

Government Tax Audit Stress Test



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Introduction

Large companies have to dig deepest into their pockets after government tax audits.

In 2010, government tax audits conducted at the level of commercial enterprises, self-employed persons, agricultural and forestry businesses as well as joint building owners investment entities sharing the losses and other taxpayers led to an additional tax revenue totaling about EUR 16.8 thousand million. The results of wage tax field audits, of special-purpose value added tax audits and of tax search services are not yet included in these additional results.

Making up 71% of the additional tax revenue, government tax audits conducted at the level of large enterprises account for the largest part of additional tax revenue. Accordingly, Deloitte decided to conduct an online survey with large enterprises that realize revenues of more than EUR 10 million or engage more than 250 employees on the reasons for these additional results. 733 representatives of such enterprises participated in the survey.

According to the survey's results, relatively few taxpayers were confronted with major additional expenses as a result of the audit of wage tax and value added tax (VAT) issues in contrast to income taxes including transfer prices. In this context, the survey found that, when it comes to transfer prices, additional tax expenses are directly related to the group's registered office.

Additionally, in the areas income taxes, transfer prices and value added tax, a relation between the size of the enterprise and the amount of the additional expense was established. The survey further disclosed that, for income taxes and value added tax, the amount of the additional expenses increases in line with the size of the tax department of the enterprise concerned.

For all types of taxes, it could, however, be concluded that, at the level of enterprises with big tax departments, it was possible to reduce the percentage of "very high additional expenses".

The results of the survey show that there are additional expenses for particular industries only on account of certain special operating features of the relevant enterprise. However, caution should be exercised in evaluating the results, as the size of data sets considerably vary between the industries.

1. General results of the survey

1.1 Basic conditions of government tax audits

1.1.1 Audited periods

The focus of the periods audited is on the years 2005 until and including 2009 for income taxes in general (hereafter referred to as: income taxes), income taxes with respect to transfer prices (hereafter referred to as: transfer prices) and value added tax.

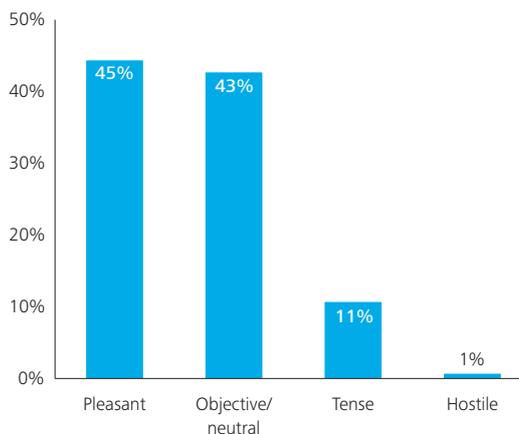
With respect to wage tax, the focus is on the years 2008 until and including 2010. Accordingly, a “timely tax audit” is rather carried out for wage tax.

With respect to the issue of transfer prices, 12% of participants, as opposed to 3% to 5% for the other three tax types, gave no details. Furthermore, 29% of participants, as opposed to 1% to 5% for the other tax types, stated that the issue of transfer prices had not (yet) been audited at the level of their enterprises.

1.1.2 Atmosphere during the audit

During the government tax audit, a pleasant (44%) or objective/neutral (43%) atmosphere prevailed at the majority of enterprises. 11% of participants noted, however, that the atmosphere had been tense, 1% noted even a hostile atmosphere (Fig. 1).

Fig. 1 – Atmosphere during the government tax audit



Government tax audits have so far been conducted in a timely manner rather for wage tax.

The findings of the survey showed that, with respect to income taxes and transfer prices, the relevant additional expenses were more frequently relevant or very high at enterprises at which the atmosphere was tense or hostile.

1.2 Relevant tax types with respect to additional expenses

With respect to wage tax, 74% of the participants stated that the government tax audits did not lead to any major expenses in this area. For value added tax, the additional expense was also low: 70% of the enterprises had not incurred any relevant additional expenses.

A different result was established for the areas income taxes and transfer prices: Only 45% (income taxes) and 58% (transfer prices) of the participants answered that the government tax audits had not led to major additional expenses.

For 24% (income taxes) and 23% (transfer prices) of the enterprises, the respective government tax audits led to relevant or very high additional expenses.

Even though a pleasant or objective/neutral tax audit atmosphere prevails at the majority of enterprises, reports of tense or even hostile atmosphere (12%) should be cause for reflection.

1.3 Income Taxes

1.3.1 Additional expenses in the area of income taxes (in general)

Tax audit conclusions regarding the issue of general income taxes lead more often to relevant or very high additional expenses than other issues, such as transfer prices, wage tax and value added tax. Thus, 45% of the enterprises asked did not report major additional expenses, whereas 24% of respondents reported relevant or very high additional expenses (Fig. 2).

On account of the importance of income taxes for additional expenses resulting from government tax audits, a differentiated analysis was performed. In a first step, it was initially examined whether there is a relation between the factors domestic or foreign headquartered companies size, of the enterprise as well as number of employees at the tax department and additional expense.

Headquarter location

With respect to the influence of the factor “foreign or domestic headquarter” on related additional expenses, it was not possible to establish an obvious statistical relation. Therefore, it is not possible to conclude that relevant or very high additional expenses on account of government tax audits arise more often for enterprises

with a foreign headquarter in comparison with enterprises with domestic headquarter.

Size of the enterprise

It has been possible to establish a statistical relation between additional expenses and the size of the enterprise. For enterprises included in size category I¹, about half of the respondents (55%) stated that the government tax audit did not result in a significant additional expense. For the remaining bare half of enterprises allocated to size category I, even 16% reported a relevant or very high additional expense as a result of a government tax audit. In comparison, far less enterprises classified as size category III stated that the government tax audit did not result in any significant additional expenses (29%), but that relevant to very high additional expenses were incurred as a result of the government tax audit (concerning 37% of enterprises asked). In this context, it has to be taken into account that the classification as an additional expense has already been put in relation to taxes paid prior to the conduct of the government tax audit and surely does not indicate additional expenses requested in absolute terms (Fig. 3).

Fig. 2 – Additional expense: income taxes in general

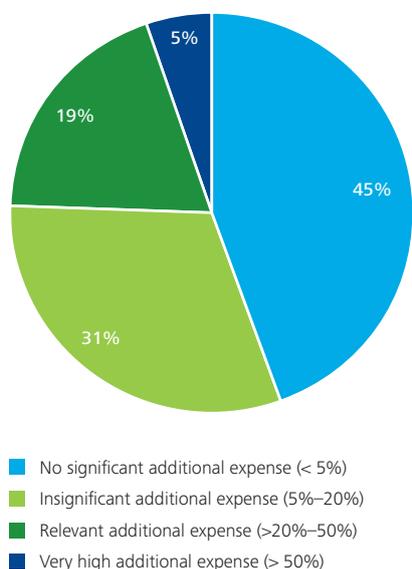
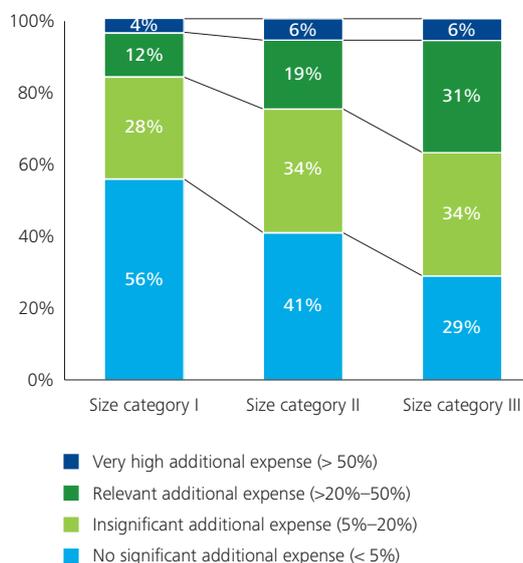


Fig. 3 – Additional expense: income tax in general by size categories



¹ For a definition of the size categories see page 35

Number of employees in tax department

The result of the relation between size of the enterprise and higher additional expense is underlined by a comparison of additional expenses with the respective number of employees in the tax department. Thus, for enterprises with tax departments with more than ten employees, only around every fifth respondent (21%) stated that no significant additional expenses arose. For enterprises with four to ten employees in the tax department, this was, however, the case for 37% of respondents, with less than four employees even for 47%. With the large tax departments, there was, however, a relevant or very high additional expense in 62% of the cases; for small (20%) or medium-sized tax departments (34%), this was far less often the case (Fig. 4).

1.3.2 General income tax issues

Within the issue of income taxes, general income tax issues most frequently lead to relevant or very high additional expenses. Especially the provision expense issue (excluding pensions and early-retirement part-time work) was often stated (17% of respondents), followed by measurement of fixed assets (12%) and other differences between financial statements and tax balance sheets (10%) (Fig. 5).

Fig. 4 – Additional expense: income taxes in general by tax department size

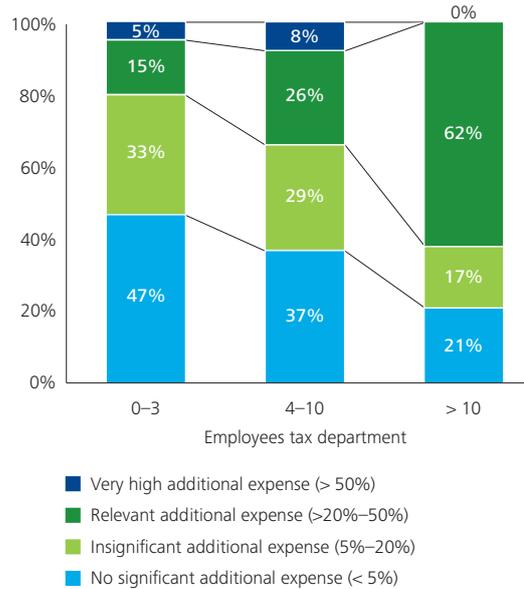
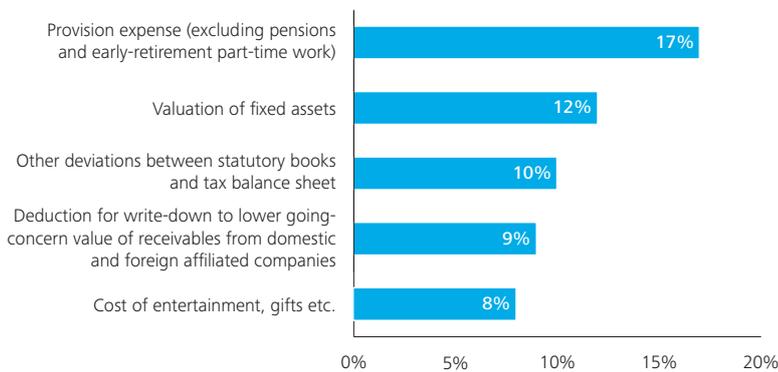


Fig. 5 – Top 5 income tax issues

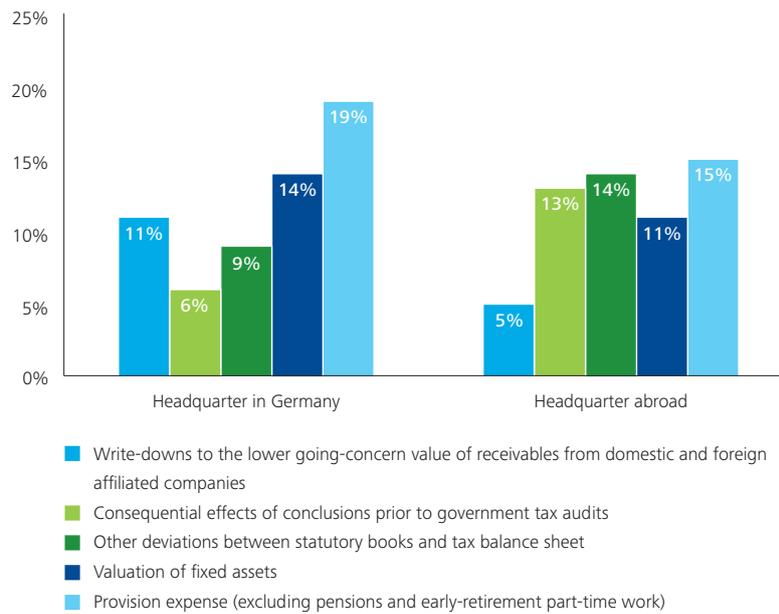


Headquarter location of the group

The evaluation shows that, in relation to general income tax issues, a headquarter of the enterprise in the domestic territory or abroad has an influence on whether a government tax audit results in relevant or very high additional expenses.

