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Richard T. Ainsworth

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GERMAN VAT COMPLIANCE – MOVING ONE STEP CLOSER TO AUTOMATED THIRD-PARTY SOLUTIONS

Richard T. Ainsworth

Recent developments in German VAT compliance, notably the imposition of *criminal* penalties for failing to *immediately* amend a preliminary return that is known to be in error, are leading businesses to third-party VAT solutions.[1] Germany is not alone in the creative use of criminal enforcement to collect the VAT,[2] but the size and importance of the German economy make these developments difficult to ignore.

What makes the German developments so interesting is that these new compliance measures are arising through case law as well as statute. German statute is changing, but more importantly the way the law interprets tax compliance is changing just as significantly. In this environment, it is risky to have VAT compliance an entirely in-house affair when the tax department is in a remote jurisdiction. Outsourcing basic return functions with VAT compliance specialists is becoming a professional necessity.

The risks brought on by changing compliance rules are a particular concern for multinational enterprises (MNE) that have global tax exposure. Keeping up to date on processing and procedural issues from a distance is difficult. Third party VAT specialists that narrowly focus on following changes in the global return and reporting landscape become invaluable aids for MNEs. They automate processes, minimize missteps, and help the tax manager avoid pitfalls. When *criminal* enforcement is involved (as it is in Germany), these pitfalls can be both financially and personally very painful.

This paper compares two similar compliance regimes in two similar consumption taxes – preliminary VAT returns in Germany and estimated retail sales tax returns in the US States. Both regimes have the same concern – the tax administration wants to encourage taxpayers to make timely and accurate estimated payments of a tax that is not yet fully due. It is clear that German enforcement is far more stringent than the American. For a tax manager steeped in the retail sales tax, the German approach is

[1] Judgment of the First Criminal Chamber of the *Bundesgerichtshof* of March 17, 2009, No. BGH 1 StR 342/08 (Note: at this single citation there are two related documents from the court. The first is a "decision, or solution" [*beschluss*] and the second is the "case, or judgment" [urteil]. They deal with different aspects of the same fact pattern. Both are needed to appreciate how the law is developing in this area).

[2] Article 205 of the Criminal Law (People's Republic of China) imposes a death penalty for VAT fraud. Offenders that *issue* fraudulent VAT Special Invoices or other invoices for securing improper export VAT refunds, or improper VAT credits the penalty is imprisonment for up to three years and financial penalties between RMB 20,000 to RMB 200,000. However, if the criminal offenders have swindled large sums of from the state and the offense is considered serious then life imprisonment or the death penalty is possible with financial penalties from RMB 50,000 to RMB 500,000, or confiscation of property. Similar penalties (up to and including the death penalty) are imposed under Article 206 for the act of *forging* the fraudulent invoices that are the subject of Article 205. There are no reports of anyone being put to death for VAT fraud in China. Jane K. Winn & Angela Zhang, *China's Golden Tax Project: A Technological Strategy for Reducing VAT Fraud,* WEALTH STRATEGIES JOURNAL 2, n.6 (July 16, 2010) *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1641379

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difficult to fathom and its recent developments nearly impossible to anticipate – and herein lies the pitfall for American tax managers with global compliance responsibilities.

What appears to be happening in Germany is that the *Bundesgerichtshof* is very conscious of a particularly damaging kind of tax fraud lurking in the background of the EU VAT – missing trader intra-community fraud (MTIC.)[3] MTIC fraud takes advantage of a known weakness in the EU VAT[4] – one that the EU Commission is having a very difficult time dealing with.[5] The European Economic and Social Committee estimates that MTIC losses in the EU fall in a range between €200 billion to €250 billion.[6]

Opportunistic fraudsters always seem to be on the periphery of the EU VAT. MTIC fraudsters are the precise kinds of taxpayers who would want to file inaccurate preliminary returns, underestimating the tax that's due, and using this ruse to cover-up substantial fraudulent activities. In brief, these fraudsters purchase supplies without VAT, sell onward with VAT, planning all the time to under report and disappear with VAT in hand before authorities arrive. This is the unstated background informs the *Bundesgerichtshof's* decision.

Because missing trader frauds are uncommon in the retail sales tax, the American perspective on the importance of accurate estimated sales tax returns differs substantially from the German attitude on the importance of preliminary VAT returns. In fact, Germany and Austria have been so concerned about MTIC fraud that they have effectively proposed changing the EU VAT into an American retail sales tax.[7] Until

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[3] There are several permutations of this fraud, but the essential elements are that a taxable person ("missing trader") acquires goods from trader in another Member State free of VAT, has an obligation to self-assess and remit VAT when it sells onward – but does not do so. The taxable person then disappears with the VAT. MTIC fraud takes advantage of a temporary relinquishment of normal VAT obligations (the acquisition of supplies without paying VAT), a disruption that has been deliberately put in place to implement the destination principle in cross-border intra-community sales, but which is causing significant fraud problems.

