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Via email only

Highest revenue authorities of the *Länder*

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SUBJECT **Guidance note on coordinated external tax audits with tax administrations of other states and jurisdictions**

ENCLOSURES **1**

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With reference to the outcome of discussions with the representatives of the highest revenue authorities of the *Länder*, the following principles shall apply with respect to conducting coordinated external tax audits with tax administrations of other states and jurisdictions, in addition to the guidance note on international administrative assistance through the exchange of information in tax matters (Federal Ministry of Finance circular dated 23 November 2015 – IV B 6 – S 1320/07/10004:007, Federal Tax Gazette I 2015, p. 928).

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1. General aspects

When exchanging information, the revenue authorities must uphold the principles of proportionality, protection of the taxpayer in accordance with the law (including adherence to tax secrecy requirements), reciprocity and a balanced exchange (section 117 subsection (3) of the German Fiscal Code (*Abgabenordnung*)).

With measures that are based on the EU Mutual Assistance Act (*EU-Amtshilfegesetz*), it must be assumed that reciprocity exists, irrespective of how the Mutual Assistance Directive (Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC) has been implemented in the respective country. The authorities may, however, take varying implementations of the Directive into account when exercising their discretionary powers in the individual case (see section 4 subsection (4) of the EU Mutual Assistance Act).

Coordinated bilateral and multilateral external tax audits may also be conducted within the framework of international administrative assistance, in addition to the exchange of information on request and the spontaneous or automatic exchange of information. These include simultaneous audits (simultaneous tax examinations) and joint external tax audits (referred to internationally as “joint audits”), which represent a special form of coordinated external audit.

Officials from the German tax administration may be posted to other countries for the purposes of responding to a request for information without this necessarily being linked to a particular investigation by a foreign revenue authority (for example, the conducting of an external tax audit). Authorised German officials may also be posted to another EU member state in other situations than a coordinated external audit, if this is necessary due to the complexity of a particular request for information (section 11 of the EU Mutual Assistance Act). Provided they have been authorised to do so (see sections 4, 10 and 11 of the EU Mutual Assistance Act), officials may also conduct interviews in foreign countries with taxpayers, their fiscal representatives or the foreign officials responsible for the case being audited, in order to investigate the internationally relevant aspects. These kinds of measures must be proposed, initiated and conducted in accordance with the rules that apply to coordinated external audits (see also section 4.2.3 of the “Guidance note on international administrative assistance through the exchange of information in tax matters”).

For more details about the options for obtaining information relating to third countries, including in situations unrelated to the performance of an external tax audit, please refer to the “Guidance note on international administrative assistance through the exchange of information in tax matters” (section 4.2.3) and the Federal Ministry of Finance circular dated

10 November 2015 (IV B 6 – S 1301/11/10002, Federal Tax Gazette I 2016, p. 138). In addition, Articles 8 and 9 of the Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988, as amended by the Protocol amending the Convention of 27 May 2010 (hereinafter referred to as “the Administrative Assistance Convention”, Federal Law Gazette II 2015, p. 966), must be observed.

1.1 Aims of coordinated external audits

The main aim of coordinated external audits (the umbrella term for these kinds of audits, which covers both simultaneous external tax audits (simultaneous tax examinations) and joint external tax audits) is to achieve consensus when determining the relevant facts with the participation of foreign officials during the audit. If consensus can be achieved on the facts of the case, the participating tax administrations then each reach their own conclusions pursuant to their national laws, independently of each other.

Achieving consensus on the relevant facts can also help to avoid international taxation conflicts (including conflicts involving double non-taxation) and any ensuing mutual agreement procedures, or at least make these conflicts simpler and expedite their resolution. In addition, achieving consensus on the relevant facts can provide the basis for a taxpayer to apply for an advance pricing agreement (APA).

If the aim of a joint external tax audit is not only to achieve consensus on the relevant facts but to reach a legally binding agreement with the other participating tax administration(s) regarding the tax treatment of the consensually determined facts (particularly in relation to issues of transfer pricing and the allocation of profits between permanent establishments), then this is only possible by means of a mutual agreement procedure following a corresponding application by the taxpayer. The rules for initiating and conducting mutual agreement procedures remain unchanged (see the “Guidance note on international mutual agreement procedures and arbitration procedures in the area of taxes on income and capital”, Federal Ministry of Finance circular of 13 July 2006 – IV B 6 – S 1300 – 340/06, Federal Tax Gazette I 2006, p. 461; for more information on APAs, please see the “Guidance note on advance pricing agreements”, Federal Ministry of Finance circular of 5 October 2006 – IV B 4 – S 1341 - 38/06, Federal Tax Gazette I 2006, p. 594 and section 4 below).