Thus, enterprises with domestic registered office far more often have to bear relevant or very high additional expenses on account of write-downs to the lower going-concern value of receivables from affiliated companies (11%) than enterprises with foreign registered office (5%). On the other hand, additional expenses resulting from conclusions prior to government tax audits as well as from other differences between financial statements and tax balance sheets occur much more frequently at the level of enterprises with foreign registered office (Fig. 6).

Fig. 6 – Additional expense: income tax in general by place of registration

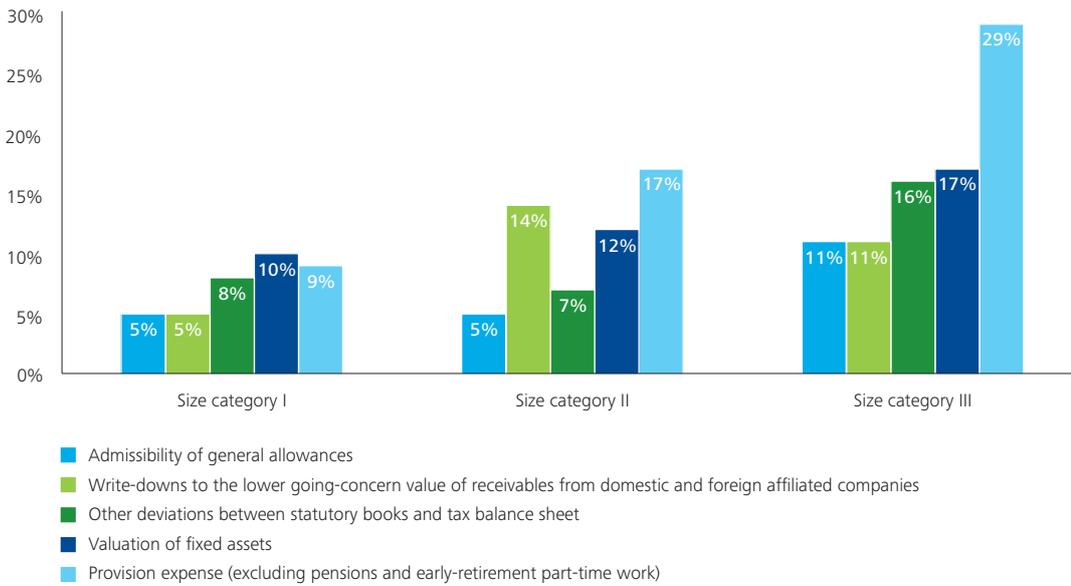


Size of the enterprise

An analysis of additional expenses on account of general income tax issues in relation to the size of the enterprise also disclosed differences. Thus, it is striking that, for the biggest enterprises asked, relevant or very high additional expenses generally occur much more often. This is in line with the observation described above regarding the issue of income taxes (excluding transfer prices) as a whole. This is particularly evident for addi-

tional expenses resulting from provision expense, which affects the biggest enterprises (29%) much more often than the other two size categories (9% and 17%, respectively). Write-downs to the lower going-concern value of receivables from affiliated companies more often lead, however, to relevant or very high additional expenses for enterprises of size category II than for the other size categories (Fig. 7).

Fig. 7 – Additional expense: income tax in general by size categories



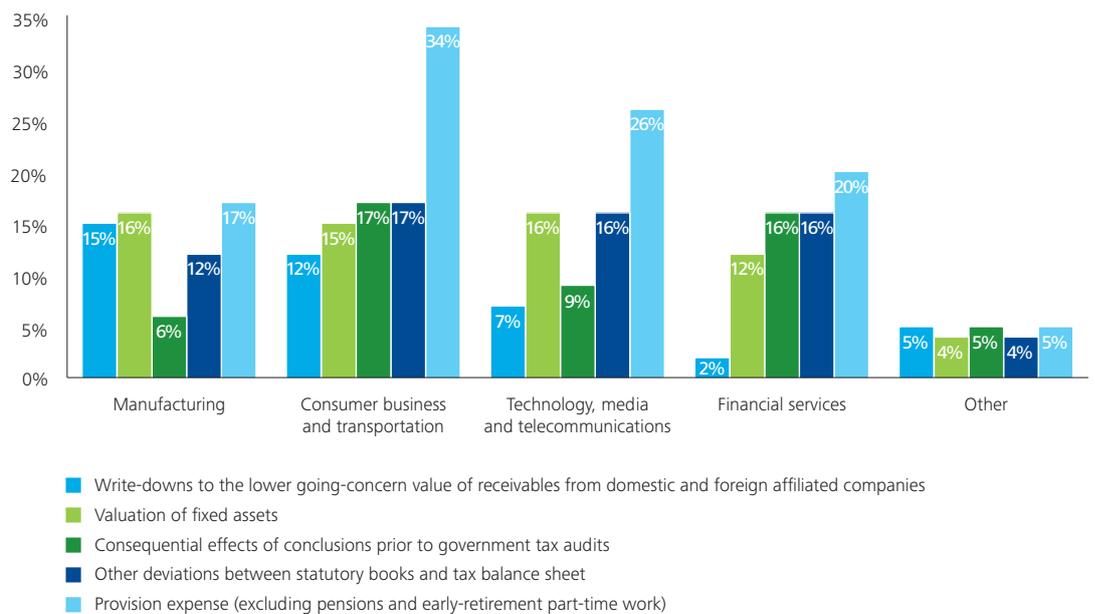
As the size of data set greatly varies, it is difficult to make industry-specific statements.

industry, 15% of the enterprises stated that they have to bear related relevant or very high additional expenses. The issue of provision expense was particularly often mentioned in the consumer business and transportation industries at a rate of 34% and, hence, twice as often as, for example in the manufacturing industry (Fig. 8).

Industry

Under the restriction of the varying size of data sets, the information on hand presents the following: Enterprises operating in the financial services sector rarely have to bear high additional expenses resulting from write-downs to the lower going-concern value of receivables from affiliated companies (2%). In the manufacturing in-

Fig. 8 – Additional expense: income tax in general by industries

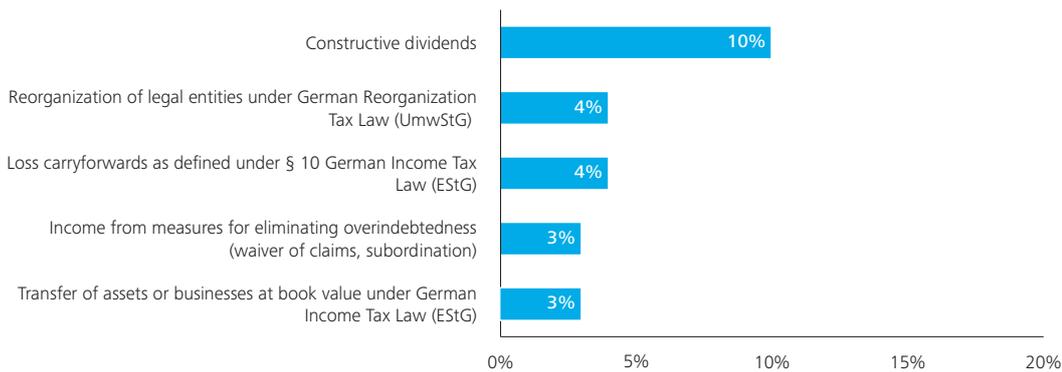


1.3.3 Specific income tax issues

In general, specific issues, however, were mentioned less frequently in comparison with the issue of general income taxes and are therefore likely, in the aggregate, to have led to a lower additional expense than general income tax issues.

Regarding the group of specific issues, the following topics most frequently led to relevant or very high additional payments (Fig. 9).

Fig. 9 – Additional expense: income tax in general by specific issues

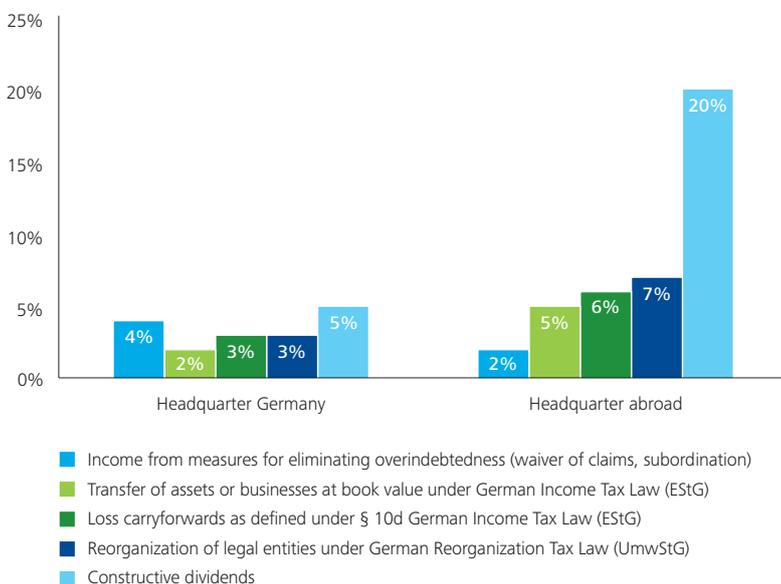


Headquarters location of the group of the enterprise

Like for general income tax issues, the fact whether the group management or group parent company has its registered office in the domestic territory or abroad also has a substantial influence on additional expenses incurred within the scope of government tax audits for special issues. In particular, results showed that enterprises with foreign headquarters much more often incur corresponding additional expenses resulting from constructive dividends than enterprises with domestic headquarter (Fig. 10).

Constructive dividends (verdeckte Gewinnausschüttung) lead the list of specific issues resulting in additional expenses following government tax audits.