[4] The EU VAT underwent a significant change in 1993 when internal fiscal frontiers were abolished. [Council Directive 91/680/EEC of 16 December 1991 supplementing the Sixth Directive with a view to the abolition of fiscal frontiers, O.J. (L – 376) 1]. The current system is based on the Benelux 50 system, which applied to the cross-border supply of goods among Belgium, Luxembourg and the Netherlands. However the Benelux system was known to be susceptible to cross-border fraud. [Redmar A. Wolf, *The Sad History of Carbon Carousels*, 6 INTERNATIONAL VAT MONITOR 403 (2010).] The EU Council was aware of this problem before adoption, and accepted the risk. [Economic Policy Committee to the Council and the Commission, *Indirect Aspects of the Harmonization of Indirect Taxes,* (April 6, 1988) No. II/066/2/88-EN at 15.] Upon the adoption of the current system "… missing trader fraud in the Europena Union exploded …" Christian Amand & Kris Boucquez, *A New Defense for Victims of EU Missing-Trader Fraud?* 4 INTERNATIONAL VAT MONITOR 234, 236 (2011).]

[5] European Commission, Green paper – On the future of VAT: Towards a simpler, more robust and efficient VAT system (COM(2010) 695/4); Pricewaterhouse Coopers, *Study of the feasibility of alternative methods for improving and simplifying the collection of VAT through he means of modern technologies and/or intermediaries* 129 (Final Report – September 20, 2010) TAXUD/2009/AO-05.

[6] European Economic and Social Committee, *Proposal for a Council Directive amending Directive 2006/112/EC on the common system of the value added tax, with regard to the duration of the obligation to respect a minimum 'standard rate."* COM (2010) 331, O.J. 52/67 (February 17, 2011).

[7] Communication from the Commission to the Council in accordance with Article 27(3) of Directive 77/388/EEC, (July 19, 2006) COM (2006) 404 final (discussing the Austrian request at ¶2.1 and the

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something like this happens in the EU, the "tax intuition" of American tax managers may not appreciate the importance of preliminary returns in Germany and may not easily anticipate compliance developments like those in the *Bundesgerichtshof's* decision BGH 1 StR 342/08.

GERMAN VAT

Annual returns; preliminary (monthly) returns; BGH 1 StR 342/08

Annual returns. German VAT returns are due annually.[8] Preliminary returns, reflecting VAT that is tentatively due based on three months of activity, are required quarterly,[9] unless the previous year's VAT payable exceeded €7,500. In this case preliminary returns must be filed monthly.[10] Monthly returns are the norm for major businesses in Germany.

Preliminary returns. VAT liability associated with preliminary returns must be paid no later than the tenth day after the end of the filing period (monthly or quarterly).[11] A one-month filing and payment extension is allowed upon written application.[12] If a taxpayer is filing monthly then a special prepayment of 1/11 of last year's VAT is required.[13] Thus, in a full year either five or thirteen returns are due – a set of four or twelve preliminary followed by the annual return.

BGH 1 StR 342/08. On March 17, 2008 the *Bundesgerichtshof* (Federal Supreme Court, First Criminal Chamber)[14] determined that the filing of an incorrect preliminary VAT return was a criminal offense if the omission was intentional or done with gross negligence. This offense is deemed separate from offences associated with an incorrect filing of the annual return.

German request at 2.2 to adopt a universal reverse charge in all business to business [B2B] transactions, a rule that would have VAT only collected by a business selling to a consumer [B2C] which is the classic definition of a retail sales tax). Thus,

> The reason given by Austria for introducing this request is in the pretext of being a tool to tackle carousel or missing trader fraud, and because it had positive experiences from the introduction of reverse charge in the construction sector. Austria believes that VAT fraud, especially carousel fraud and fraud by means of fictitious invoices, can no longer be prevented using conventional methods. …
>
> The reason given by Germany for introducing this request is similar to that of Austria, but unlike the Austrian proposal, the German system foresees significant additional reporting by the taxable persons.

[8] Article 16 (1), Value Added Tax Act (UStG) *Umsatzsteuergesetz* indicates that the taxation period is the calendar year. The annual return [*Umsatzsteuererklärung*] must be submitted by May 31 of the following reporting period.

[9] Article 18 (2), Value Added Tax Act (UStG) *Umsatzsteuergesetz.*

[10] Article 18 (2), Value Added Tax Act (UStG) *Umsatzsteuergesetz* (monthly returns are also required during the first and second years after the commencement of business activities).

[11] Article 18 (1), Value Added Tax Act (UStG) *Umsatzsteuergesetz.*

[12] Article 18 (6), Value Added Tax Act (UStG) *Umsatzsteuergesetz.*

[13] Article 18 (6), Value Added Tax Act (UStG) *Umsatzsteuergesetz.*

[14] *Supra* note 1 [*urteil*] *Bundesgerichtshof* No. BGH 1 StR 342/08.

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Although the lower court determined that penalties applied to the filing of an incorrect preliminary return, those penalties were incorrectly measured by the *interest due* on the under-declared VAT. The *Bundesgerichtshof* indicated that these penalties are properly measured by the *full amount* of the VAT involved. Essentially, the penalty is 100% of the unpaid tax.[15]

On the same day the *Bundesgerichtshof* [16] also determined that a taxpayer has a legal obligation to correct a tax filing (a preliminary or a final return) as soon as the taxpayer becomes aware that inaccuracies on the return are resulting in lower tax payments. In short, an omission (the intentional failure to comply with the obligation to correct an inaccurate return) is an offence, separate and distinct from the violation(s) resulting from filing the inaccurate returns themselves.

