 3 Recommendations for the practice

An off-the-shelf Tax CMS does not exist, because companies are not all the same. What is the same, however, is that every company must now deal with this issue. So far, Tax CMS have mainly helped with criminal tax liability; in the future, companies will benefit in the sense of a serious tax partnership. The German legislator has now laid the foundation for this. Initially, it seems as only larger companies will benefit, as the German Federal Central Tax Office (BZSt) must “declare its approval” for the audit simplification. This is incomprehensible to me, as small and medium-sized businesses are often much further along with the issue of a Tax CMS.