Fig. 10 – Additional expense: income tax special issues by the headquarter location



Size of the enterprise

For special issues, it was also established that the additional tax expense generally tends to increase in line with an increasing size of the enterprise. The additional expense due to constructive dividends led more frequently to additional expenses than the other special issues for all size categories of the enterprises (Fig. 11).

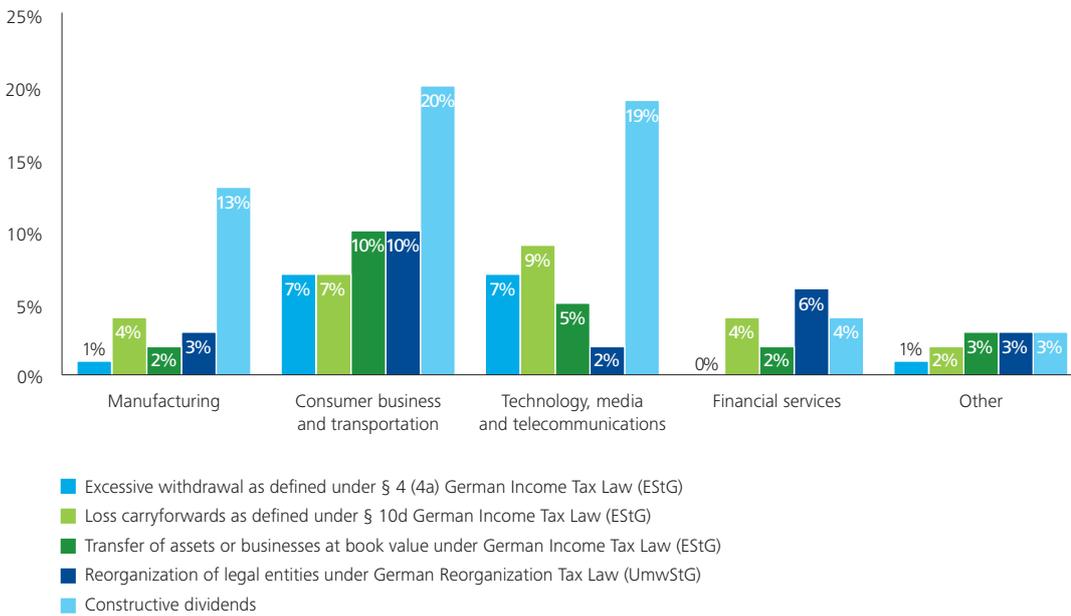
Fig. 11 – Additional expense: income tax by special issues by size categories



Industry

Based on the restrictions mentioned above (1.3.2 at the end), the following results can be established: For the specific income tax issues with relevant or very high additional expenses that were mentioned most frequently, there have been differences depending on the industry where the concerned enterprise operates. The issue of constructive dividends affects all industries, even though to a different extent. Especially in the consumer business and transportation industries, the specific issues mentioned led to additional expenses, whereas their relevance is much less significant in the financial service sector (Fig. 12).

Fig. 12 – Additional expense: income tax by specific issues by industries



1.3.4 Cross-border issues

In comparison with the income tax issues mentioned above (general and special issues), cross-border issues evidently play a less significant role.

Thus, imputation, which led to relevant or very high additional expenses only for 5% of enterprises asked, was mentioned most often. The following issues most frequently resulted in additional tax payments (Fig. 13).

Size of the enterprise

It is also evident that the risk of the additional expenses on account of cross-border issues obviously plays a less significant role for category I enterprises than for the two other categories. In line with the ascending size of the enterprise, especially the percentage of imputation under the German Law on External Tax Relations (AStG) is increasing among the overall additional expense (Fig. 14).

Fig. 13 – Additional expense: income tax by cross-border issues

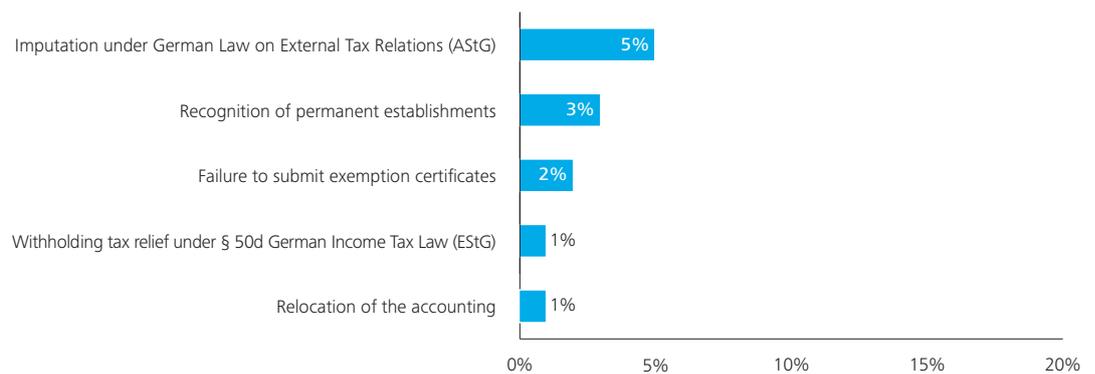
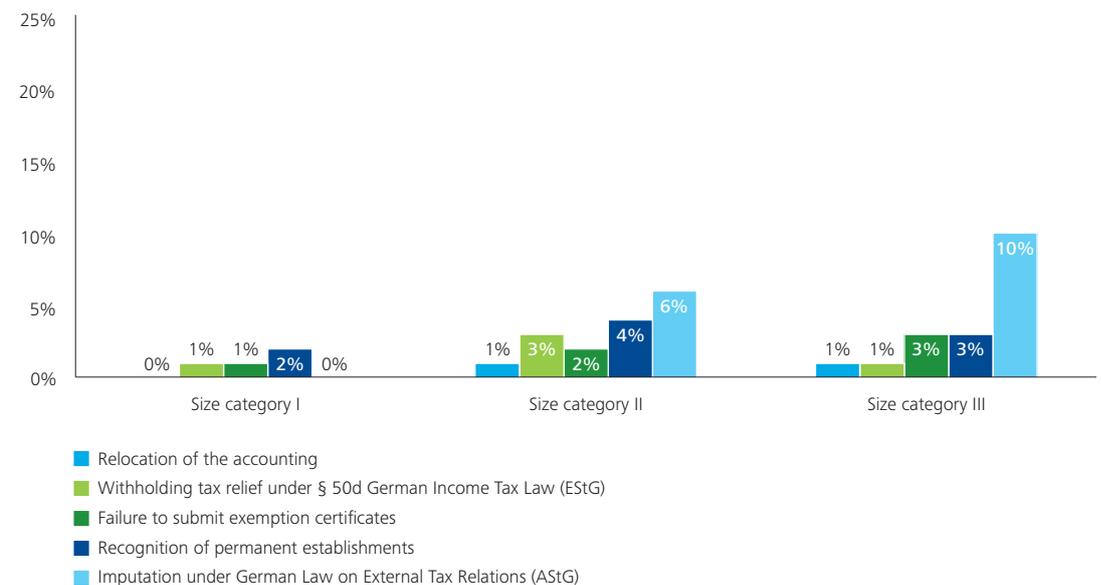


Fig. 14 – Additional expense: income tax by cross-border issues by size categories



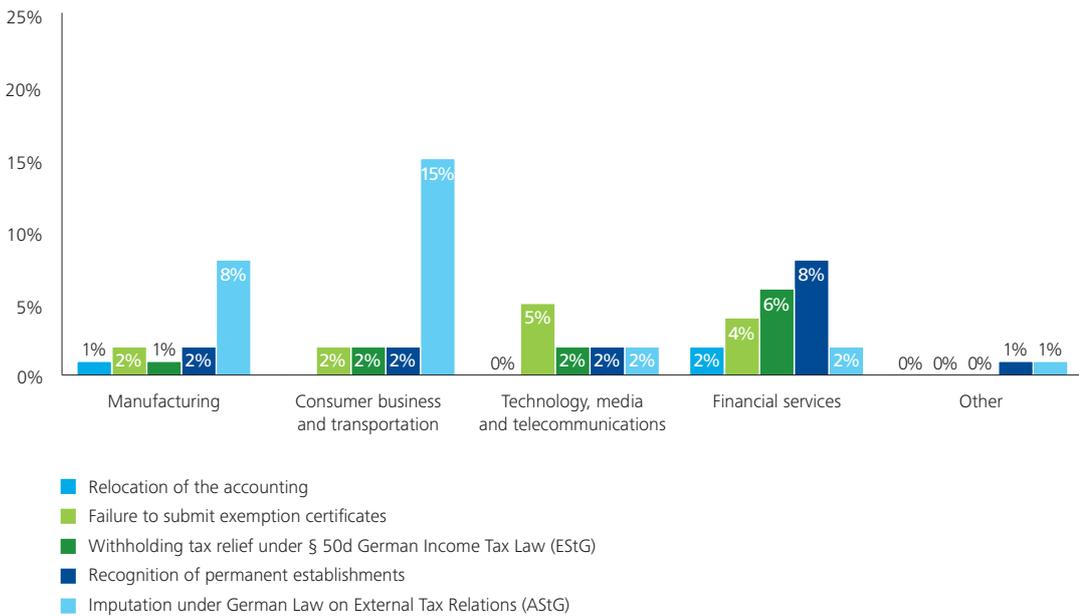
Industry

For the above-mentioned issues with most frequent relevant or very high additional expenses, the study disclosed statistically significant differences depending on the respective industry where the concerned enterprise operates in. This result is, however, to be treated with caution due to different size of data set. Here, it is also obvious that, in comparison with imputation under the German Law on External Tax Relations (AStG), the remaining cross-border income tax issues relatively rarely

led to additional expenses. Imputation particularly affects the manufacturing and the consumer business and transportation industries. The most important issue of the financial service sector is recognition of permanent establishments (Fig. 15).

Based on influencing factors, the evaluation found that, in this context, it played no statistically significant role, whether the enterprise had a domestic or foreign headquarter.

Fig. 15 – Additional expense: income tax by cross-border issues by industries



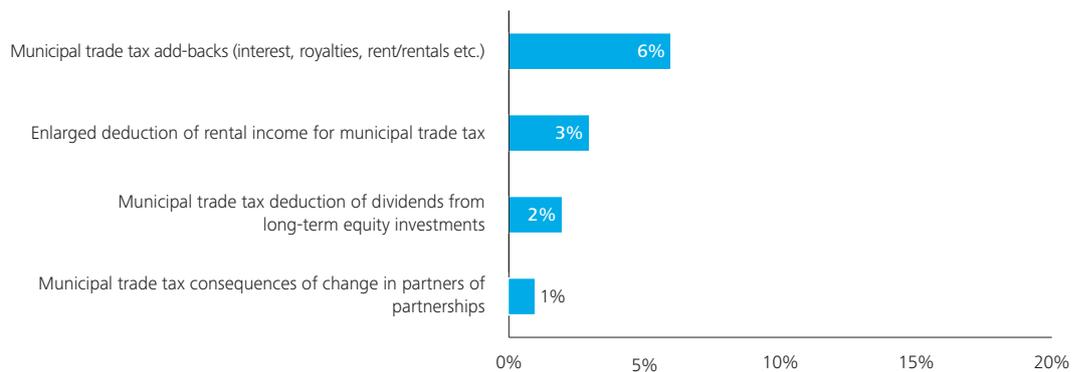
As regards the municipal trade tax, the add-back items play a significant role.