1.2 Audit order

The German revenue authorities conduct external audits (as referred to in sections 193 et seq. of the Fiscal Code) of German taxpayers. Consequently, audit orders as referred to in section 196 of the Fiscal Code are only issued to German taxpayers. The foreign auditors must not be identified by name in the audit order.

2. Legal basis for coordinated external tax audits

2.1 Simultaneous external tax audits (simultaneous tax examinations)

In the case of simultaneous external tax audits, the participating revenue authorities each conduct independent tax audits on their own territory in accordance with their domestic tax procedural law. The German tax administration acts in accordance with the provisions of the Fiscal Code applicable to domestic external audits (sections 193 et seq. of the Fiscal Code; Tax Audit Regulation (*Betriebsprüfungsordnung*), 2000). The information that is obtained is promptly exchanged with other revenue authorities if it could be relevant to taxation procedures in the other contracting state. The legal basis and procedures for the international exchange of information apply in this context.

2.1.1 Simultaneous audits with other EU member states

Section 12 of the EU Mutual Assistance Act provides for the option of organising simultaneous external tax audits with the revenue authorities of other EU member states. The information that is obtained in this context must be exchanged, as must information and findings that are necessary beforehand for organising the external tax audit, provided such exchanges are permissible under section 4 of the EU Mutual Assistance Act. In addition, the spontaneous exchange of information pursuant to section 8 of the EU Mutual Assistance Act is also possible. This is not restricted by the provision in section 12 subsection (1), second sentence, of the EU Mutual Assistance Act.

2.1.2 Simultaneous audits with third countries

Simultaneous external tax audits are also possible in cooperation with countries or territories that are not EU member states.

Simultaneous audits can be conducted on the basis of provisions in double taxation agreements that correspond to Article 26 of the OECD Model Tax Convention, if the competent authorities¹ agree to do so.

In addition, Article 8 of the Administrative Assistance Convention provides for the option of conducting simultaneous tax examinations at the request of one of the contracting parties. Pursuant to Article 8, the competent authorities² of the contracting parties may agree to conduct, each in its own territory, simultaneous tax examinations of a person or persons in which the contracting parties have a common or related interest and to exchange any relevant information which they so obtain.

2.2 Joint external tax audits by the German tax administration

The German revenue authorities may conduct external tax audits with foreign tax administrations simultaneously and on a joint basis. In this case, the German officials are present in the other EU member state, and the foreign officials are present in Germany, during the relevant stages of the audit. The participating tax administrations establish the priorities for the simultaneous joint external tax audit by mutual agreement and develop a strategy for investigative measures. In the case of joint external tax audits, too, the participating tax administrations each conduct independent external audits on their own territory in accordance with their domestic tax procedural law.

2.2.1 Joint external tax audits with other EU member states

Sections 10 and 11 of the EU Mutual Assistance Act apply with regard to arranging the presence of German officials in another EU member state and vice versa. If taxpayers provide their consent, certain investigative actions may be conducted by foreign officials in the presence of German officials, such as examining records and interviewing individuals (active audit rights; see section 10 subsection (3) of the EU Mutual Assistance Act). The information obtained during the joint external tax audit is (directly) exchanged, provided it is foreseeably relevant for taxation in the other EU member state (sections 1, 4, 6, 8, 12 of the EU Mutual Assistance Act).

¹ In Germany, the competent authority pursuant to Article 26 of the OECD Model Tax Convention is the Federal Central Tax Office (BZSt).

² The competent authority pursuant to Article 8 of the Administrative Assistance Convention is the Federal Central Tax Office.

2.2.2 Joint external tax audits with third countries

Provisions in double tax agreements corresponding to Article 26 of the OECD Model Tax Convention provide for the option of officials from the other contracting state being present in Germany and attending the relevant stages of external tax audits (see section 2.1.2 above). The foreign officials do not have any additional powers beyond this; in particular, they do not have the right to pose questions to the individual concerned, even with their consent, or to examine documents (no active audit rights).

Article 9 of the Administrative Assistance Convention also provides for the option of allowing representatives of the competent authority of the requesting contracting party to be present in Germany. Beyond this, foreign officials whose presence in Germany is based on Article 9 of the Administrative Assistance Convention do not have the right to interview individuals or examine documents (no active audit rights).

2.2.3 Posting of German officials to EU member states

The procedure for posting officials within the EU is carried out in accordance with the provisions of the other EU member state, in particular the provisions of the EU's Mutual Assistance Directive that have been transposed into the national law of the EU member state in question.