Criminal law requires an exception at this point. If the initial inaccurate return was itself an intentional violation of the return requirements, then the omission to correct these inaccuracies cannot be a separate violation. Under the principle of *nemo tenetur,*[17] the failure to disclose an initial crime cannot be regarded as a second offense if this would mean that the taxpayer would be compelled thereby to testify against himself.

The *Bundesgerichtshof's* decision affirms this principal, but limits its scope. Taxpayers may still be obligated to correct earlier filed returns (even if they had intentionally violated their original filing obligations) depending upon somewhat subtle distinctions about the level of intent associated with the initial filing.[18]

If the offender had acted with first or second-degree levels of intent (that is, if he willfully submitted an erroneous return, or if he was at least fully aware that the return he filed was erroneous when filed) then *nemo tenetur* protects the taxpayer from a second offence when the taxpayer does not correct those returns.[19]

However, if the taxpayer initially acts with a lower level (third degree) of intent (*dolus eventualis*), or in other words, if he was aware that the return *might possibly be wrong*, but simply did not bother to check it for accuracy, then by not correcting the return the taxpayer has committed a second offence. The taxpayer will be subject to penalties measured by the total amount of VAT omitted.[20] Unfortunately, *dolus eventualis* is precisely the level of intent that is most commonly attributable to the busy

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[15] Jochen Meyer-Burow & Ocka Stumm, *VAT Compliance: How to Avoid Tax Offenses – VAT and Tax, Germany* BAKER & MCKENZIE NEWSLETTER (February 28, 2011) at 2.
[16] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08.
[17] *Nemo tenetur se ipsum accusare* means that a party is not obligated to say or do anything that may be used against him in a criminal trial.
[18] Jochen Meyer-Burow & Ocka Stumm, *Recent Developments in German Criminal Law and Their Impact on VAT Compliance*, INTERNATIONAL VAT MONITOR (May/June 2011) 161, 162.
[19] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶¶ 14 through 21 (setting out the levels of knowledge and at ¶21 specifically indicating the secondary authorities for and against the criminal intent distinctions as applied to criminal tax evasion).
[20] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶¶27 through 31 (presenting the constitutional provisions in support of the *nemo se ipsum tenetur accussare* principle in German law arguments).

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tax manager of a global MNE who has far too many returns to file and far too few VAT specialists with the language and research skills needed to stay fully compliant.

Facts of BGH 1 StR 342/08. The defendant in the case was the managing director (the CEO) of a limited partnership (GmbH), who had been in his position since 1979.[21] During the period from 1979 through 2003, the company had reported the wrong VAT amounts consistently. The years 2001 through 2003 were at issue in the case, although an audit was performed only for portions of 2003.[22]

The company's computer system could not (or simply did not) produce the VAT reports from the bookkeeping records,[23] and as a result both preliminary and annual VAT returns were completed manually.[24] Employees were instructed to go through incoming and outgoing invoices by hand. The *Bundesgerichtshof* noted that in 2002 a €3.7 million error was made (sales totaling €12.8 million were made, but only €9.1 million were reported).[25] Input tax was also incorrectly reported. It was too low by €62,000.[26]

The *Bundesgerichtshof* noted that the defendant was told in the first half of 2002 that VAT was accumulating in the books of the company and was not being reported or remitted to the tax authorities.[27] It also noted that he was aware that the VAT returns were being created manually (suggesting to the *Bundesgerichtshof* that there he should have known that there was at least the possibility of an error on the returns).[28] In spite of these warnings the managing director did nothing. He did not check either the annual return or the series of preliminary returns for errors.[29]

The managing director was aware of this situation because in October of 2003 the tax office conducted an audit. It was determined at that time that at least for the period from February 2003 through May 2003 actual sales substantially exceeded reported sales.[30] The *Bundesgerichtshof* indicated that it should have been apparent to the defendant that not only might there be more errors in 2003, but he also should have

[21] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶3.
[22] *Supra* note 1 [*urteil*] *Bundesgerichtshof* No. BGH 1 StR 342/08 at ¶3 (indicating that errors in the VAT filings were clear from 2001 through 2003).
[23] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶3.
[24] *Supra* note 1 [*urteil*] *Bundesgerichtshof* No. BGH 1 StR 342/08 at ¶¶3-4 (indicating that employees drafted the returns manually).
[25] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶3.
[26] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶3.
[27] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶14 (indicating that the defendant knew about the errors from mid 2002).
[28] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶6 (indicating that the defendant was told about the manual processing and knew about it and the potential errors before the tax authorities knew about it).
[29] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶3 (indicating that in spite of having advance notification of the inaccuracies , the defendant did nothing to check the returns).
[30] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶4 (indicating that the audit was confined to the February through May period of 2003).

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anticipated that the preliminary returns from January through December 2002 might also be incorrect.[31]

However, the defendant still did nothing. A correction would clearly have been possible after the 2003 audit because the accounting records were now well in order. Correct sales figures were available.[32] The defendant therefore was under a clear obligation to *immediately* (without undue delay)[33] take affirmative steps to correct returns previously filed.