1.3.5 Municipal trade tax issues

The municipal trade tax issues principally lead to relatively low additional expenses at the level of the enterprises asked. Relevant or very high additional payments primarily resulted from qualifying instances in respect of municipal trade tax add-backs (Fig. 16).

An analysis of municipal trade tax issues in view of the headquarter, its size and the industry where the enterprise operates in discloses that both the headquarter location and the size of the enterprise have no statistically significant influence.

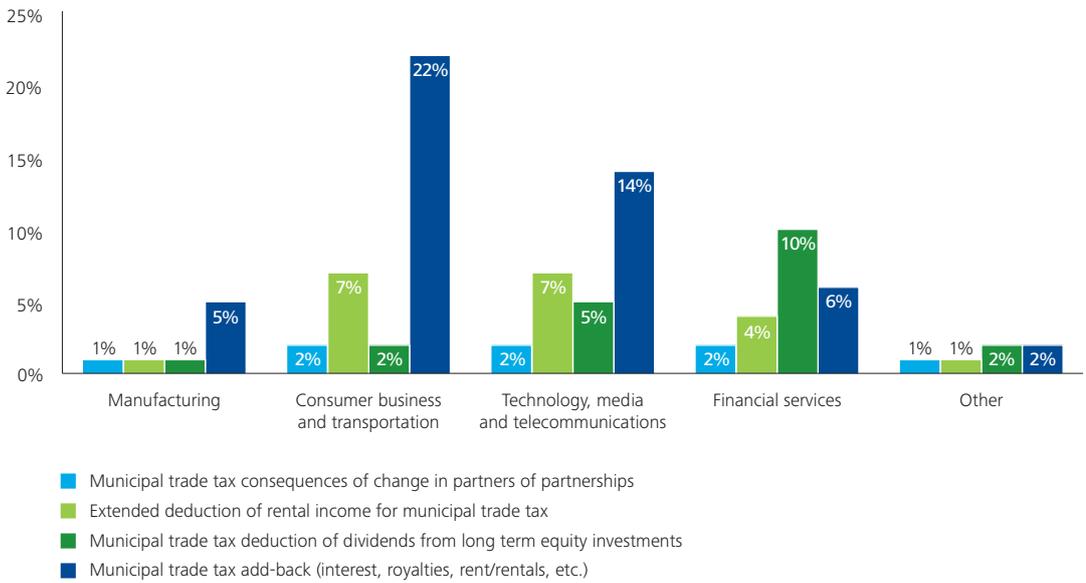
Fig. 16 – Top 4 municipal trade tax issues



Industry

While relevant to very high additional expenses resulting from municipal trade tax issues were only rarely mentioned in the manufacturing industry, a high additional expense, especially on account of municipal trade tax imputation, is especially obvious in the consumer business and transportation as well as technology, media and telecommunications industries, whereas effects of municipal trade tax deduction of dividends dominate in the financial service sector. However, also in this context, the constriction of the statistical evaluation must be considered (Section 1.3.2 at the end) (Fig. 17).

Fig. 17 – Additional expense: municipal trade tax by industries

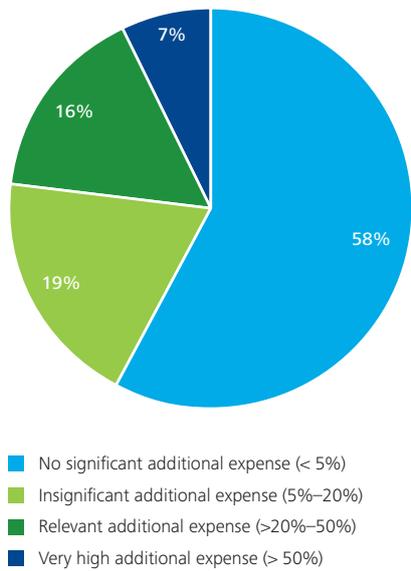


1.4 Transfer prices

1.4.1 Additional expenses in the area of transfer prices in general

In the aggregate, 77% of the participating enterprises incurred only insignificant or no additional expenses at all. Only 7% of the government tax audits led to very high additional expenses (Fig. 18).

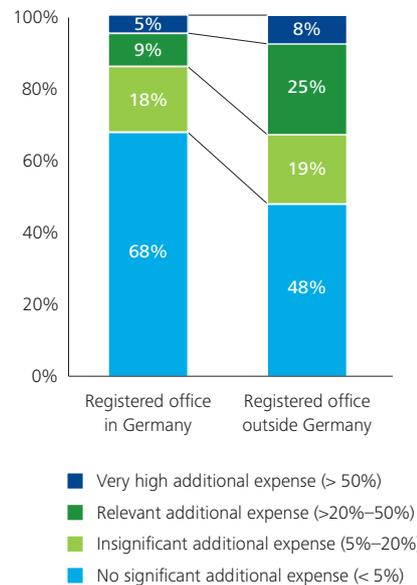
Fig. 18 – Additional expense: transfer prices



Headquarter location

Enterprises whose group parent company is headquartered outside Germany incur much higher additional expenses in comparison. Thus, the percentage of enterprises whose group parent company is headquartered in the domestic territory and that incurred no significant expenses was around 20 percentage points higher than for enterprises whose group parent company is located abroad. Considering only relevant and very high additional expenses of those enterprises whose group parent company is located in Germany, the results show a similar difference of around 20 percentage points (Fig. 19).

Fig. 19 – Additional expense: transfer prices by group's place registration



Enterprises whose group parent company is headquartered outside Germany are exposed to considerable higher additional expenses as a result of audits of transfer price issues.

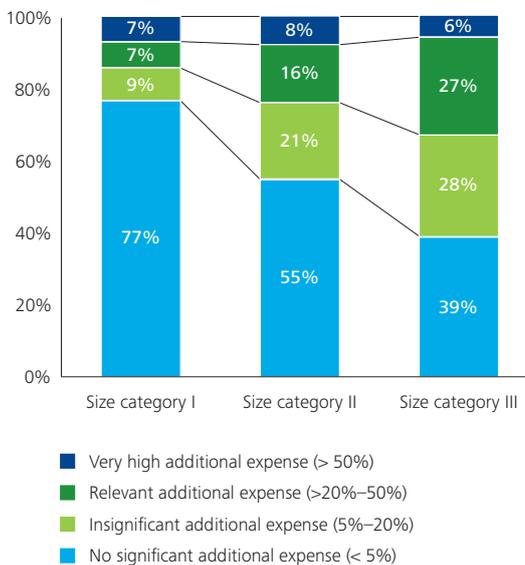
However, attention must be given to the fact that enterprises having their headquarters outside Germany more frequently than the other enterprises provided information on the issue of transfer prices. Furthermore, cross-border business relationships between affiliates are naturally more frequent at enterprises with a foreign group parent.

As regards enterprises, which are located in Germany and whose group parents also reside outside in Germany, transfer price issues may only come up in connection with trading relationships with foreign group companies. This factor may explain the fact that they are less frequently subject to this issue during tax audits than the enterprises with group parents abroad.

Size of the enterprise

As already shown in connection with the other areas, the survey also found a link between the size of the enterprise and additional expenses in the area of transfer prices. The larger the concerned enterprises, the higher the relative additional expenses tend to be in the area of transfer prices. Considerable differences were found with respect to low and relevant additional expenses (Fig. 20).

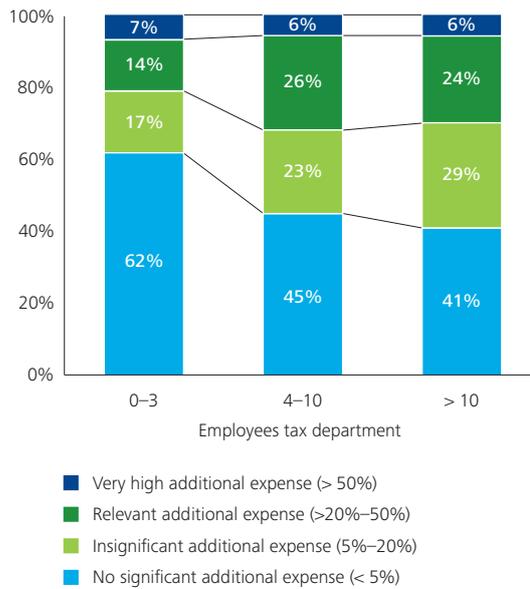
Fig. 20 – Additional expense: transfer prices by size categories



Number of employees in the tax department

The consequences of the size of the tax department for the additional expenses are not as significant as the effect of the size of the enterprise, although the additional expenses tend to increase with the ascending size of the tax department. Medium-sized tax departments, however, have a greater share in relevant and very high additional expenses (Fig. 21).

Fig. 21 – Additional expense: transfer prices by tax department size



1.4.2 Additional expenses in the area of transfer prices

As regards the issue transfer prices, the participants could chose from twelve issues, for which they could give information on additional expenses. As a result, the most important issues for relevant and very high additional expenses were profit margins and documentation. The top five issues are displayed in the following figure 22.

Headquarter location

The above mentioned top five issues most frequently subject to relevant and very high additional expenses varied significantly in statistic terms depending on where the group's headquarter is located.

This again demonstrates that group parent companies whose registered office is situated outside Germany relatively frequently incur relevant or very high additional expenses, as had already been described above (Fig. 23).

Fig. 22 – Top 5 transfer pricing issues

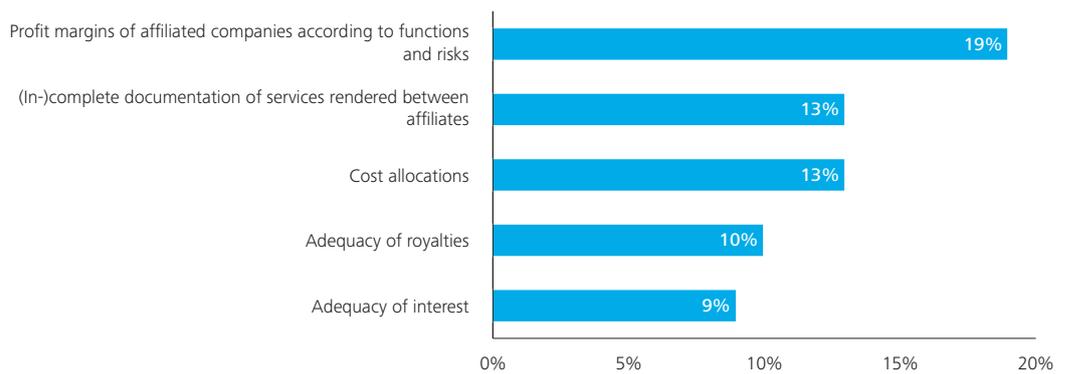
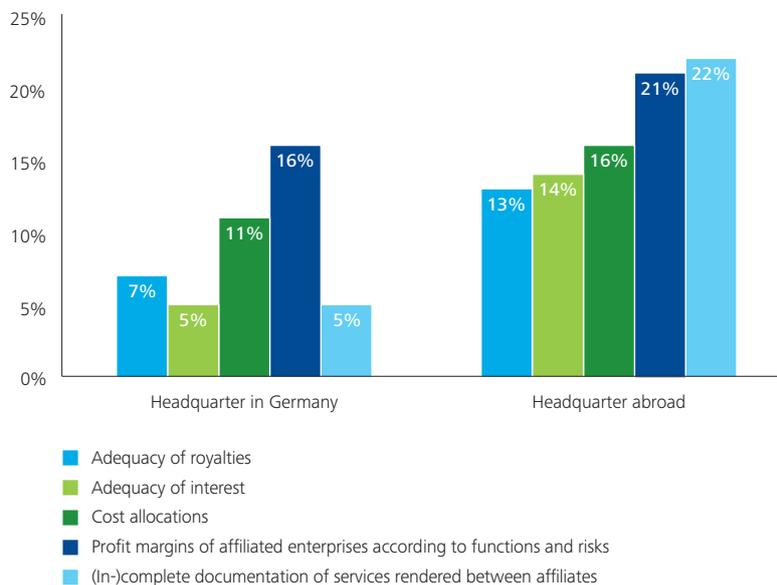


Fig. 23 – Additional expense: transfer prices by headquarter



It is also particularly striking that companies whose group parents' headquarters are situated abroad considerably more frequently incur relevant or very high additional expenses in connection with (in-)complete documentation of the services rendered between affiliates. The analysis does not reveal any reasons for this issue, but this difference shows that there is a lot of catching up to do.