If posted German officials are present in other EU member states, they must at all times be able to produce written authority stating their identity and their official capacity (section 11 in conjunction with section 10 subsection (4) of the EU Mutual Assistance Act).

2.2.4 Powers of German officials in EU member states and third countries

In terms of providing international administrative assistance by exchanging information, the powers of German officials are based on the applicable provisions for taxes as defined in section 1 of the Fiscal Code (section 117 subsection (4), first sentence, of the Fiscal Code, section 4 subsections (1) and (2) of the EU Mutual Assistance Act). If the external auditor performs audit procedures in a foreign country, he or she acts within the framework of the external audit ordered in accordance with German law (sections 193 et seq. of the Fiscal Code).

The necessary investigations by the foreign tax authority are conducted in accordance with its relevant national laws (see section 4.2.3 of the "Guidance note on international administrative assistance through the exchange of information in tax matters"). Officials posted abroad have only those powers arising from German law and the national law of the requested state. If

broader investigative powers or rights exist under the law of the requested EU member state or third country than in German law, the posted official is not permitted to make use of these means of obtaining information (see item 15 of the commentary on Article 26 of the OECD Model Tax Convention).

If the requested EU member state or third country, being aware of the limited powers of the German external auditor who is present, is nevertheless willing to exercise its broader rights for the investigation into tax affairs, then the relevant investigations must be carried out by officials of the requested EU member state or third country. This does not lead to any extension of the investigating powers of the German officials. The information provided by the requested state is not subject to any restrictions with regard to analysis by the German revenue authorities, because this information could also have been provided to the German authorities without the posted German officials being present in the foreign country.

The obligations and restrictions that must be observed by the posted external auditor include any special requirements resulting from the national law of the requested state (e.g. special formal requirements for requesting documents) which must be observed in addition to the German procedural rules. Restrictions arising from German procedural law must, however, still be respected even if the national law of the requested state does not have any comparable rules (see, for example, section 4.2.1 of the “Guidance note on international administrative assistance through the exchange of information in tax matters”, with regard to the rights to refuse to give information or provide documentation).

If the central liaison offices³ agree, German officials may be present in the offices of the revenue authorities in the other EU member state and be present during administrative enquiries carried out in the other EU member state (passive audit rights, see Article 11(1) of the EU Mutual Assistance Directive). If the other EU member state has implemented the option stipulated in Article 11(2) of the EU Mutual Assistance Directive in its domestic law and the competent central liaison offices have reached a corresponding agreement, German officials are also permitted to interview individuals and examine documents in the presence of foreign officials (active audit rights). Whether it is necessary to obtain the approval of the taxpayer/parties involved depends on the national law of the other EU member state. Granting German officials in another EU member state investigative powers that go beyond these active audit rights is only possible if the law of the other EU member state so allows.

³ The central liaison office pursuant to the EU Mutual Assistance Act is the Federal Central Tax Office, in accordance with section 2 subsection (2) of that Act.

Any information necessary for coordinating and preparing a simultaneous or joint external tax audit may be exchanged, provided this is permissible under section 4 of the EU Mutual Assistance Act. The results of the respective audit must be exchanged during and after the audit (sections 4, 6, 8 of the EU Mutual Assistance Act). To this end, it is necessary that the German officials, particularly the auditors, are given the status of the competent authority responsible for the international exchange of information.

If information is contained in documents which the foreign revenue authorities have access to, the other EU member state should ensure that the German officials are given copies of these documents.

The information and documents that German officials obtain in other EU member states or third countries are subject to the same tax secrecy requirements under section 30 of the Fiscal Code as information and data about taxpayers or third parties obtained within Germany.

2.2.5 Posting of officials from EU member states or third countries to Germany

Foreign officials who are present in Germany are not public officials within the meaning of section 7 and section 30 subsection (1) of the Fiscal Code and section 355 of the Criminal Code (*Strafgesetzbuch*).

Officials from foreign tax administrations may carry out investigative activities in Germany only if this is permissible under the legal provisions of the posting EU member state or third country as well as under German procedural rules. If the legal provisions of the posting EU member state or third country give the foreign official additional powers, this does not constitute a legal basis with regard to investigations in Germany.

Auditors from other EU member states or third countries may exercise their powers only in the presence of German officials. Under section 114 of the Fiscal Code, the German auditor is responsible for the legality of investigative activities conducted in Germany and must make sure that officials from other EU member states or third countries do not overstep the powers they have in Germany (see section 114 subsection (2) of the Fiscal Code).

2.2.6 Powers of officials from EU member states or third countries in Germany

Foreign officials who are present in Germany must observe any restrictions or obligations arising from national provisions of the other EU member state or third country that differ from German procedural rules. Their obligation to observe secrecy is laid down in the national provisions of the posting country, the international agreements on which the exchange of information is based, and the EU's Mutual Assistance Directive (see section 2.7 below).