Importantly, the statute of limitations on an *omission to correct* returns is not co-extensive with the statute of limitations on the *erroneous returns* themselves.[34] Thus, even if the tax office could no longer audit the 2002 returns because the statute had run, this would not protect the defendant from penalties associated with the failure to correct the earlier returns. The obligation to make a correction arose in 2003 and has a longer statute of limitations.

In addition, correcting the 2002 annual return (due May 31 of 2003) does not relieve the taxpayer of the obligation of correcting each of the erroneous preliminary returns. This is true even though these preliminary returns are only tentative monthly estimates that roll up into the annual return.

Outcome of BGH 1 StR 342/08. The lower court penalized the defendant based on his omission to make corrections to the 2002 preliminary returns, and also for his failure to submit a correct 2002 annual return. Fortunately, only financial penalties were imposed. At the District Court penalties were calculated on the interest due on the unpaid 2002 VAT.[35] The defendant was acquitted on charges for 2003 (the omission to correct the 2003 returns) because there were evidentiary problems at trial.[36]

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[31] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶4 (indicating that the defendant should have expected errors in the 2002 returns).

[32] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶5 (indicating that the efforts made during the audit made the accurate records for the earlier period available to the manager).

[33] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶12 (referencing the requirement under §153 of the *Abgabenordnung* (General Tax Code) and secondary sources in further support indicating that, "Under this provision, the taxpayer is to immediately, i.e., without undue delay make and display the correct position to the tax authorities …").

[34] The statute of limitations is normally four years for a tax assessment, but for willful tax evasion it is ten years. §§169 - 171 of the *Abgabenordnung* [General Tax Code]. The beginning of the period is the end of the tax year (December 31 of the calendar year in which the taxes are incurred). Under the *Strafgesetzbuch*, StGB (Criminal Code) §78 III, s 4, the normal statute of limitations is five years, however after December 25, 2008 the criminal statute of limitations was raised to ten years under §376 of the *Abgabenordnung* [General Tax Code]. Thus, the 2002 tax years in this case were under the five year statute.

[35] Jochen Meyer-Burow & Ocka Stumm, *Recent Developments in German Criminal Law and Their Impact on VAT Compliance*, INTERNATIONAL VAT MONITOR (May/June 2011) 161 (indicating that the District Court's interest-based penalty).

[36] *Supra* note 1 [*urteil*] *Bundesgerichtshof* No. BGH 1 StR 342/08 at ¶¶1 & 13 (indicating that the District Court of Nuremberg-Fueth acquitted the defendant with respect to the 2003 return years on March 10, 2008, and the reason was that the information was "patchy" and not "well established").

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The *Bundesgerichtshof* upheld the conviction related to 2002, but declared that financial penalties were improperly determined. Penalties should be based on the amount of the VAT not remitted (not the interest on that VAT amount).[37] Thus, even though the manager was fined €8,100 by the *Landgericht* (District Court),[38] the *Bundesgerichtshof* directed the amount to be re-determined. The *Landgericht* did not impose a prison term, and the *Bundesgerichtshof* followed suit. A five-year term was possible.[39]

AMERICAN RETAIL SALES TAX

Monthly (rarely quarterly or annual) returns; Prepayments (estimates); no duty to correct

The American retail sales tax is more compressed than the German VAT. Retail sales rather than the whole supply chain are the normal subject of the tax; final returns are predominantly monthly, not annual or quarterly; estimates are normally submitted 15 days ahead of the final return, rather than being stretch out over an entire calendar year.

Quarterly and yearly returns are possible under most American retail sales tax regimes, although they tend to be made available only for the very smallest taxpayers. For example, in Arkansas the main rule is for sales tax returns to be due monthly: "… on or before the twentieth (20th) day of each month …"[40] A quarterly return is permitted when the average amount of tax due for the previous fiscal year (July 1 through June 30) does not exceed $100.00 per month.[41] A yearly return is also permitted, but this is only for taxpayers that have an average monthly liability of less than $25.00, based on the taxpayer's liability the previous fiscal year.[42] However, filing other than monthly is not elective. In no case may an Arkansas taxpayer file a quarterly or annual return without first receiving notice from the Director that it would be proper.[43]

Although generally similar, there is a great deal of variety in the American retail sales tax. One state, Hawaii, has a returns filing and payment regime that is the complete inverse of the German VAT structure. Where the German VAT has monthly preliminary returns with estimated tax amounts rolling-up into an annual return, Hawaii does just the opposite. It requires monthly returns followed by an "annual reconciliation return." The Hawaiian "annual return" is more of a report than a return. It is used for crosschecking, internal accounting controls, and a qualification requirement for general excise tax

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[37] Jochen Meyer-Burow & Ocka Stumm, *Recent Developments in German Criminal Law and Their Impact on VAT Compliance*, INTERNATIONAL VAT MONITOR (May/June 2011) 161 (indicating that the District Court's interest –based penalty was deemed incorrect on appeal and that the amount should be based on the full amount of the unreported VAT – essentially a 100% penalty).

[38] *Supra* note 1 [*beschluss*] *Bundesgerichtshof*, No. BGH 1 StR 342/08 at ¶1.