Additionally, the survey shows that both enterprise categories incur considerable additional expenses with respect to the issue "profit margins of affiliated companies according to functions and risks", i.e. 16% of the enterprises, whose group parent has its registered office in Germany, and 21% of the enterprises with their group's registered office being located abroad.

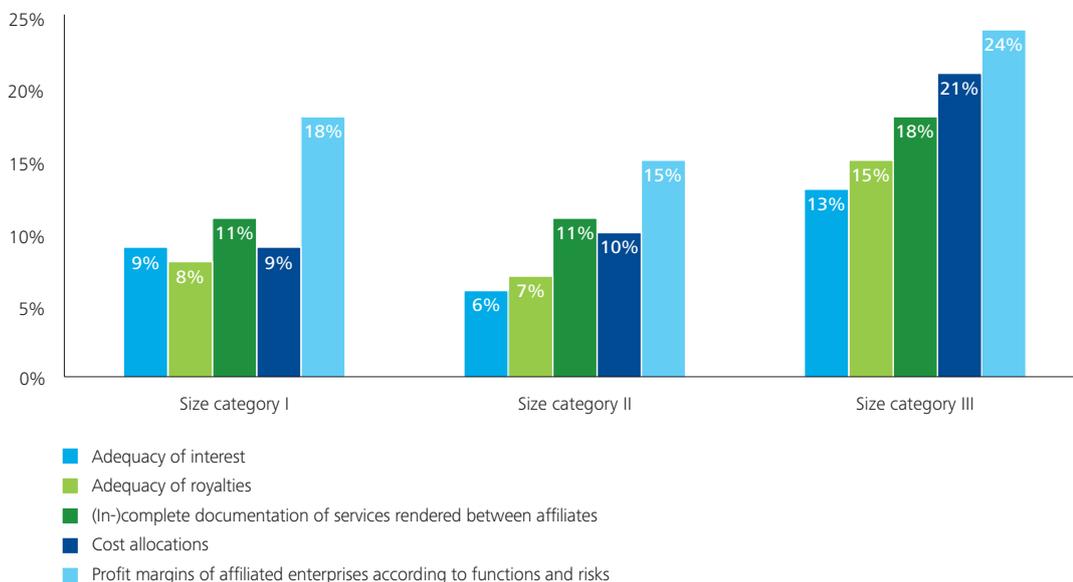
Size of the enterprise

Based on the top five issues mentioned above, the survey comes to the following results (Fig. 24) depending on the size of the enterprise.

The issue profit margin is the most significant for all enterprises of all size categories taken as a whole and also in each single size category, i.e. I. category: 18%; II. category: 15%; III. category: 24% of the respondents (For details about the size category see page 35).

Furthermore, it is striking that the largest enterprises asked, in the aggregate, incurred considerably more frequently relevant and very high additional expenses, whereas the two lower size categories have been affected to a similar extent, even though there are differences concerning the individual issues.

Fig. 24 – Additional expense: transfer prices by size categories



The size of the tax departments affects the relative amount of additional expenses.

Industry

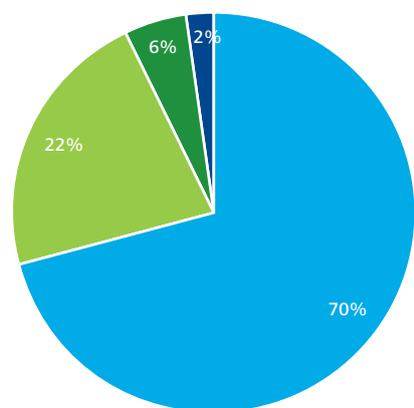
An analysis of the above mentioned issues with the most frequently relevant and very high additional expenses depending on the industry cannot provide relevant findings due to only a few results for this area in the individual industries. An analysis of additional expenses would be only possible for the manufacturing industry.

1.5 Value added tax (VAT)

1.5.1 Additional expenses in the area of VAT in general

In the aggregate, 92% of the participating companies did not incur VAT-related additional expenses at all or only low additional expenses during the years covered by the survey. Only 2% of the VAT-related government tax audits led to very high additional payments (Fig. 25).

Fig. 25 – Additional expense: VAT



- No significant additional expense (< 5%)
- Insignificant additional expense (5%–20%)
- Relevant additional expense (>20%–50%)
- Very high additional expense (> 50%)

Registered office of the group of the enterprise

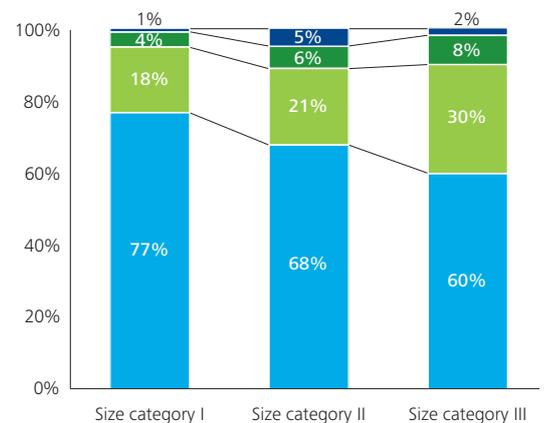
According to the survey, the location (Germany or abroad) of the headquarter of the group does not significantly influence the additional expenses that are incurred as a result of a government tax audit.

Size of the enterprise

An analysis of VAT-related additional expenses according to the individual size categories is presented in the following figure 26.

However, there is no significant statistical link.

Fig. 26 – Additional expense: VAT by size categories



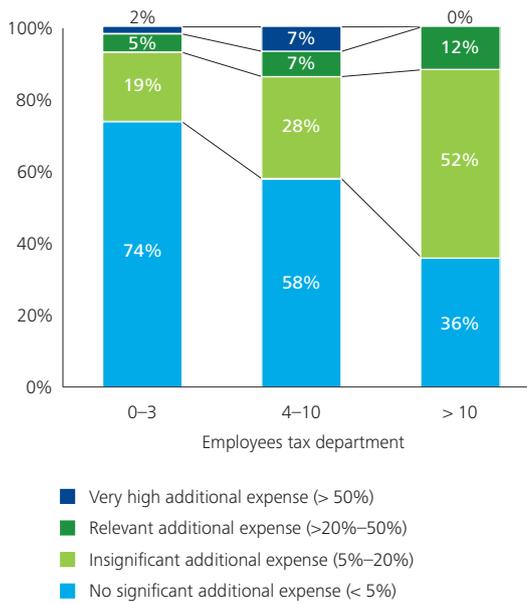
- Very high additional expense (> 50%)
- Relevant additional expense (>20%–50%)
- Insignificant additional expense (5%–20%)
- No significant additional expense (< 5%)

Number of employees in the tax department

An analysis of the VAT-related additional expenses according to the size of the tax departments of the enterprises is presented in the following figure 27.

The size of the tax departments affects the relative additional expenses. Whereas 74% of the tax departments involving three or fewer employees did not find any significant additional expenses as part of VAT-related government tax audits, enterprises with tax departments having more than ten employees only account for 36%.

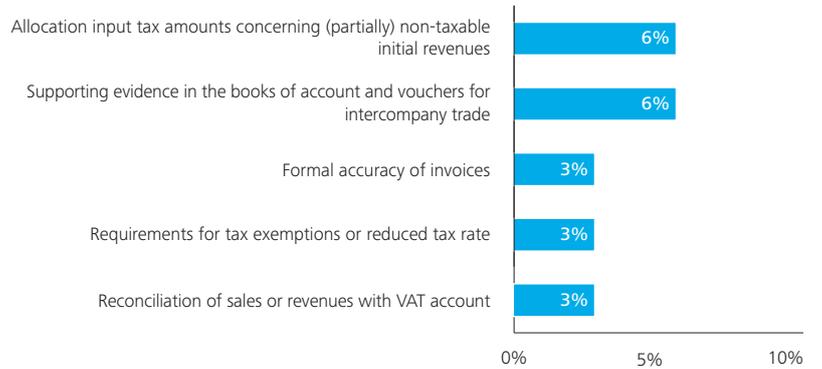
Fig. 27 – Additional expense: VAT by tax department size



1.5.2 Specific additional expenses in the area of VAT

Based on the VAT issues covered as part of the survey, relevant and very high additional payments primarily relate to the allocation of input tax amounts concerning (partially) non-taxable initial revenues and supporting evidence in the books of account and vouchers for intercompany trade (6% each) (Fig. 28).

Fig. 28 – Top 5 VAT issues

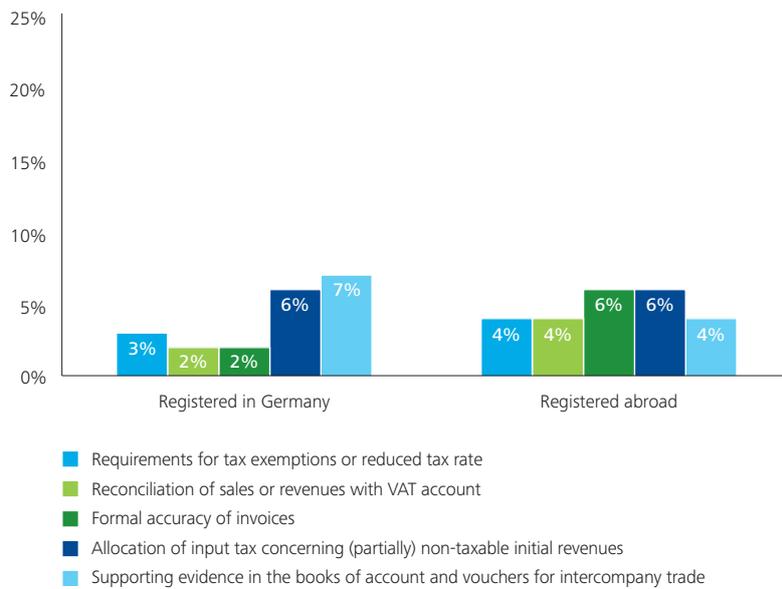


Registered office of the group of the enterprise

An analysis of the additional expenses of enterprises whose group's registered office is in Germany and those whose group's registered office is outside Germany showed similar results. The first group mentioned incurred relevant and very high additional payments primarily with respect to supporting evidence in the books of account and vouchers for intercompany trade (7%)

and to the allocation of input tax amounts concerning (partially) non-taxable initial revenues (6%). By contrast, the issue of formal accuracy of invoices led to significantly higher additional expenses for the enterprises with a foreign group parent company (6%) rather than for the enterprises with a domestic group parent company (Fig. 29).