Officials from other EU member states who are on German territory, particularly for the purpose of conducting a coordinated external audit, must be able to produce written authority stating their identity and official capacity (section 10 subsection (4) of the EU Mutual Assistance Act).

Officials from other EU member states may be present in the offices of German revenue authorities and attend administrative enquiries if this has been agreed by the central liaison offices responsible (passive audit rights; section 10 subsection (1) of the EU Mutual Assistance Act). Such an agreement may also allow officials from the other EU member state to interview individuals and examine records in the presence of German officials. Active audit rights are subject to the individuals' consent to the interview and examination (section 10 subsection (3) of the EU Mutual Assistance Act). Obligations and restrictions under German procedural rules also apply to officials from other EU member states.

2.2.7 Tax secrecy and data protection

All information contained in tax files is generally covered by tax secrecy (section 30 of the Fiscal Code), regardless of whether it relates to taxpayers themselves or to their personal or business environment. Tax secrecy must therefore be observed both when making use of and when providing administrative assistance. Under section 30 subsection (4) number 2 of the Fiscal Code, disclosure of information obtained is permissible if explicitly provided by law. One such explicit provision is contained in section 117 subsection (2) of the Fiscal Code, which states that revenue authorities may provide international legal and administrative assistance on the basis of nationally applicable international agreements, nationally applicable legal instruments of the European Union, and the EU Mutual Assistance Act.

All the information necessary for preparing and conducting a coordinated external audit can be exchanged, provided that this is permissible under section 4 of the EU Mutual Assistance Act in conjunction with section 117 subsection (4) of the Fiscal Code. However, it must be ensured from an organisational point of view that no trade, commercial or professional secrets or trade processes are disclosed to foreign officials.

If the information that is relevant to the other EU member state is contained in documents to which German revenue authorities have access, German revenue authorities can hand over copies of or extracts from these documents to officials from the other EU member state provided that this does not affect the rights of third parties. Non-relevant contents must be blacked out if necessary.

A measure carried out on the basis of section 117 subsection (2) of the Fiscal Code in conjunction with section 4 of the EU Mutual Assistance Act does not constitute unauthorised disclosure and therefore does not represent a violation of tax secrecy, provided that the conditions set out in the EU Mutual Assistance Act are met. Under section 4 subsection (1), first sentence, of the EU Mutual Assistance Act, German tax authorities must provide all responses that may be of importance for the assessment of taxes in another EU member state.

Under section 4 subsection (6), first sentence, of the EU Mutual Assistance Act, a request from another country may not be refused on the grounds that the information requested is not required for tax purposes under German law. The relevance of the requested information for taxation in the requesting EU member state does not need to be established conclusively. It is sufficient to determine from an ex ante perspective that the information may be relevant for tax assessment. The authorities receiving the request must transmit all the relevant information at their disposal in the form of reports, certifications and other documents, or certified copies of documents, provided that the conditions are met. Under Article 25 of the EU Mutual Assistance Directive, implemented in German law by means of section 19 of the EU Mutual Assistance Act, officials from other EU member states must observe data protection requirements and may use the information obtained only under the conditions specified in the provision.

Officials from third countries must comply with the secrecy provisions contained in the international agreements on which the exchange of information is based (administrative assistance agreements, double taxation agreements, agreements on the exchange of information in tax matters (TIEA)). They must also comply with their respective national provisions concerning secrecy (see also section 1.6.2 of the “Guidance note on international administrative assistance through the exchange of information on tax matters”).

3. Conducting coordinated audits in practice

3.1 Responsibilities

The Federal Central Tax Office is the competent authority in the area of administrative assistance in tax matters (section 5 subsection (1) number 5 of the Fiscal Administration Act (*Finanzverwaltungsgesetz*)). The Federal Ministry of Finance has designated the Federal

Central Tax Office as the central liaison office within the meaning of Article 4(2)(1) of the Mutual Assistance Directive. Under section 5 number 25 of the Fiscal Administration Act, the Federal Central Tax Office is also the revenue authority responsible for administering the insurance premium tax, which includes conducting external audits. To the extent that the following provisions refer to the tax offices responsible for external audits, they also apply *mutatis mutandis* to the Federal Central Tax Office division responsible for external insurance tax and fire protection tax audits. The central liaison office is in charge of communicating with the other member states.

The central liaison office receives proposals for coordinated external audits from foreign tax administrations and sends the German tax administration's audit proposals to foreign tax administrations. It reviews the legal permissibility of incoming and outgoing audit proposals.