[39] *Supra* note 1 [*urteil*] *Bundesgerichtshof* No. BGH 1 StR 342/08 at ¶5 (indicating that imprisonment penalties of up to five years were not imposed under §370 of the *Abgabenordnung* [General Tax Code])

[40] ARK. CODE ANN. § 26-53-125(a)(1)(A).

[41] ARK. CODE ANN. § 26-53-125(d)(1) (indicating that after receiving notice the quarterly reports are due on or before July 20, October 20, January 20 and April 20).

[42] ARK. CODE ANN. § 26-53-125(d)(2) (indicating that after receiving notice the annual reports are due on or before January 20 for the preceding twelve month period).

[43] ARK. CODE ANN. § 26-53-125(a)(1)(B)

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benefits.[44] This "return" is due on the twentieth day of the fourth month following the close of the fiscal year.[45]

Estimated retail sales tax returns. Seven states, Alabama,[46] Arizona,[47] Arkansas,[48] California, Florida,[49] North Carolina, and Tennessee,[50] require estimated return in the sales and use tax. Estimates are required from taxpayers who have (or who expect to have) large tax liabilities. In all cases civil penalties apply where there is a failure to file or a failure to pay estimates. There are additional penalties for negligence and fraud. Criminal penalties apply when the omissions are willful, and include financial and imprisonment punishment options. Thus, American retail sales tax regimes that have an estimated payment element are similar to the reporting structure of the German VAT.

However, in no case does an American retail sales tax impose a punishable duty on the taxpayer to correct a previously filed erroneous return. Incorrect returns *can be* amended, but in light of the fact that errors are penalized automatically they are not often amended voluntarily. American retail sales tax penalties apply in spite of the taxpayer's amended return. In addition, court action is not necessary to assess penalties (a significant difference with most VAT jurisdictions).

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[44] HAW. REV. STAT. § 237-33; Sec. 2, Act 155 (H.B. 2595), Laws 2010.

[45] HAW. REV. STAT. § 238-5(c).

[46] In Alabama taxpayers with an average monthly liability in excess of $1,000 during the previous year are required to make estimated payment by the twentieth of the current month equal to either 66 2/3% of the actual liability for the corresponding month in the prior year, or 66 2/3% of the current month's estimated liability. The remained to the tax is due with the return on the twentieth of the following month. ALA. CODE § 40-23-7.

[47] In Arizona taxpayers that have a combined transaction privilege tax, telecommunications services excise tax, and county excise tax liability of $100,000 or more in the preceding year must make annual estimated payments of those taxes. The payment amount is either: the actual transaction privilege tax liability got June 1 through June 15, or half of the actual transaction privilege tax liability for may. For 2013 the $100,000 threshold will return to $1 million. ARIZ. REV. STAT. § 42-5014(D).

[48] In Arkansas retailers with average net sales of more than $200,000 per month in the preceding calendar year must make prepayments using one of two methods: either (1) two payments of 40% of the preceding year's monthly average (payable on the twelfth and twenty-fourth of the current month) followed by the remainder the month after, or (2) one payment of 80% of the total due for the current month (payable on the twenty-fourth of the current month) followed by the remainder the next month. ARK. CODE ANN. § 26-52-512.

[49] In Florida taxpayers who paid more than $200,000 in sales and use tax the previous year must make estimated payments in the current year. The estimates are based on one of three methods: (1) 60% of the prior year's month average; (2) 60% of the same month's liability in the previous year; (3) 60% of the current month. Estimates are due monthly on the first day of the previous month, and are late by the 20th day. FLA. STAT ANN. § 212.11(1) & (4); Florida Tax Information Publication, No. 02A01-14 (September 27, 2002).

[50] In Tennessee the determination of the amount and timing of estimated payments is largely left to the Commissioner's discretion. TENN. CODE ANN. § 67-6-5059B0 indicates:

> In cases where the commissioner determines, based on the best information available, that a taxpayer either has or may have an average monthly liability of five hundred dollars ($500) or more, the commissioner shall require advance estimated payments of tax in such amounts as he deems necessary to protect the state's interest as a condition precedent to the payment and filing of tax returns on any basis other than monthly.

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American penalties tend to fall into two broad categories. The penalty is either a flat percentage of the liability (frequently subject to a dollar minimum), or the penalty increases with the amount of time the taxpayer is delinquent (with a cap set several months out). Criminal penalties are similar, but they are contingent on proof of willfulness. The most striking element of the American retail sales tax penalty regime is its automatic operation. Once the penalty trigger is pulled, there is very little that can be done to minimize its financial impact (other than appeal for a penalty waiver after the fact).

German/American differences in their approach to errors; errors in prepayments/ estimates; errors on returns; errors in final tax payments have an effect on how taxpayers in these jurisdictions interact with their tax authorities. Where the German system fosters a "correction required, if noticed" attitude, the American system fosters a "catch me, if you can" attitude. As a consequence where the "tax intuition" of an American tax manager to the discovery of an unintended error may be to wait for the tax authorities to assess applicable penalties and interest, the German expectation is that the tax manager will immediately make needed corrections and notify the tax authorities of the errors.

For an American MNE filing VAT returns in Germany the point of the *Bundesgerichtshof's* decision in BGH 1 StR 342/08 is that criminal penalties apply when tax directors do not act if they know of or even if they only suspect filing errors. It also puts tax directors on alert that the statute of limitations for the offense of failing to act may extend well beyond the statute of limitations of the underlying errors.