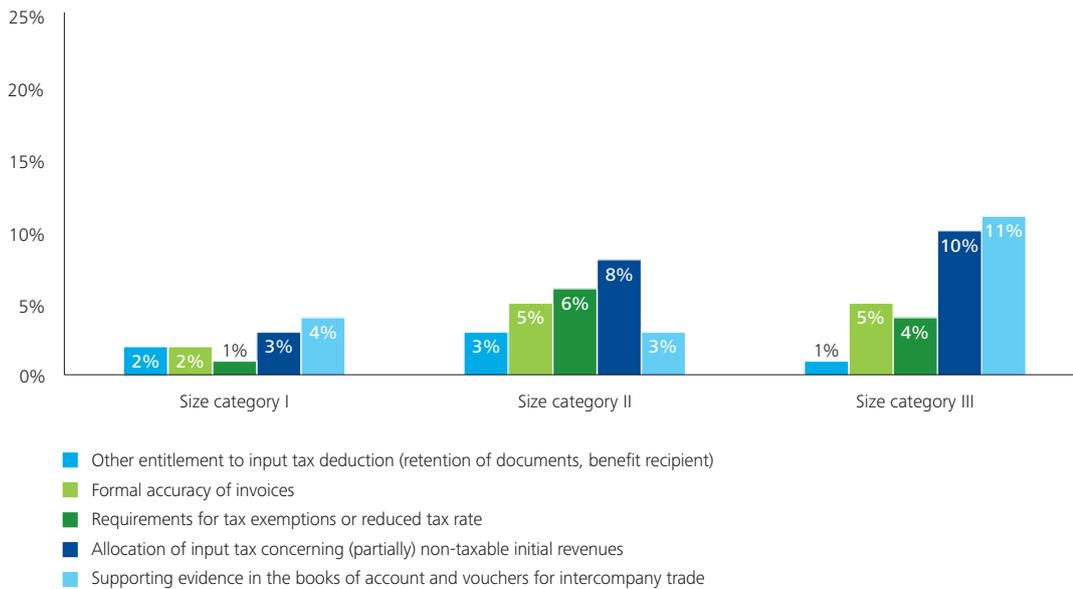
Fig. 29 – Additional expense: VAT by place of group's registration



Size of enterprise

With respect to large enterprises, the survey found that the two issues supporting evidence in the books of account and vouchers for intercompany trade (11%) and allocation of input tax concerning (partially) non-taxable initial revenues (10%) again dominate the assessment of additional tax expenses. With decreasing size of the enterprises, however, no other VAT issues significantly influenced the occurrence of additional expenses (Fig. 30).

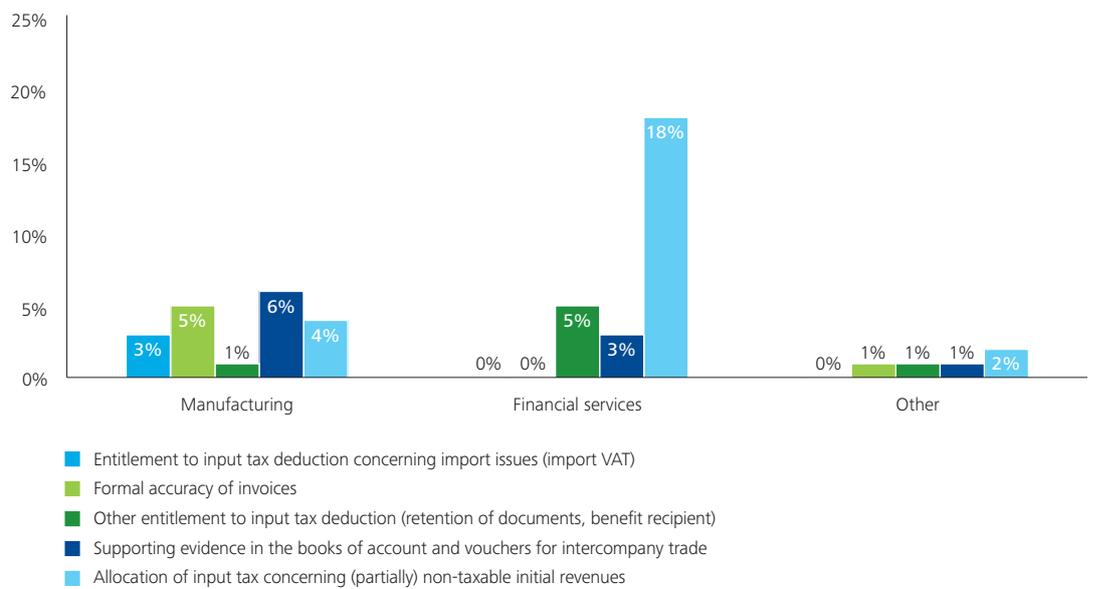
Fig. 30 – Additional expense: VAT by size categories



Industry

As regards the industry-specific allocation of high or very high VAT-related additional expenses, it is striking that primarily enterprises in the financial services industry incurred significantly higher VAT-related additional expenses as a result of the allocation of input tax amounts concerning (partially) non-taxable initial revenues (18%) (Fig. 31).

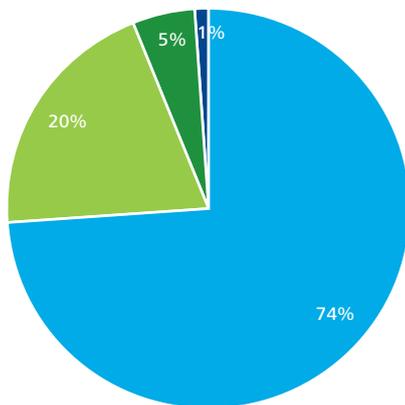
Fig. 31 – Additional expense: VAT by industries



1.6 Wage tax

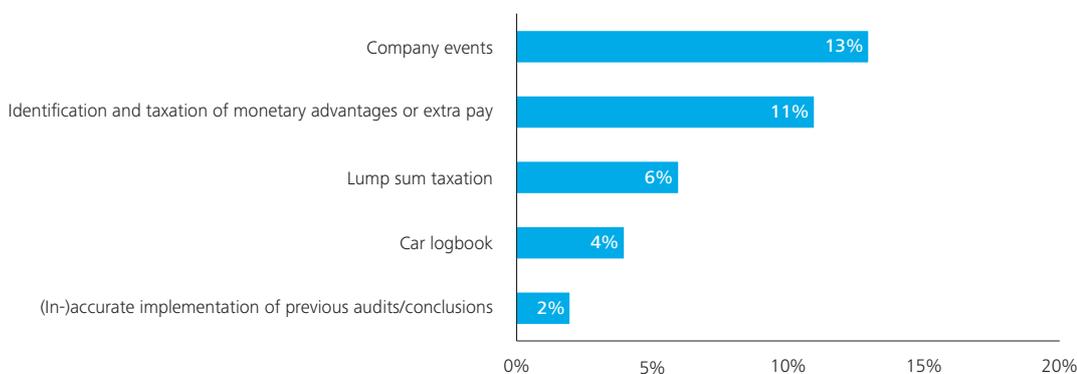
According to the answers given by the respondents, wage tax-related audits extremely rarely led to relevant and very high additional expenses for the enterprises (6%). 94% of the respondents reported by contrast that they incurred only low or no additional expenses at all (Fig. 32).

Fig. 32 – Additional expense: wage tax



- No significant additional expense (< 5%)
- Insignificant additional expense (5%–20%)
- Relevant additional expense (>20%–50%)
- Very high additional expense (> 50%)

Fig. 33 – Top 5 wage tax issues



The government tax audits associated with wage tax focused on the audit areas “company events” and “taxation of monetary advantages and extra pay”.

Factors such as the domestic or foreign headquarter of the enterprise’s group, size of the enterprise, and number of the employees in the tax department are not significantly affecting the wage tax-related additional expenses.

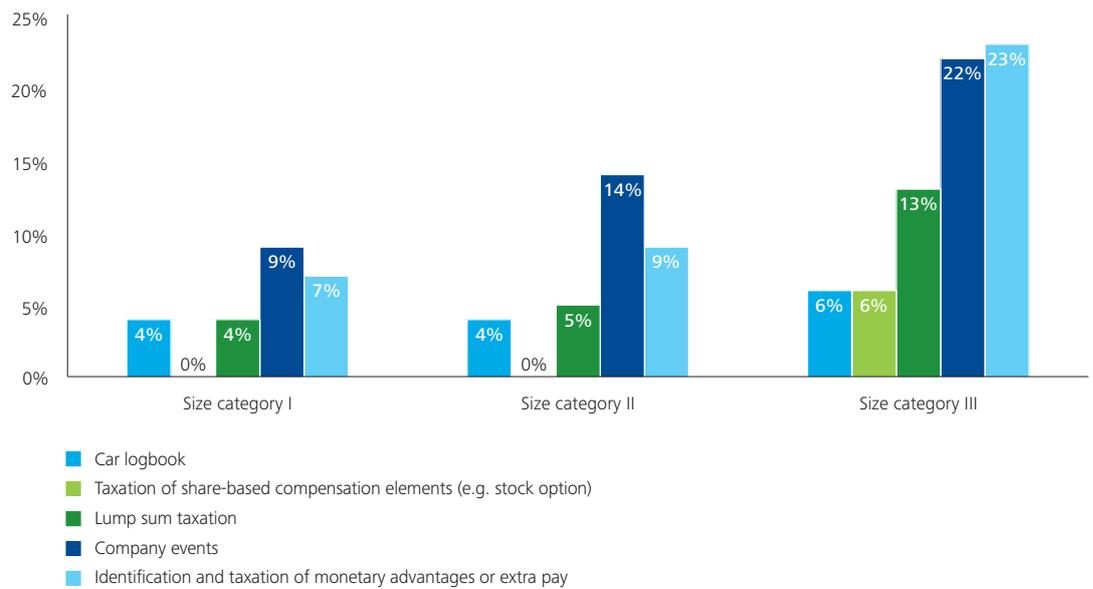
The most frequent wage tax issues are presented in figure 33.

While the survey found no statistical significance of the industry, in which the enterprises operate, for wage tax-related additional expenses in general, an analysis of the individual size categories concerning specific wage tax issues, however, leads to a statistically significant result, which is shown in figure 34.

