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Global Tax Alert

OECD releases Germany Stage 2 peer review report on implementation of Action 14 minimum standard

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Executive summary

On 9 April 2020, the Organisation for Economic Co-operation and Development (OECD) released the Stage 2 peer review report of Germany relating to the outcome of the peer monitoring of the implementation of the Base Erosion and Profit Shifting (BEPS) minimum standard under Action 14 on improving tax dispute resolution mechanisms. Stage 2 focuses on monitoring the follow-up of any recommendations resulting from Germany's stage 1 peer review report.

Overall, the report concludes that Germany addressed almost all the shortcomings identified in its Stage 1 peer review report.

Detailed discussion

Background

In October 2016, the OECD released the peer review documents (i.e., the Terms of Reference and Assessment Methodology) on Action 14 which form the basis of the Mutual Agreement Procedure (MAP) peer review and monitoring process under BEPS Action 14.

The Terms of Reference translate the approved minimum standard into a basis for peer review, consisting of 21 elements complemented by 12 best practices. The Terms of Reference assess a Member's legal and administrative framework,

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including the practical implementation of this framework to determine how its MAP regime performs relative to the 21 elements in four key areas: (i) preventing disputes; (ii) availability and access to MAP; (iii) resolution of MAP cases; and (iv) implementation of MAP agreements.

The Assessment Methodology establishes detailed procedures and guidelines for a two-stage approach to the peer review and monitoring process. Stage 1 involves the review of a Member's implementation of the minimum standard based on its legal framework for MAP and the application of this framework in practice. Stage 2 involves the review of the measures taken by the Member to address any shortcomings identified in its Stage 1 peer review. In light of the above, the OECD has also released a schedule for Stage 1 of the peer review process and a questionnaire for taxpayers. The schedule catalogues the assessed jurisdictions into ten batches for review.

Both of these stages are desk-based and are coordinated by the Secretariat of the Forum on Tax Administration's (FTA) MAP Forum.[1] In summary, Stage 1 consist of three steps or phases:

(i) Obtaining inputs for the Stage 1 peer review

(ii) Drafting and approval of a Stage 1 peer review report

(iii) Publication of Stage 1 peer review reports

Input is provided through questionnaires completed by the assessed jurisdiction, peers (i.e., other members of the FTA MAP Forum) and taxpayers. Once the input has been gathered, the Secretariat prepares a draft Stage 1 peer review report of the assessed jurisdiction and sends it to the assessed jurisdiction for its written comments on the draft report. When a peer review report is finalized, it is sent for approval of the FTA MAP Forum and later to the OECD Committee on Fiscal Affairs (CFA) to adopt the report for publication.

For Stage 2, there are two steps or phases: (i) approval of the Stage 2 peer monitoring report of an assessed jurisdiction; and (ii) publication of the Stage 2 peer review reports. More specifically, an assessed jurisdiction should within one year of the adoption of its Stage 1 peer review report by the CFA submit a detailed written report (Update Report) to the FTA MAP Forum. The Update Report should contain: (i) the steps that the assessed jurisdiction has taken or is taking to address any shortcomings identified in its peer review report; and (ii) any plans or changes to its legislative or procedural framework relating to the implementation of the minimum standard. Members of the FTA MAP Forum should also provide their comments on the Update Report provided by the assessed jurisdiction. Based on the Update Report submitted by the assessed jurisdiction and the input from the peers, the Secretariat will revise the Stage 1 peer review report of the assessed jurisdiction with a view to incorporate these updates in the Stage 2 peer monitoring report of the assessed jurisdiction. After adoption by the CFA, the Stage 2 peer monitoring report will be published.

Minimum standards peer review reports

The report is divided into four parts, namely:

(i) Preventing disputes

(ii) Availability and access to MAP

(iii) Resolution of MAP cases

(iv) Implementation of MAP agreements

Each part addresses a different component of the minimum standard.