The California and North Carolina sales tax systems are typical of the American approach. North Carolina has a standard monthly return system, whereas California has a non-standard quarterly regime.

California – prepayment of estimates. California's sales and use tax is based on calendar-year quarterly returns that are due the last day of the next month.[51] The Board of Equalization (BOE) may determine other periods for specific taxpayers with the due date for the returns and payments moved to the last day of the next month following the end of the period.[52]

If however, estimated taxable receipts average $17,000 per month a taxpayer must file quarterly prepayment reports and prepay the tax.[53] The BOE notifies taxpayers when they cross this threshold.[54] There are two prepayment schedules for determining the amount of the prepayment. Both schedules are reasonably complex.[55] The filing and

[51] CAL. TAX CODE § 6452.
[52] CAL. TAX CODE § 6455.
[53] CAL. TAX CODE §§ 6471 & 6472.
[54] The threshold may increase to $50,000. CAL. TAX CODE § 6203(d) through (h).
[55] First schedule. In the first, third and fourth calendar quarters 90% of the tax for the first two months of the quarter must be prepaid. For the second quarter there are two prepayments. 90% of the tax due for April must be prepaid and for the second prepayment a payment of 90% of the tax due for May plus 90% of the tax due for the first fifteen days of June must be prepaid (or in the further alternative, 135% of the tax due for May). CAL. TAX CODE § 6471

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payment dates are the twenty-fourth day of March, September an December for the first, third and fourth quarterly prepayments. For the second quarter two prepayments are due, one on the twenty-fourth of May and the other on the twenty-fourth of June.[56]

California – penalties for delinquent prepayments. California has an automatic and objective penalty regime for taxpayers required to make prepayments, but who fail to do so. There are two tiers of penalties.

- Failing to make a prepayment by the due date, but making it before the last day of the month following the quarter in which the payment was due. Penalty - 6% of the repayment.[57]
- Failing to make prepayment by the last day of the month following the quarter in which the payment was due, but who files a timely return and full payment. Penalty - 6% of the required 90% repayment figure for each of the monthly periods within the quarter for which the required payment was not made.[58]
- If there is negligence or intentional disregard of the law, these penalties increases to 10%.[59]

Significantly, California does not require taxpayers to correct erroneous returns, even when errors are known. Interest on missed prepayments is calculated from the date on which the payment is due until the actual date of prepayment.[60] However, penalties are not reduced for taxpayers who immediately correct errors, as compared with those who delay until the due date of the quarterly return.

For example, assume a taxpayer should make a prepayment of $10,000 for the first quarter. The prepayment is due on March 24th. The quarterly return is due April 30th. If the taxpayer files a report (on time) that incorrectly estimates that the tax due is $4,000, and if $4,000 is remitted, then it does not matter if the taxpayer (a) corrects the report on March 30 and pays the additional $6,000 at that time, or if he (b) waits until April 30th. The penalty is the same – 6% of $6,000. Penalties could rise if the error was intentional or due to negligence.

North Carolina – prepayment of estimates. North Carolina has a simpler approach to prepayments than does California. The simplicity can be seen in three areas: (1) North Carolina's prepayment regime works with monthly, not quarterly returns, (2)

Second schedule. In the first, third, and fourth calendar quarters the prepayment is one-third of the taxable receipts from the previous year's corresponding quarters times the current tax rate. In the second quarter there are again two payments. The first is equal to one third of the receipts for the corresponding quarter the previous year, and a second payment equal to one-half of the taxable receipts for the corresponding quarter in the previous year previous times the current tax rate. CAL. TAX CODE § 6471

[56] CAL. TAX CODE § 6472.

[57] CAL. TAX CODE §§ 6476; & 6479.3. .

[58] CAL. TAX CODE §§ 6477 (although the difference seems subtle, making the prepayment *on or after* the due date changes the base of the penalty calculation from an estimated base [that could be determined by last year's liability] to an amount that is 90% of the actual liability).

[59] CAL. TAX CODE §§ 6478.

[60] CAL. TAX CODE §§ 6592.5 (the applicable rate is a modified adjusted rate per month or fraction thereof, CAL. TAX CODE §§ 6592.5(b)).

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North Carolina has a simple prepayment calculation requiring electronic filing and payment, and (3) North Carolina penalizes delinquent prepayments under uniform electronic filing rules, rather than under a separate penalty regime.

North Carolina requires prepayment of sales taxes for monthly return filers who are consistently liable for at least $15,000 a month in State and local sales and use taxes.[61] The prepayment is remitted the month before the tax payment is due, and becomes a credit against the tax due. The prepayment is due at the same time as the current month return. The amount due is 65% of any of the following:

- The amount of tax due for the current month
- The amount of tax due for the same month in the preceding year.
- The average monthly amount of tax due in the preceding calendar year.[62]

As of March 1, 2010 any taxpayer required to file a *monthly return with prepayment obligation* is required to remit the tax electronically. Taxpayers making monthly returns with prepayments are required to execute two payment transactions each month (one payment for the current period and a second payment for the next reporting period).[63]

North Carolina – penalties for delinquent prepayments. Interest is charged on payment delinquencies from the day a payment is due until the tax is finally paid, based on an interest rate set every six months.[64] The penalty regime is universal. Prepayment deficiencies are not penalized differently than other tax deficiencies.

