



KMLZ VAT NEWSLETTER

Self-disclosure: Prohibition of compensation and surcharge

1. Self-disclosure only effective if surcharge is paid

In 2011, the legislature added sec. 398a to the German General Fiscal Code, to encompass the Illegal Earnings Combat Act. Since then, the effectiveness of a voluntary self-disclosure depends in most instances on whether the taxable person pays a surcharge to the tax authorities, in addition to the tax evaded plus interest. The amount of the surcharge depends on the total of tax evaded. An additional 10% of the tax evaded is to be paid if this tax totals EUR 100,000, 15% if it amounts to between EUR 100,000 and EUR 1,000,000 and 20% if the tax evaded exceeds EUR 1,000,000. According to the fiscal authorities, the surcharge is to be paid, in full, by each accomplice. It is irrelevant whether the accomplice has gained a personal benefit as a result of the tax evasion.

2. Prohibition of compensation

As of 1 January 2015, the legislature explicitly ruled that the prohibition of compensation, as part of the assessment of the surcharge, in accordance with sec. 398a of the German General Fiscal Code, is to be applied. The prohibition of compensation is regulated by sec. 370 para. 4 sentence 3 of the German General Fiscal Code. As far as criminal law is

Surcharges complicate self-disclosures

The effectiveness of a voluntary self-disclosure depends on the payment of a surcharge; even from evasion amounts of as little as EUR 25,000. The legislature has, as from 1 January 2015, once again increased the amount to be paid. According to the fiscal authorities, the surcharge is to be paid, in full, by each accomplice. It is irrelevant whether the accomplice has gained a personal benefit from the act of evasion. Furthermore, VAT liability and input VAT deduction are not offset for the purposes of the assessment of the surcharge. For this reason, a heavy penalty might be due, even if there is no burden of payment from a VAT perspective.

concerned, VAT liability and input VAT deduction must be viewed independently. From a criminal law point of view, VAT and related input VAT cannot be offset. The criminal and the tax procedures differ considerably. In the latter case, VAT and input VAT are offset for the assessment of the surcharge.

3. Consequences of the prohibition of compensation

The application of the prohibition of compensation for assessing the surcharge in accordance with sec. 398a of the German General Fiscal Code can have a significant economic impact on entrepreneurs who correct inaccurate tax returns by means of the voluntary self-disclosure process.

For example, assuming an entrepreneur has not declared domestic input and output transactions from national supplies, each totaling EUR 2 million within the calendar year, due to these transactions having been conducted "under the counter". If he corrects these supplies by means of a voluntary self-disclosure, this will not have any initial effect, from a VAT



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point of view. VAT liability and input VAT deduction are declared and offset in the same amount. There is no burden of payment. However, from a criminal law point of view, the prohibition of compensation applies. The amount of VAT liability that was under declared (19% of EUR 2 million = EUR 380,000) and the input VAT deducted in the same amount are not offset. The entrepreneur will have evaded tax amounting to EUR 380,000.

4. Surcharge in the case of voluntary self-disclosure

The law enforcement authorities in our example might decide not to prosecute for tax evasion due to the voluntary self-disclosure if the entrepreneur pays the corresponding surcharge. In this case, the entrepreneur would have to pay 15% of the tax evaded, namely EUR 57,000, as a surcharge, to the tax office. The penalty arises for the correction of annual VAT returns but not for the correction of monthly or quarterly VAT returns.

5. Direct economic connection

According to the case law of the Federal Court of Justice, the prohibition of compensation is not effective in cases where there are tax-reducing reasons that have a direct economic connection with the induced "evasion success" due to the incorrect statements. The case law is misleading as the Federal Court of Justice rejects an exception from the prohibition of compensation in the proportion VAT and input tax. Companies are often unsure of when an actual direct economic connection exists.

6. Prohibition of compensation for intra-Community acquisitions and reverse-charge-supplies

The Federal Fiscal Court recently decided that there is a direct economic connection between VAT to be declared for intra-

Community acquisitions and the corresponding right to deduct the acquisition VAT. Therefore, the prohibition of compensation does not apply. The Federal Court of Justice has, to date, explicitly refused to accept such an exception. This leads to significant legal uncertainties. If one follows the view of the Federal Fiscal Court, there is no tax evasion due to the offsetting of VAT liability and input VAT deduction. The entrepreneur would not have to correct this and the penalty would be obsolete. However, if the prohibition of compensation was also applied to intra-Community acquisitions, the taxable person, in the example given above – here: voluntary self-disclosure of hitherto undeclared intra-Community acquisitions in the amount of EUR 2 million – would have to pay a surcharge in the amount of EUR 57,000 to the tax office to obtain impunity from prosecution. Besides intra-Community acquisitions, the question whether the prohibition of compensation is to be applied is also raised with regard to reverse-charge supplies in terms of sec. 13b of the German VAT Act. Here, the legal situation is also unclear.

7. Practical tip

There are good reasons for assuming an exception from the prohibition of compensation in the case of intra-Community acquisitions and reverse-charge-supplies according to sec. 13b of the German VAT Act due to the direct economic connection. However, a final determination, by case law, is still pending. This should be noted in terms of preparing a voluntary self-disclosure. Furthermore, a disclosure, in accordance with sec. 153 of the German General Fiscal Code, should always be provided in case of doubt due to the uncertain legal situation.