Overall, Germany addressed almost all of the shortcomings identified in its Stage 1 peer review report.

Preventing disputes

According to the peer review report, Germany meets the requirements of the Action 14 minimum standard concerning the prevention of disputes. Germany has an extensive tax treaty network with over 90 tax treaties and has signed and ratified the European Union (EU) Arbitration Convention. All of Germany's tax treaties include a provision relating to MAP. The MAP provisions in tax treaties and the EU Arbitration Convention are implemented directly in Germany's domestic law and as such take, pursuant to Section 2 of the German Fiscal Code (Abgabenordnung), precedence over German tax law.

Out of Germany's 93 tax treaties, 91 tax treaties contain a provision equivalent to Article 25(3), first sentence, of the OECD Model Tax Convention requiring their competent authority to endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the tax treaty.

With a view to inter alia update the tax treaties slightly differing from Article 25(3), first sentence, OECD Model Tax Convention, Germany signed the Multilateral Instrument (MLI) and is currently preparing the ratification of this instrument, which is expected for 2020. Where tax treaties will not be modified by the MLI, Germany is either already in negotiations with the relevant treaty partners or such negotiations are envisaged or planned in order to bring them in line with the Action 14 minimum standard. In addition, Germany reported it will seek to include Article 25(3), first sentence, of the OECD Model Tax Convention in all of its future treaties.

The two tax treaties that are considered not to contain the equivalent of Article 25(3), first sentence, of the OECD Model Tax Convention, are not expected to be modified by the MLI to contain the required provision. However, for one treaty, negotiations on the replacement of the existing treaty currently in force have been completed, which includes the required provision. For the second treaty, bilateral negotiations are envisaged. The report recommends that Germany should, for the first treaty, as quickly as possible sign and ratify the new treaty to have the required provision in place, and for the second treaty continue negotiations to include the required provision.

Furthermore, Germany has in place an Advance Pricing Agreement (APA) program. It is allowed to enter into bilateral and multilateral APAs, but only for those cases for which a tax treaty is applicable, as Germany considers the provision concerning the MAP in tax treaties as the legal basis for bilateral and multilateral APAs. The APA program also enables taxpayers to request roll-backs of bilateral APAs and such roll-backs are granted in practice. In the period from 1 January 2017 until 30 September 2018, Germany received 18 requests for roll-back of which all requests were accepted, but are still pending, as the related APA procedures are also still pending.

With regard to the APA program, the report does not include or specify any recommendations or areas for improvement.

Availability and access to MAP

Germany also meets the requirements regarding the availability and access to MAP under the Action 14 minimum standard. Germany provides access to MAP in all eligible cases (including transfer pricing cases, cases of audit settlements and in relation to the application of treaty and/or domestic anti-abuse provision). It further has in place a notification/consultation process for those situations in which its competent authority considers the objection raised by taxpayers in a MAP request as not justified.

Germany also has clear and comprehensive guidance on the availability of MAP and how it applies this procedure in practice, both under tax treaties and the EU Arbitration Convention. In its Stage 1 peer review it was identified that this guidance did not specify the contact details of Germany's competent authority. In 2018, Germany published an update of its MAP guidance in the Circular of 9 October 2018 (BStBl I 2018, 1122; 2018 MAP Guidance), which now reflects these contact details. Germany's MAP guidance is published in German and easily found on the website of Germany's Federal Ministry of Finance.[2]

Resolution of MAP cases

While Germany's competent authority for the years 2016 and 2017 did not close MAP cases on average within a timeframe of 24 months (which is the pursued average for resolving MAP cases received on or after 1 January 2016), as the average was 26.34 months, it managed to reduce this average in 2017 as compared to 2016: from 26.34 months to 22.59 months. Its MAP inventory as per 31 December 2017 increased about 5% (from 1,177 to 1,241 cases) as compared to its inventory as per 1 January 2016. However, the recent submitted 2018 MAP statistics show that the inventory as per 31 December 2018 as well as the average timeframe decreased to 1,198 cases and 22.21 months respectively.