The tax office responsible for the external audit decides which cases to propose for a coordinated external audit and for what reasons (section 12 subsection (1) of the EU Mutual Assistance Act). The central liaison office informs the EU member states in question of these proposals, provides reasons for its choices, and specifies the time period in which the external audits are to be conducted (section 12 subsection (2) of the EU Mutual Assistance Act). In addition, the central liaison office concludes agreements with other EU member states on conducting coordinated external audits (section 12 and section 10 subsection (3) of the EU Mutual Assistance Act).

When another EU member state proposes a coordinated external audit, the central liaison office simultaneously informs the tax office responsible for the external audit and the federal audit directorate. The responsibilities within Germany remain unaffected.

The tax office responsible for the external audit decides whether it will participate in the audit. The central liaison office informs the other EU member state of the tax office's agreement or reasoned refusal (section 12 subsection (3) of the EU Mutual Assistance Act). The responsibilities within Germany remain unaffected.

In addition, the Federal Central Tax Office (federal audit directorate) can encourage the tax office responsible for the external audit to conduct or participate in a coordinated external audit.

The central liaison office coordinates each coordinated external audit in consultation with the competent *Land* revenue authorities (section 12 subsection (4) of the EU Mutual Assistance Act). The central liaison office must be informed of the progress of the coordinated external audit regularly and without delay.

The external audit is conducted by the revenue authorities responsible under section 195 of the Fiscal Code, if necessary with the involvement of the Federal Central Tax Office's federal audit directorate (section 19 subsection (1), first sentence, of the Fiscal Administration Act).

The above comments apply accordingly to audits with third countries.

3.2 Consultation of the taxpayer during a coordinated external audit

International administrative assistance in coordinated external audits affects the rights of the domestic party concerned. In principle, the taxpayer and all other domestic parties to which the exchange of information pertains must be consulted in a timely manner (section 117 subsection (4), third sentence, in conjunction with section 91 of the Fiscal Code). The aim is to give them the opportunity to comment and raise objections.

In principle, taxpayers need to be consulted whenever information is exchanged between countries with the aim of selecting companies for coordinated external audits. However, consultation may be dispensed with until the audit order is disclosed if prior consultation would jeopardise the success of the audit (section 12 subsection (5) of the EU Mutual Assistance Act). Decisions to dispense with a consultation in other exceptional cases are also taken by the competent revenue authority at its discretion, with due regard for the general principles set out in section 91 of the Fiscal Code. This exercise of discretion must be recorded (see section 3.7 on selection meetings below).

During the consultation, the German taxpayer must be made aware of the following:

- The planned presence of officials from other EU member states in Germany and of German officials in other EU member states (section 10 subsection (1) and section 11 of the EU Mutual Assistance Act)
- The planned exchange of information between Germany and the other EU member state (section 10 subsection (2) and section 12 subsection (1) of the EU Mutual Assistance Act)
- The right to interview the taxpayer being audited by the other member state (section 10 subsection (3), first sentence, first alternative, of the EU Mutual Assistance Act), subject to the approval of the foreign taxpayer, if required
- The right to check the records of the taxpayer being audited by the other EU member state (section 10 subsection (3), first sentence, second alternative, of the EU Mutual Assistance Act), subject to the approval of the foreign taxpayer, if required

If the taxpayer was already consulted on the planned exchange of information in connection with coordinated external audits, there is generally no need for further consultation if information is to be exchanged or disclosed as part of the external audit.

Responsibility for the consultation lies with the German tax office conducting the external audit and, in the cases set out in section 19 subsection (3) of the Fiscal Administration Act, the Federal Central Tax Office. They inform the central liaison office of the outcome of the consultation or of the fact that a consultation was dispensed with.

The consultation can take place orally or in writing (using the appropriate form, see Annex). The consultation can be combined with the audit order and with the request for consent under section 10 subsection (3) of the EU Mutual Assistance Act. Where the consultation is oral, a record must be kept of the consultation and the participant's comments. In general, the time limit for the consultation is four weeks unless a longer time limit seems necessary in a specific case.

3.3 Objections of the taxpayer

Objections to the planned exchange of information and the presence of foreign officials during investigations in Germany must be lodged with the German tax office responsible for the external audit and, in the cases set out in section 19 subsection (3) of the Fiscal Administration Act, with the Federal Central Tax Office.

The competent tax office forwards any objections to the central liaison office via official channels, including all documents that are relevant to the decision. The tax office can comment on the taxpayer's objections. The central liaison office makes a decision and communicates the outcome to the taxpayer and the competent tax office.