North Carolina imposes a failure to file penalty of 5% of the amount of unpaid tax for each month or fraction of a month it remain unfiled (up to a total of 25%).[65] A failure to pay incurs a penalty of 10% of the amount due (not less than $5).[66] If a payment delinquency is because of a fraudulent intent to evade payment of the tax, then the penalty is 50% of the total deficiency, and a class H felony (imprisonment up to 3 years).[67]

As was the case with California, North Carolina does not require, nor does it create financial incentives that would encourage taxpayers to correct erroneous returns after errors become known. Other than the penalty for a failure to file, once a penalty has been triggered in North Carolina it is collectable in full. The penalties for failure to pay (whether fraudulent or not) are automatic and reasonably flat. Other than the first five months of a failure to file, North Carolina does not use its penalty structure to encourage taxpayers to act better, it punishes for a bad act already performed.

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[61] N.C. Gen. Stat. § 105-164.16(b2) (effective October 1, 2011 the prepayment threshold in increased to $20,000 per month).
[62] N.C. Gen. Stat. § 105-164.16(b2)(1) through (3).
[63] North Carolina Department of Revenue, *Important Notice: Monthly With Payment Filers Required to File Electronically* (March 1, 2011) at 2.
[64] N.C. Gen. Stat. § 105-241.1(a)(i).
[65] N.C. Gen. Stat. § 105-236(a)(3).
[66] N.C. Gen. Stat. § 105-236(a)(4).
[67] N.C. Gen. Stat. § 105-236(a)(6).

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CONCLUSION

Compliance under the German VAT should not be a significant problem for a German tax manager working for an enterprise that conducts its business primarily in Germany (although that was not the case for the manager in BGH 1 StR 342/08). The same should be true for a California tax manager of a firm that does business mostly in California who is dealing primarily with the California retail sales tax. In addition, because of similarities among the retail sales taxes in the US, the California tax manager should also be reasonably confident in his compliance abilities in most other retail sales and use tax regimes in the US.

However the California manager's "tax intuition" might not hold him in good stead under the German VAT. This would particularly be the case with respect to the duty to affirmatively correct errors in prior tax filings. Not only has this requirement developed under German case law, but in addition, there is nothing even remotely similar to this requirement in the US.

In fact, the American approach to unintended errors is to wait for the errors to be identified by the tax authorities. Penalties in the US are by and large flat and automatic. American penalties are not normally reduced by self-identification, nor are the increased by an omission to make voluntary corrections. Even more troubling for the California manager should be the fact that criminal penalties (with considerably longer statutes of limitations) apply if he ignores his affirmative duty to correct filing and payment errors as soon as he (not the tax administration) becomes aware of them. This may not be just a German VAT problem for this manager. If he works for a MNE that has operations in fifty or more jurisdictions the same or similar problem can arise in many countries.

Solution – CSP. The solution for the American tax manager is to contract with a certified service provider (CSP)[68] that includes the German VAT within the catalogue of jurisdictions it supports. The MNE should be able to reach an agreement with the CSP to provide the same level of security for German VAT compliance that it provides under the Streamlined Sales and Use Tax for retail sales tax compliance in the US.

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[68] A certified service provider (CSP) is a term of art used in the Streamlined Sales Tax Agreement. It is defined at §203 of the STREAMLINED SALES AND USE TAX AGREEMENT (adopted November 12, 2002, amended November 19, 2003 and further amended November 16, 2004) *available at* http://www.streamlinedsalestax.org [hereinafter SSUTA] providing for fully digital compliance with sales and use taxes through certified intermediaries and certified software solutions. The SSUTA certification process involves measuring software against three third party standards; (1) the AICPA's SAS 94 [AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, PROFESSIONAL STANDARDS, Vol. 1 AU § 319 *The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit, as amending SAS No. 55 Consideration of Internal Control in a Financial Statement Audit*]; and (2) the US-GAO Federal Information Systems Control Audit Manual [U.S. GOVERNMENT ACCOUNTING OFFICE, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, FEDERAL INFORMATION SYSTEMS CONTROL AUDIT MANUAL, (FISCAM) Vol. 1 (GAO-AIMD12.19.6) *available at* http://www.gao.gov/special.pubs/ai12.19.6.pdf.]. In addition, software developers must comply with (3) ISO Number 17799 [INTERNATIONAL ORGANIZATION FOR STANDARDIZATION, ISO 17799: INFORMATION TECHNOLOGY, SECURITY TECHNIQUES, CODE FOR INFORMATION SECURITY MANAGEMENT (ISO/IEC 17799:2005)].

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A CSP is "… an agent under the [Streamlined Sales Tax] Agreement [that agrees] to perform all of the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases."[69] A CSP uses government certified transaction tax compliance software to determine taxability, identify rates, and populate returns.[70] Absence of formal software certification outside of the SSUTA may make reliance on a CSP for VAT compliance more difficult in some respects, but it should not deter taxpayers and third-party providers from reaching agreement on how to provide this service. The tax administrations of most of the world's developed economies have agreed (through the OECD) that software certification is the way tax compliance will develop.[71] Leading CSPs can meet these needs today, and governments may be encouraged to step forward with formal certification mechanisms if they see it happening in the private sector more often.

