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Joint Audits in Germany
Competent Tax Court has again ruled in favor of instigating a Joint Audit against taxpayer's will

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Joint Audits have been enjoying increasing popularity for some time now in Europe. German tax authorities promote them as an effective means of clarifying the facts of cross-border cases and avoiding double taxation. Evidence of the fact that taxpayers do not always approve of coordi-nated tax audits may be taken from the procedures before the competent tax court Cologne in recent years (decisions dated 23 May 2017 - 2 V 2498/16 and dated 20 October 2017 - 2 V 1055/17).

With the competent authority (i.e., German Federal Tax Office) in its district the tax court Cologne has exclusive jurisdiction over any claim against a coordinated tax audit, joint audit or any other means of cross-border mutual assistance between the German and foreign tax authorities. The court's recent decisions on claims against simultaneous tax audits and against joint audits show a clear tendency towards allowing coordinated tax audits per se. This impression was confirmed by the court's recent decision as of 12 September 2018 (2 K 814/18).

Summary of the decision

The German and Austrian tax authorities conducted a coordinated tax audit of the A-group with subsidiaries in Austria and Germany. The Austrian tax authorities had initiated the coordinated tax audit which focused on intra-group real-estate transactions. The Austrian tax authorities in-tended to verify whether payments were improperly booked on the private accounts of share-holders or the managing directors by examining specific clearing accounts and cash transactions in Germany. According to the German and Austrian tax authorities national means of investiga-tion were exhausted. The exchange of information on clearing accounts and cash transactions was to result in further clarification.

The tax court Cologne dismissed the action as the legal requirements to a coordinated tax audit according to the implementation law to the European Mutual Assistance Directive (EU-directive 2011/16/EU) are fulfilled. As in all previous cases, the court failed to differentiate between a simultaneous tax audit and a joint audit but assumed that the legal requirements are the same. According to the court, a coordinated tax audit aims at the exchange of "presumably substantial" information. According to the ECJ's ruling in the Berlioz case (ECJ v. 16.5.2017 - C-682/15,ECLI:EU:C:2017:373), the standard of examination is limited to determining whether based on the requested information a lack of relevance for taxation of the requested information becomes apparent. This was not the case, since there was a reasonable possibility that the clear-ing accounts would provide information on operating income and expenses of the companies of the A-group. Also, the court assumed that the principle of subsidiarity of national investigation activities to-wards international official assistance was observed. Insofar the court relied on the tax authori-ties' statement that cross-border business transactions of the A-group cannot be sufficiently clari-fied by purely national means.

Finally, the German Federal Tax Office had employed its discretion appropriately; a coordinated tax audit was the most appropriate means of clarifying and reconciling the facts.

Comments and practical recommendations

This decision is fully in line with the two previous decisions on coordinated tax audits (dated 23 May 2017 - 2 V 2498/16 and dated 20 October 2017 - 2 V 1055/17). In general, in light of this precedence, the success rate in appealing against coordinated tax audits appears to be limited.

It is in line with standing case-law by the German Federal Tax Court that the threshold to start a tax audit is rather low (see for cases of a second audit for already pre-audited years the decision as of 23 July 1985 - VIII R 48/85). Also, the ECJ has set a low threshold for mutual assistance by requiring a mere possibility the requested information bear relevance for local taxation.

In practice, it is, therefore, recommendable to focus one's claim on the German Federal Tax Of-fice's shortcomings in terms of employing its discretion appropriately. For example, in this case, the tax court Cologne mis-defined the goal to be achieved by the coordinated tax audit as clarify-ing and coordinating the facts of the case. According to the regulatory purpose of the European Mutual Assistance Directive and the German implementation law, the legitimate purpose of a coordinated tax audit should, however, be limited to clarifying the facts (EU Directive 2011/16/EU, recital 7) and not its coordination which, at least in terms of transfer pricing cases, is indistinguishable from coordinating the tax treatment of audited IC transactions.

In addition, the Austrian tax authorities focused on particular information (i.e., specific clearing accounts and cash transactions in Germany). Therefore, the less burdensome and, therefore, more appropriate means of mutual assistance would have been an individual request for specific information.

In light of the moderate prospects in litigation, MNEs should weigh the advantages of a coordi-nated tax audit and approach the possibility of a joint audit actively. In this context one should work towards an agreement with the tax authorities similar to the so-called Joint Audit Frame-work developed by the OECD (OECD Joint Audit Report 2010). In the Joint Audit Frameworks key points of the tax audit should be laid down prior to the start of the audit:

- Determination of the type of tax audit (simultaneous or joint audit) and scope (audit fields);
- Other framework conditions, e.g. examined financial years, planned number of meetings, language of examiner's questions and answers, contact persons of both tax audit teams, admissibility of a double enquiry of documents and information already submitted to na-tional tax audit;
- Assurance that taxpayer may participate in joint meetings.