If the central liaison office considers the taxpayer's objections to be justified, the coordinated external audit is not conducted. The national external audit can be initiated regardless of any objections to the exchange of information and the presence of foreign officials.

If the objections are considered unjustified, the taxpayer is informed in a timely manner prior to the disclosure of information to the other country (see section 3.2.1 of the "Guidance note on international administrative assistance through the exchange of information in tax matters").

3.4 Consent of the taxpayer under section 10 subsection (3) of the EU Mutual Assistance Act

Officials from other EU member states who are present during joint external tax audits being conducted in Germany may interview individuals and examine records in the presence of German officials. The prerequisites are (i) that the central liaison offices agree and (ii) that the individuals concerned consent to the interview and the examination of records. If an individual refuses to cooperate, this refusal is treated like a refusal expressed towards German officials (section 10 subsection (3), third sentence, of the EU Mutual Assistance Act). Consent is to be obtained by the German tax office responsible for the external audit. This is to be done in conjunction with the consultation.

Requests for consent can be made orally or in writing. Consent in written form should be requested to ensure that the documentation is legally admissible. If consent is given orally, a written record is to be kept. The tax office informs the central liaison office without delay of the fact that consent was requested and whether it was given or refused.

This applies in particular if previously given consent is withdrawn, or partially withdrawn, during the course of the audit. The central liaison office in Germany informs the central liaison office of the other EU member state if consent was refused or withdrawn. If the taxpayer withdraws consent under section 10 subsection (3) of the EU Mutual Assistance Act, any information obtained up to that point can still be used without restriction.

If the taxpayer refuses consent to interviews or examinations of documents by foreign officials, the foreign officials have no independent rights to conduct interviews or examine documents directly (section 10 subsection (3) of the EU Mutual Assistance Act). However, this does not affect their right to be present under section 10 subsection (1) of the EU Mutual Assistance Act. This means that foreign officials can continue to be present in the offices of the German revenue authorities and attend administrative enquiries if this has been agreed by the central liaison offices of the countries involved. If no consent has been given, the foreign official's relationship to the taxpayer is that of a passive observer. Nevertheless, it is still possible to request the same information and documents that can be transmitted as part of an exchange of information under section 4 of the EU Mutual Assistance Act (see section 10 subsection (2) of the EU Mutual Assistance Act).

Internal *Land* rules pertaining to competences in connection with any proposals for a coordinated external audit must be observed. Proposals by German authorities must be sent to the central liaison office via official channels. The form *Auskunftsersuchen zur Zusammenarbeit der Verwaltungen im Bereich der direkten Steuern* (“Request for administrative cooperation in the field of direct taxation”) may be used for this purpose⁴.

The transmission letter should also contain a statement regarding the consultation of the taxpayer in accordance with Annex 3 of the “Guidance note on international administrative assistance through the exchange of information in tax matters”.

The proposal to conduct a coordinated external audit must include the following:

- precise identification of the taxpayer(s) concerned who are outside Germany,
- the name of the country or countries with which the coordinated external audit is to be conducted,
- designation (as specific as possible) of the issues that the audit will focus on, in order to provide the foreign tax authorities with the information they need to approve the requested coordinated external audit,
- a statement explaining why a coordinated external audit is especially suited to the aim of ascertaining the facts and assessing them for tax purposes,
- designation of the calendar years or fiscal years that come into question for the audit.

The central liaison office reviews the legal permissibility of the proposal for a simultaneous or joint external audit and forwards the proposal to the competent authority of the country and/or EU member state(s) concerned, together with a request that such competent authority/authorities participate in the proposed coordinated external audit. If necessary, the central liaison office designates an audit coordinator to coordinate further arrangements with domestic and foreign authorities. In such cases, the audit coordinator takes on the tasks of the central liaison office (see also section 3.6 below).

⁴ This form is to be sent electronically to the central liaison office at:

Federal Central Tax Office, Central liaison office, Division St I 7, 53221 Bonn, Germany, phone: +49(0)228/406-2880, fax: +49(0)228/406-3119, e-mail: de.sia@bzst.bund.de.

If the competent authority of the other country or EU member state agrees to participate in the audit, the central liaison office assigns, via official channels, responsibility for the exchange of information to the external auditor named by the competent *Land* revenue authority and, if applicable, to the participating federal auditor.

Joint external tax audits are an appropriate means for ascertaining all facts with a cross-border dimension, especially in connection with transfer pricing issues; questions regarding permanent establishments; investigations of tax planning and tax avoidance schemes; and investigations of complex business restructuring schemes.