While the wage tax issues mentioned above more frequently led to relevant and very high additional ex-

penses for the largest enterprises, primarily as a result of company events and the identification and taxation of monetary advantages or extra pay, smaller enterprises incurred such additional expenses considerably less frequent. It is also evident that taxation of share-based compensation elements only leads to additional expenses for the largest companies.

Fig. 34 – Additional expense: wage tax by size categories



2. Summary of Major Findings

2.1 Issues according to their additional tax burden

2.1.1 Income taxes and transfer prices dominate in comparison to wage tax and VAT

Our survey verifies that the highest relevant additional tax burden are incurred in the area of income taxes and transfer prices. 24% of all participants said that they incurred relevant additional expenses associated with income taxes (more than 20% up to 50%) or very high additional expenses (more than 50%). Concerning transfer prices, the percentage is 23% of all participants. It must be underlined, however, that these figures do not relate to the absolute amount of the additional expenses, but rather to the relative additional expenses as a result of the government tax audit compared to the original tax assessment so that the results remain comparable among each other, even though the absolute amount of the previously assessed taxes did completely vary.

Concerning additional expenses as a result of government tax audits, wage tax and VAT are far behind the income taxes, as the share of relevant additional expenses, i.e. expenses of more than 20% up to 50% or of more than 50%, only accounts for 6% and 8%, respectively.

In this context, emphasis must be placed on the fact that enterprises with foreign group parents are confronted with considerably higher risks of additional income tax expenses than enterprises with domestic group parents. Primarily with respect to transfer prices and documentation, they incur higher additional expenses. This especially relates to the commitment to regularly collect appropriate documents about the issue and about the adequacy of prices. There are various reasons for this phenomenon, which were not covered by this survey. However, Germany's particularly strict requirements may play a role in this context, as the foreign parent company cannot live up to this standard at group level and rather elects an approach that covers the average requirements of the most possible jurisdictions.

2.1.2 The top issues

Income taxes

- Acceptance of provision expenses
- Measurement of fixed assets
- Constructive dividends
- Other differences between financial statements and tax balance sheet

The survey identified the most significant issues and particular risk exposures.

From time to time, this issue leads to particularities based on the place of residence of the group parent company. Accordingly, the risk "measurement of fixed assets" is much lower for enterprises controlled by foreign group parents, whereas the reorganization of legal entities according to the Reorganization Tax Law is less critical for enterprises with domestic parents.

The size of an enterprise is also significant. Enterprises of size category I for instance are subject to minor risks concerning the inclusion of foreign entities' income under German Law on External Tax Relations (AStG) and the issue of reorganization of legal entities under Reorganization Tax Law.

Municipal trade tax

- Imputation of interest, licenses, rent/leases, etc.
- Additional deduction by rent and lease income

In the area of municipal trade tax, the survey found no significant differences between enterprises controlled by domestic or foreign companies.

Transfer prices

- Profit margins of affiliated companies according to functions and risks
- Documentation of business relationships between affiliates

However, the survey found that it is much less difficult for domestic-headquartered enterprises to provide adequate documentation than for enterprises dominated by foreign group parents. Instead, the domestic-headquartered enterprises have more difficulties in dealing with cost allocation. The criterion of size alone, however, does not lead to significant differences.

Wage tax

- Company events
- Monetary advantage (identification and taxation)

Value added tax

- Allocation of input tax concerning partially non-taxable revenues
- Supporting evidence in the books of account and vouchers for EU and third country deliveries

Size- or residence-related factors do not result in statistically significant differences.

Analysis based on industries

The analysis of the information provided concludes that concerning the additional expenses there are no significant differences between the individual industries. From time to time, there are only particularities that result from the nature of the operative business, as from the difficulty in allocating input tax concerning partially non-taxable and taxable revenues in the financial services industries or public healthcare sector.

2.2 Other risk exposures

2.2.1 Effect of size of the enterprise on additional expenses

Large companies with high tax charges have relatively higher additional tax expenses as a result of government tax audits. It is striking that the largest companies (size category III) incur relevant or very high additional income tax expenses much more frequently just as enterprises with large tax departments do. As the amount of the additional tax expenses does not represent the absolute figure, but is rather based on the originally assessed tax, the explanation that large companies generally pay high taxes does not count for this phenomenon. It has to be rather concluded that large tax departments are obviously able to completely avoid very high additional expenses (more than 50% of the assessed taxes), as for instance in the area of income taxes, but are exposed to considerably higher risks in the area of relevant additional expenses (more than 20% up to 50%). One may assume that with the increasing size of an enterprise, the complexity of tax issues and, thus, risk exposure is also increasing. However, by contrast, the survey found that the large enterprises could just better avoid the very high additional expenses.

This fact may mean on the one hand that large companies with large tax departments focus on highly risky issues, but at cost of "everyday business transactions".

On the other hand, it may mean that the enterprises are able to optimize its originally assessed tax expense due to its size or personnel and accept probably substantial additional expenses as a result of later government tax audits provided that the risk is lower than additional expenses of 50%.

2.2.2 Atmosphere during government tax audits may be improved

Although only 12% of the participants described the atmosphere during the government tax audit to be tense or hostile, in evaluating this figure, it must be considered that the core of these tax audits is an objective and technical evaluation of issues in the enterprise. It may be assumed that these discussions are expected to take place within at least a neutral atmosphere. However, if 12% of those cases lead to tense atmosphere, this may be an indication that there is a not immaterial demand for improvements of those situations with not only "tax-relevant" challenges to face.

Our findings show that substantial additional income tax-related expenses significantly increase, if the atmosphere during government tax audits is tense/hostile. However, caution should be exercised in jumping to conclusions, as, on the one hand, the information about additional expenses partially relate to several tax types, while the atmosphere is an issue that is generally observed, and on the other hand, reasons and effects are unclear (chicken-and-egg phenomenon). However, a pattern can generally be recognized, with that pattern being statistically significant with regard to income taxes, but not being statistically significant with respect to wage tax and VAT.

2.2.3 Period between tax declaration and audit is still very long

The information about the last completed audits or current audits show that the number of the completed government tax audits (with respect to the key tax expenses "income tax" and "transfer prices") are lowest for the years subsequent to 2006. Accordingly, the majority of the audits cover periods, which date back up to five years.

It is obvious that the taxpayers have to put massive efforts just into the preparation of historical facts, especially if restructurings had been carried out or the financial information systems had been adjusted or converted.

At the time of the tax declaration, the taxpayer, however, is required to be able to cope with the legal regulations and also recently introduced regulations, without being sure about the interpretation of laws at this time.

It remains to be seen whether the conduct of the “timely government tax audit” (§ 4a Tax Audit Regulations (BpO)) will ease this issue. It may be assumed that it will be very difficult to make up for the currently existing gap of five years.

Due to the high additional income tax expenses it may be, therefore, advisable for the taxpayer to contact the responsible tax office early before the actual government tax audit will take place and discuss risky issues and also implement the achieved result in practice accordingly. Large groups frequently do that already. This is advisable only just because it is the only way to avoid inevitable additional expenses that relate from late interest.

Adopting mitigating strategies early.

3. Survey Background

To gain a more detailed insight into the classification of additional results and the special features of government tax audits at the level of large businesses, Deloitte & Touche GmbH conducted a survey within this group of clients in October 2011.

3.1 Conduct of the Survey

3.1.1 Nature of conduct

Within the framework of the survey, the clients of the Tax Service Line of Deloitte & Touche GmbH had been contacted by email and asked to fill in an online questionnaire concerning the conduct of previous government tax audits within their enterprise.

The first part of the questionnaire included general questions regarding the registered office of senior group management (domestic territory or abroad), the industry of the enterprise as well as its size (sales revenues and number of employees). Furthermore, the size of the respective tax department (number of staff employed) was interrogated.

The second part of the questionnaire was very detailed and related to previously conducted government tax audits: What types of taxes and periods were audited? How was the atmosphere during the government tax audit? What issues were audited and what were the respective resulting additional tax expenses? In answering these questions, it was possible to choose between several replies. If no field was selected, this was classified as "no reply" in the evaluation. If, in answering the question concerning the different types of taxes audited, only given types of taxes had been marked, the questionnaire was restricted thereafter to said tax types when it came to detailed questions concerning the individual audits.

3.1.2 Survey participants

733 respondents successfully participated in the survey. The evaluation finally covered the results of 588 respondents, which represented "large enterprises" generating revenues of at least EUR 10 million or with more than 250 employees.

Although the fact that it had been possible for the persons interviewed not to give any details was considered in evaluating the study, the classification basis of results only included the respective answers where details had been given. If, for example, the question about the location of the headquarter was not answered by 11 persons out of 588 participants, e.g. the domestic to foreign headquarter ratio was only related to a total number of 577 enterprises.

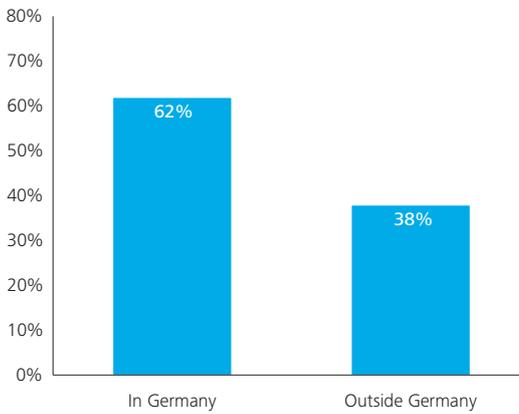
To enhance the understandability of the text, the following statements refer to 588 enterprises. As mentioned above, the exact number of participating enterprises is less relevant to the results of the survey because the classification of results only relates to the answers actually given.

3.2 General

3.2.1 Registered office of the group of enterprises asked

62% of the enterprises have, hence, their group's registered office in Germany and 38% have their group's registered headquarter abroad (Fig. 35).

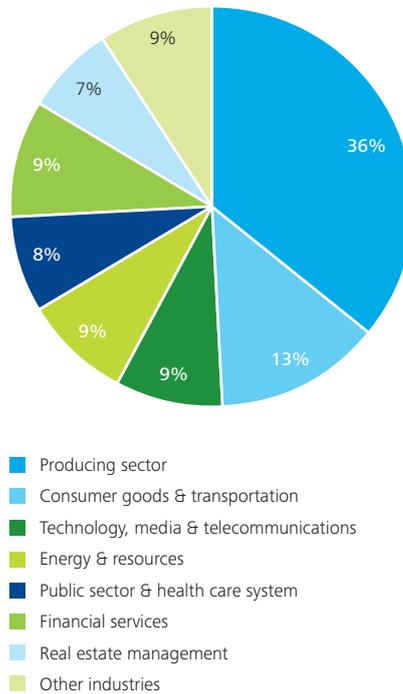
Fig. 35 – Headquarter of enterprise



3.2.2 Industry of enterprises asked

Accounting for 36%, the majority of the concerned enterprises operate in the producing sector, whereas enterprises in the consumer goods or transportation sectors make up for 13% and in the financial service sector for 9%. Furthermore, 9% of the enterprises stated that they operated in the technology, media or telecommunications sectors. Additional 9% are allocated to the energy and resources sector. The public sector and the health care system were stated by a total percentage of 8% of the respondents, real estate management was stated by 7%. 9% of the enterprises operate in other industries (Fig. 36).