In this respect, Germany added during the period 2016-17 additional staff to its competent authority and increased the number of face-to-face meetings and communications with its treaty partners. Nevertheless, the average timeframe to close attribution/allocation cases remains above 24 months and has increased since 2016. Germany should therefore closely monitor whether these additions in resources to the MAP function and other actions taken will be sufficient to ensure a timely, effective and efficient resolution of MAP cases, in particular in relation to attribution/allocation cases. Where the outcome of this monitoring is that this is not ensured, Germany is recommended to hire or assign more staff to the competent authority, to ensure that delays in: (i) the coordination between the Federal Tax Office and the tax administration of the Länder; and (ii) in providing position papers and responses to such papers can be avoided, as well as to enable a more frequent liaising with its treaty partners.

In addition, according to the report, Germany meets all of the other requirements under the Action 14 minimum standard in relation to the resolution of MAP cases. Germany's competent authority uses a pragmatic approach to resolve MAP cases in an effective and efficient manner, and the performance indicators used are appropriate to perform the MAP function. In its Stage 1 peer review report, the

OECD determined that personnel of tax administrations of the Länder directly involved in the adjustment at issue can participate in competent authority meetings during which MAP cases are resolved, for which the risk was identified that this bears the risk that the competent authority function is not performed entirely independent from the approval or direction of the tax administration personnel directly involved in the adjustment at issue concerning the resolution of MAP cases during such meetings. Since then, Germany has instructed staff in charge of MAP cases to follow the guiding principles agreed by the FTA MAP Forum on the cooperation between the tax administration personnel directly involved in the adjustment at issue and the competent authority prior to and throughout the MAP process with a view to ensure independency of the competent authority in handling and resolving MAP cases. This staff is regularly reminded to follow these principles. With this action taken, the identified risk has been sufficiently addressed, according to the report.

Implementation of MAP agreements

Lastly, according to the report, Germany also meets the Action 14 minimum standard regarding the implementation of MAP agreements. Germany reported that generally all MAP agreements reached during the period of 1 April 2017 through 30 September 2018 were implemented on a timely basis. Although Germany does not monitor the implementation of MAP agreements, no issues have surfacedregarding the implementation throughout the peer review process.

Out of Germany's 93 tax treaties, 68 contain a provision that is equivalent to Article 25(2), second sentence, of the OECD Model Tax Convention that any mutual agreement reached through MAP shall be implemented notwithstanding any time limits in their domestic law. The remaining 25 tax treaties contain neither a provision that is equivalent to Article 25(2), second sentence, of the OECD Model Tax Convention, nor the alternative provisions under Article 9(1) and Article 7(2).

Four out of these 25 tax treaties are expected to be modified by the MLI to include the equivalent of Article 25(2), second sentence, of the OECD Model Tax Convention. With regard to the remaining 21 tax treaties that will not be modified by the MLI, Germany is either already in negotiations with the relevant treaty partners or such negotiations are envisaged or planned with a view to bring them in line with the Action 14 minimum standard.

Implications

In a post-BEPS world, where multinational enterprises (MNEs) face tremendous pressures and scrutiny from tax authorities, the release of Germany's Stage 2 peer review report represents the continued recognition and importance of the need to achieve tax certainty for cross-border transactions for MNEs. While increased scrutiny is expected to significantly increase the risk of double taxation, the fact that tax authorities may be subject to review by their peers should be seen by MNEs as a positive step to best ensure access to an effective and timely mutual agreement process.

Endnotes

1. http://www.oecd.org/tax/forum-on-tax-administration/about/.
2. https://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF_Schreiben/Internationales_Steuerrecht/Allgemeine_Informationen/2018-10-09-Verstaendigungsverfahren-Schiedsverfahren-Merkblatt.pdf.

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