3.6 Initiation of a coordinated external audit by the revenue authorities of other countries

The central liaison office reviews proposals for coordinated external audits submitted by other countries and, where necessary, appoints an audit coordinator to coordinate further arrangements with the competent *Land* authorities and the Federal Central Tax Office (federal audit directorate). In such cases, the audit coordinator takes on the tasks of the central liaison office.

The competent *Land* revenue authority sends its agreement or reasoned refusal to the Federal Central Tax Office via official channels, for the purpose of forwarding to the foreign revenue authority (section 12 subsection (3) of the EU Mutual Assistance Act). If the competent revenue authority agrees to participate in the audit, the central liaison office assigns responsibility for the exchange of information to the external auditors named by the competent tax office and, if applicable, to the participating federal auditors. The same applies to cases involving third countries.

3.7 Selection meetings

If two or more EU member states wish to exchange information with the objective of selecting companies that are to be the subject of coordinated external audits, a selection meeting may be held for this purpose (section 12 subsection (1), second sentence, of the EU Mutual Assistance Act). Such meetings – which are to be attended by representatives from the other EU member state(s), the competent German authorities, and the central liaison office – seek to clarify whether coordinated external audits are legally permissible and can be carried out in practice with a reasonable amount of resources. The same applies to cases involving third countries.

A selection meeting can be initiated by sending an informal notification to the central liaison office.

Information that is likely to be relevant for tax purposes is exchanged in advance, i.e. during preparations for coordinated external audits and particularly during the selection meetings (sections 4 and 6 of the EU Mutual Assistance Act in conjunction with section 117 subsection (4) of the Fiscal Code). Officials may exchange information at the selection meetings only insofar as they have already been assigned responsibility for the exchange of information by the central liaison office or by the audit coordinator.

As a rule, the party to which the exchange of information pertains is to be notified of the exchange of information in a timely manner and consulted in advance (section 117 subsection (4), third sentence, of the Fiscal Code). In exceptional cases, prior consultation may be dispensed with if the exchange of information takes place in accordance with the EU Mutual Assistance Act, or if the consultation is not required by the circumstances of the individual case (section 91 subsections (2) and (3) of the Fiscal Code), and the decision to dispense with consultation is made with due discretion in accordance with section 91 of the Fiscal Code (see section 3.1.2 of the “Guidance note on international administrative assistance through the exchange of information in tax matters”).

Furthermore, prior consultation may be dispensed with until the audit order is disclosed if prior consultation would jeopardise the success of the audit (section 12 subsection (5) of the EU Mutual Assistance Act).

If at the selection meeting the participating EU member states agree to conduct a coordinated external audit, the meeting may proceed as the initial meeting (see section 3.8 below), insofar as the consultation of the taxpayer has already addressed the issue of a coordinated external audit.

3.8 Initial meeting of the coordinated external audit

At the initial meeting, the participating tax administrations should reach agreement on the goals and framework of the coordinated external audit. One goal of the coordinated external audit is to achieve a joint and consensual determination of the facts. Another goal of a joint external tax audit can be to reach a legally binding agreement – by way of mutual agreement procedure – regarding the tax treatment of the consensually determined facts (see section 1.1 above).

One purpose of the initial meeting is to introduce the case under audit. The participating auditors should discuss the priorities of the audit, develop the overall audit plan, and make decisions on how the cooperation should be structured. Prior to the initial meeting, as much information as possible should be compiled regarding the taxpayers to be audited and regarding the facts of the case that will be the subject of the coordinated external audit.

The minutes of the initial meeting should cover at least the following points:

- the names of the participating taxpayers,
- the goals of the coordinated external audit,
- a description of the facts to be ascertained and the areas to be audited,
- the type(s) of tax to be audited,
- the audit period (clarification of the extent to which tax assessments can be modified in formal and material terms, taking into particular account any rulings issued by a participating country),
- which working language will be used,
- the schedule and type of planned audit activities (including the presence of the audit team at the taxpayer's premises),
- the contact information of the responsible officials.

3.9 Communication and language

The official language for German taxation procedures remains German. Other languages can be designated as working languages, as long as all participants agree.

The German officials who have been assigned responsibility for the exchange of information are to provide the foreign auditors with all information that is foreseeably relevant for the assessment of taxes in the other country/EU member state(s). After they have been assigned such responsibility, these German officials are authorised to exchange verbal communications and to engage in the on-site exchange of documents and other objects. This applies as well to the exchange of information via regular mail. All activities are to be documented appropriately for the records and for the central liaison office's reference.

Insofar as digital communications are necessary, all transmissions of data that have ramifications in connection with section 30 of the Fiscal Code must be conducted exclusively via the CCN⁵ or a similarly secure network.