Fig. 36 – Industry



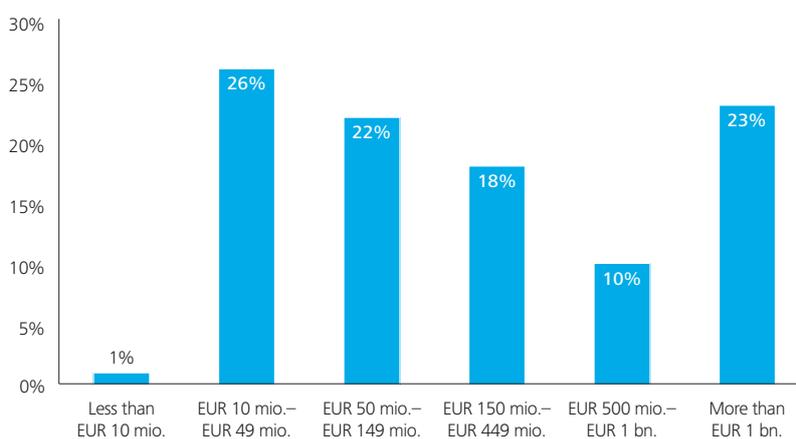
Participants are represented by enterprises that generate sales revenues from EUR 10 million onwards and sales billionaires.

3.2.3 Sales revenues of enterprises asked

Since the study is to be restricted to large businesses, i.e. businesses with sales revenues of at least EUR 10 million or a number of employees of more than 250, enterprises that did not reach these “minimum thresholds” were not taken into account for evaluation purposes.

Most of the covered enterprises disclose sales revenues of EUR 10 million up to less than EUR 50 million (26%), sales revenues of EUR 50 million up to less than EUR 150 million (22%) or sales revenues of more than EUR 1 thousand million (23%).

Fig. 37 – Sales revenues of enterprises



3.2.4 Number of employees of enterprises asked

37% of the enterprises taken into account employ up to 250 people, 19% employ between 250 and 500 people. Only 12% of participants employ more than 5,000 people (Fig. 38).

3.2.5 Size of tax department of enterprises asked

80% of the enterprises employ up to 3 persons in a tax department, 15% of the enterprises employ 4 to 10 tax experts and, at 5% of the enterprises, more than 10 employees are assigned to tax tasks.

3.3 Establishing the basis of the analysis, significance of results

3.3.1 Size categories of the enterprises

Within the framework of the evaluation, the large enterprises interrogated were classified by sales revenues and number of employees and allocated to three different size categories. The size categories I to III are shown in the following table.

In employing three persons at maximum, the large majority of the represented companies have a small or no tax department at all.

Fig. 38 – Number of employees per enterprise

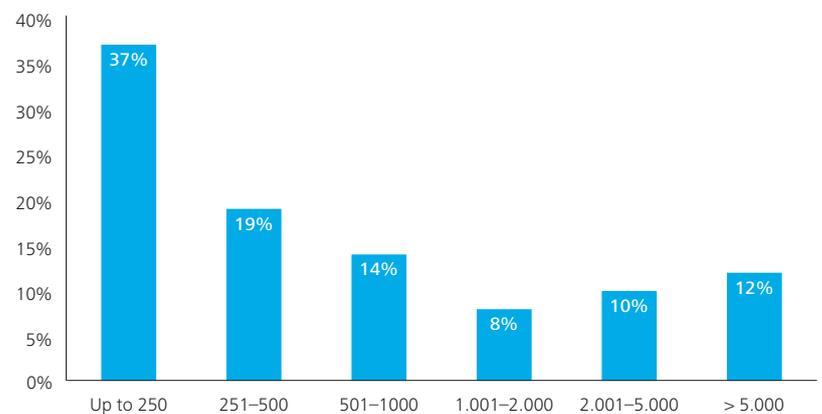


Table 1 – Size categories of the enterprises

Sales	Employees	0-250	251-500	501-1.000	1.001-2.000	2.001-5.000
	less than € 10 million	-	I	I	I	II
€ 10 million-€ 49 million	I	I	I	II	II	
€ 50 million-€ 149 million	I	I	II	II	II	
€ 150 million-€ 499 million	I	II	II	II	III	
€ 500 million-€ 1 thousand million	II	II	III	III	III	
more than € 1 thousand million	II	III	III	III	III	

Size category I includes those enterprises that realize sales of less than EUR 10 million, but employ more than 250 people. Furthermore, size category I includes enterprises employing up to 1,000 people and realizing sales ranging from EUR 10 million to EUR 50 million as well as enterprises employing up to 500 people and realizing sales of less than EUR 500 million. Also, those enterprises that employ up to 250 people and realize sales ranging from EUR 150 million to EUR 500 million have been included in size category I.

Size category II includes those enterprises that have more than 2,000 employees and realize sales of less than EUR 10 million. Also, enterprises realizing sales between EUR 10 million and EUR 50 million and employing more than 1,000 people are allocated to size category II. Enterprises realizing sales between EUR 50 million and EUR 150 million and employing more than 500 people are also included in this size category. Enterprises generating sales of at least EUR 150 million and employing more than 250 up to 2,000 people as well as enterprises realizing sales of EUR 500 million up to EUR 1 thousand million that employ up to 500 people are also included in this size category. Finally, size category II includes those enterprises that employ up to 250 people and generate sales of more than EUR 500 million.

Size category III includes enterprises generating minimum sales of EUR 150 million and employing more than 2,000 people. Enterprises employing more than 500 people and generating sales of at least EUR 500 million are also included in this size category. Finally, enterprises with more than 250 employees and generating sales of more than EUR 1 thousand million are included in size category III.

47% of the enterprises taken into account have been included in size category I, 23% of the enterprises in size category II and 30% of the enterprises in size category III (Fig. 39).

3.3.2 Percentage stated for relevant or very high additional tax expenses

One topic of the survey covered the amount of additional tax expenses as a result of government tax audits. To ensure comparability, the specific percentage of the additional charge incurred by the enterprises asked in relation to the charge prior to the government tax audit was interrogated. Potential answers were “very high additional tax expense (more than 20-50%)”, “relevant ad-

ditional tax expense (5-20%)”, “insignificant additional tax expense (less than 5%)” and “no major additional expense”.

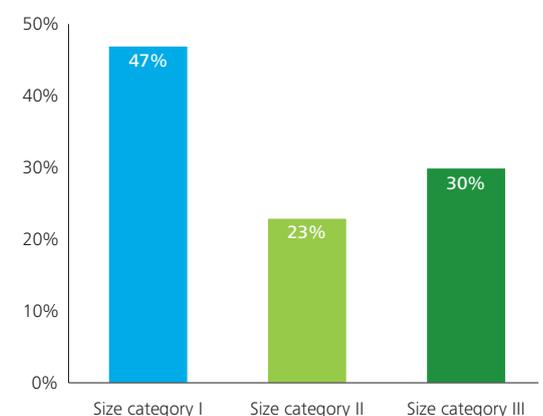
3.3.3 Top issues concerning additional expenses

Within the different tax types, which are partly further classified, it was possible to identify so-called top issues that, for a major number of enterprises, led to very high (more than 50%) or relevant additional tax expenses (more than 20%–50%) after termination of government tax audits. These additional expenses are relative, i.e. independent from the previous charge on account of taxes initially assessed with the right reserved to change the assessment.

For the purpose of these comparisons, the respective share of participants that reported relevant or very high additional tax expenses was determined. To determine the comparative ratio, the number of responses stating a relevant or very high additional tax expense was then put in relation to the total number of participants.

If, for example, 513 enterprises gave details on a tax type and 8 of these showed a very high and 80 a relevant additional tax expense for a sub-issue, the comparative ratio would be $88/513 = 17\%$. If 64 out of 513 enterprises showed a very high or relevant additional tax expense for another sub-issue, the comparative ratio would be $64/513 = 12\%$. If it has been possible to determine further comparative ratios for sub-issues of this tax type, a list of the top five within this tax type was prepared.

Fig. 39 – Size category of enterprises



The five top issues determined for “income taxes: general issues” were, for example, as follows

- Provision expense (excluding pensions and early-retirement part-time work);
- Valuation of fixed assets;
- Other differences between statutory books and tax balance sheets;
- Deduction for write-down to lower going-concern value of receivables from domestic and foreign affiliated companies;
- Cost of entertainment, gifts, etc. (Fig. 40).

Only within the “municipal trade tax” sub-section merely four top issues have crystallized.

Besides different tax types and fiscal sub-issues, the above-mentioned criteria registered office, industry, enterprise category and size of tax department have also been used as differentiation criteria for evaluation purposes.

3.3.4 Limitation of analysis possibilities

Within the scope of the study, it is not possible to make any statements regarding the absolute tax burden of the participating enterprises. This has after all not been the goal of the study. The goal was rather to classify the additional expenses after termination of government

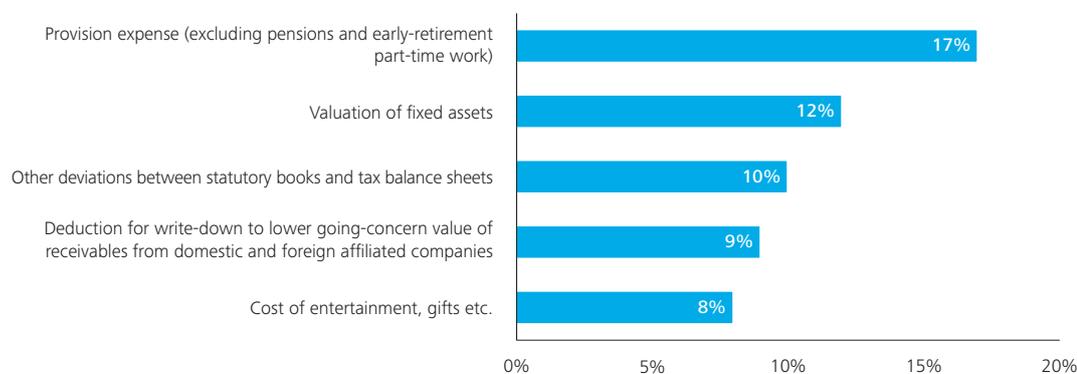
tax audits by tax types. In addition, it was to be highlighted which tax issues were specifically audited and which issues led to very high or at least relevant additional tax expenses as a result of government tax audits.

Also, the goal was to find out whether an enterprise is subject to specific risks within the scope of a government tax audit on account of the registered office of the group, its enterprise category, the size of its tax department or the industry.

The survey did not interrogate the reasons of additional tax expenses. Therefore, it was only possible, in evaluating the study, to make assumptions concerning the causes of additional tax expenses that we considered reasonable on account of the statistical results.

Statistical significance tests were performed in order to compare the additional tax expense for the different tax types. Through these tests, it was examined whether the differences identified probably rose coincidentally (insignificant) or whether the differences are systematically and probably transferable to the population (significant). Only significant relations are presented within the scope of the evaluation. Deemed random events were not further interpreted.

Fig. 40 – Top 5 income tax issues



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