Under SSUTA the assured accuracy of the software coupled with the CSP's promise to complete all necessary returns and make all necessary tax payments on time and accurately insulates the taxpayer from loss. The same kind of third-party arrangement will solve most VAT compliance problems.

Example – CSP. For example, if we assume a fact pattern like that in the *Bundesgerichtshof's* decision at BGH 1 StR 342/08. Inaccurate preliminary VAT returns are filed in Germany, which the tax manager felt were correct at the time of filing. Errors have occurred over a long period of time. Suppose we assume that the errors were in the accounting programming (the *Bundesgerichtshof's* decision is silent on this point). Suppose skew codes for one set of items were improperly aligned with the wrong tax rates.

We need to further assume that an audit is underway by the tax administration. During the audit it becomes apparent to the *tax manager* that the number of misaligned skews is quite a bit larger, and goes back for quite a bit longer than the tax authorities are currently aware of.

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[69] SSUTA § 203.

[70] Germany does not have a software certification regime similar to that in the SSUTA. Under this circumstance it would be necessary for the taxpayer and the CSP to enter into an agreement that would replicate the SSUTA through private contract.

[71] The OECD discussion of standards for certification and accreditation of software can be found in: OECD, *Electronic Commerce: Facilitating Collection of Consumption Taxes on Business-to-Consumer Cross-Border E-Commerce Transactions,* (Feb. 11, 2005) at 9 & 17-18 *available at* http://www.oecd.org. Indicating that, "… a global intermediary may be based in one country and would undertake intermediary activities in as many countries as suppliers are required to collect and remit consumption taxes on behalf of e-commerce suppliers. In cases where satisfactory levels of approval or financial security are evident, countries could be more relaxed …". The OECD discusses a range of government "approvals" for tax accounting software. At one extreme is "accreditation," an approval process functions simply as a mechanism to "formally identify" software that meets certain criteria of acceptability. At the other extreme is "certification," an approval process that designates software as "an officially authorized mechanism to perform specified functions."

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The American "intuition" in this instance would be wait for the audit to be concluded, pay the penalties and be done. The German authorities would mark this decision as a punishable offence subject to financial penalties and imprisonment. The statute on this offence will run for five or ten years (aggravated tax evasion).

The "American approach" is not what the German rules want the tax manager to do. Germany would much prefer that the tax manager to use a CSP to process the results of its own internal audit. The third-party would be instructed to take the identified errors, and quickly determine if audit adjustments are required in more areas than the government audit is likely to uncover. After an assessment the CSP would run the corrected tax rates against the proper skew codes, re-determine all preliminary and final returns and then submit amended returns with re-determined tax liability automatically.

German amnesty. At one time it would have been possible remedy for the tax manager to avoid all German tax penalties by making a selective disclosure of ONLY what the government auditors were likely to find. If he issued a voluntary disclosure, and then paid the 6% interest charge, all would be forgiven.

However, as of April 15, 2011 the voluntary disclosure rule has become far more stringent. Amnesty is still possible, but it is only possible if:

- *all relevant data for all fiscal offences relating to a specific tax, for which the statute of limitations has not expired is disclosed;*
- the amnesty is not valid if the government has commenced an audit of the underlying circumstances that would possibly uncover the errors;
- the amount of evaded tax cannot exceed €50,000;
- however, if the evaded tax does exceed €50,000, exemption from financial penalties and punishment is only possible if a voluntary payment of 5% of the evaded tax is paid.[72]

Thus, the compliance landscape has changed dramatically for VAT managers in Germany. The German rules strongly encourage internal audits, self-reviews, and self-disclosures of errors in VAT compliance on a regular basis. The efforts must be comprehensive.

A German CSP is the exact solution. Establishing a regular internal review of VAT compliance, identifying errors in advance, and then re-processing transactions through a certified system that will produce variance reports and amended returns for all VAT errors. This is precisely what the German VAT demands of its taxpayers.

[72] *Gesetz zur Vebesserung der Bekämpfung von Geldwäsche und Steuerhinterziehung.* As referenced in IBFD, Tax News Service (online), Report from Nadine Lichtblau, *Federal Council approves draft bill on combat of tax evasion and money laundering* (April 18, 2011). See also: Randal Jackson, *Germany Proposes Tighter Rules for Voluntary Disclosures,* Tax Analysts Doc 2010-26090; 2010 WTD 236-3 (explaining the background of the rule change in the abuse of the amnesty program by taxpayers caught up in the government's purchase of stolen CD's containing data on German taxpayers' hidden holdings in offshore banks where upwards of 30,000 taxpayers had come forward and applied for amnesty).

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With the *Bundesgerichtshof's* decision at BGH 1 StR 342/08 and the amendments to the voluntary disclosure program, *Gesetz zur Vebesserung der Bekämpfung von Geldwäsche und Steuerhinterziehung*, we are moving much closer to the time when MNEs with German VAT exposure will need to adopt automated third-party solutions like the CSP under SSUTA.

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