⁵ The common platform based on the common communication network (CCN), developed by the Union for all transmissions by electronic means between competent authorities in the area of customs and taxation (Article 3 no 13 of the EU Mutual Assistance Directive).

3.10 Report on the results of the joint external tax audit

The domestic and foreign officials participating in the joint external tax audit should compile a joint report summarising the results of the audit. This report should include, in particular, a description of the facts ascertained and the respective national legal appraisals of the case. It should also include each country's appraisal of the facts as they pertain to the double taxation agreement(s) that applies to the specific case.

Audit findings that were not the subject of the joint audit(s) should be included not in the joint report but rather in the relevant national audit report.

4. Legal bases and procedural steps for mutual agreement procedures and advance pricing agreements

Mutual agreement procedures and advance pricing agreements are to be kept distinct from joint external tax audits (see section 2.2 above). The function of competent authority for mutual agreement procedures and advance pricing agreements is **not** delegated to the domestic external auditors participating in the audit.

The legal bases for mutual agreement procedures are the relevant clauses of the applicable double taxation agreement (commensurate with paragraph 1 of Article 25 of the OECD Model Tax Convention) or Article 6 of the EU Arbitration Convention. These contain provisions in accordance with which the German competent authority can reach an agreement on individual cases with the competent authorities of other countries in order to resolve a taxation conflict or to eliminate taxation in breach of a tax agreement.

Details on the process of carrying out mutual agreement procedures are to be found in the Federal Ministry of Finance circular of 13 July 2006 – IV B 6 – S 1300 – (“Guidance note on international mutual agreement procedures and arbitration procedures in the area of taxes on income and capital”, Federal Tax Gazette I 2006, p. 461).

If a double taxation agreement contains a clause on mutual agreement procedures commensurate with paragraph 1 of Article 25 of the OECD Model Tax Convention, this can also be used as a basis for concluding an advance pricing agreement with the other country upon application by the taxpayer. Details on advance pricing agreements are contained in the Federal Ministry of Finance circular of 5 October 2006 – IV B 4 – S 1341 38/06 (“Guidance note on advance pricing agreements”, Federal Tax Gazette I 2006, p. 594).

5. Potential connections between (a) mutual agreement procedures or advance pricing agreements and (b) joint external tax audits

During or after a joint external tax audit (see section 2.2 above), a taxpayer may submit an application for a mutual agreement procedure relating to the audit period, as long as this is permissible under the relevant legal provisions. Such applications are suitable in particular if:

- (1) during the course of the joint external audit, solid indications arise that the taxpayer faces the risk of taxation in breach of a tax agreement,
- (2) in the view of the taxpayer, the taxation deemed appropriate in the joint report constitutes taxation in breach of a tax agreement,
- (3) in the view of the taxpayer, the taxation deemed appropriate in the joint report is in line with the double taxation agreement, but one of the participating administrations fails to issue tax assessment notices that put this into effect,
- (4) the joint external tax audit fails to reach consensus on the facts of the case, or
- (5) the auditors participating in the joint external tax audit fail to reach agreement regarding the appropriate taxation under the double taxation agreement.

The general rules pertaining to mutual agreement procedures and arbitration procedures must be observed. Moreover, joint external tax audits may also serve as the basis for advance pricing agreements. Taxpayers may submit applications for advance pricing agreements during or after joint external tax audits. In these cases, the Federal Ministry of Finance circular of 5 October 2006 – IV B 4 – S 1341 38/06 (“Guidance note on advance pricing agreements”, Federal Tax Gazette I 2006, p. 594) must be followed. As far as the additional records that must be submitted for an advanced pricing agreement are concerned (see section 3.5 of the “Guidance note for advance pricing agreements”), the requirements should normally be minimal if, for the period covered by the joint external tax audit,

- the facts of the case have been sufficiently ascertained,
- the transfer prices have been sufficiently documented as appropriate, and
- no significant changes are anticipated for the period covered by the requested advance pricing agreement.

However, for advance pricing agreements, the following information is normally necessary in addition to the facts and records already compiled during the joint external tax audit: the agreed critical assumptions (section 3.7 of the “Guidance note for advance pricing agreements”), the agreed time frame (section 3.8 of the “Guidance note for advance pricing agreements”) and the agreed reporting requirements (section 6.1 of the “Guidance note for advance pricing agreements”). The fee provisions laid down in section 178a of the Fiscal Code also apply to advance pricing agreements following joint external tax audits.

If an application for a mutual agreement procedure or advance pricing agreement is submitted following a joint external tax audit, the central liaison office forwards the joint report on the joint external tax audit to the divisions at the Federal Central Tax Office that are responsible for mutual agreement procedures and advance pricing agreements.

Head of Directorate IV B