beinformed:

Combating Tax Havens Act – Paradise Lost (some)

October 21, 2021

Since the end of 2017, the Council of the European Union has been drawing up a so-called blacklist of non-cooperative tax states. It started as a so-called “name and shame” list, but otherwise had no impact.

This changed: the Council of the EU wants Member States to use tax measures to damage business relations with such states. The aim is to avoid business relations with these states altogether. After Luxembourg (legislative process here has already been completed since 2020), Germany also has adopted its Combating Tax Avoidance and Unfair Tax Competition Act (Gesetz zur Abwehr von Steuervermeidung und unfairem Steuerwettbewerb) this year. The law is applicable from 1 January 2022.

Unlike Luxembourg, which only denies the deduction of business expenses in the case of payments as interest and royalties to a tax haven, Germany is ramping up the complete arsenal of the four possible defensive measures proposed by the Council of the European Union. And: contrary to some statements, it does not matter whether the transactions are between affiliated companies – all business relationships are caught!

Documents to beinformed:

- Combating Tax Havens Act
- EU list of non-cooperative jurisdictions

Scope

The starting point for applicability is (1) a formal inclusion in a statutory instrument, for which (2) at least one of the three substantive conditions must be met:

- Formal: Designation of the country as a tax haven in a legal ordinance issued by the Federal Ministry of Finance and the Federal Ministry for Economic Affairs and Energy (legal ordinance covers at most those countries that are also included in the EU list of non-cooperative countries).
- Substantive condition 1: Tax haven does not ensure sufficient transparency in tax matters in accordance with Section 4 of the Combating Tax Havens Act (OECD Common Reporting Standard, Exchange of Information on Request of the Global Forum, Convention on Mutual Administrative Assistance in Tax Matters)
- Substantive condition 2: Tax haven engages in unfair tax competition pursuant to Section 5 of the Combating Tax Havens Act

- Substantive condition 3: Tax haven has not committed to implementing the minimum standards of the OECD/G20 BEPS (Base Erosion and Profit Shifting) project against profit evasion and profit shifting.

Defensive measures

On the legal consequences' side, a distinction must be made between four defences:

- Denial of deduction to reduce profits pursuant to Section 8 of the Combating Tax Havens Act

  Expenses from business transactions with reference to a tax haven may not be used to reduce the profit or the surplus of income over income-related expenses.

- Withholding tax measures for payments to recipients in a tax haven according to Section 10 Combating Tax Havens Act

  Section 10 Combating Tax Havens Act provides for a limited tax liability for certain income in addition to the regular rules in Section 49 Income Tax Act, insofar as the expenses corresponding to such income would have to be taken into account in the case of an unlimited taxpayer notwithstanding the application of the business expense deduction denial and is thus intended to lead to a priority of taxation of the income recipient. Thus: business expense deduction is allowed if withholding tax can be withheld on the payments to a tax haven under this Section 10. The amount of withholding tax is 15 percent.

- Tighter rules on controlled foreign companies (CFC)

  This measure supplements the taxation of foreign income under the German CFC rules. The type of income (active or passive), the fulfilment of the so-called motive test or falling below the exemption limit are irrelevant. Income of a foreign company that is directly or indirectly downstream of a company in a non-cooperative tax jurisdiction is also caught. In addition, a provision on permanent establishments in non-cooperative tax jurisdictions has been added. Here, Section 20(2) sentence 1 of the German CFC Act applies with the proviso that it is to be applied to all income of the permanent establishment.

- Regulations on profit distributions and share disposals pursuant to Section 11 of the Combating Tax Havens Act

  The intercompany privileges under Section 8b(1) sentence 1 of the German Corporate Tax Act and comparable provisions for profit distributions under double taxation agreements are not granted if the payments are made by a corporation resident in a tax haven. The same applies to capital gains in accordance with Section 8b(2) sentence 1 of the German Corporate Tax Act or comparable regulations under double taxation agreements. In the case of natural persons as shareholders, the flat rate withholding tax system or the partial income procedure does not apply. In the context of the government draft, an addition was made to the "distribution cases" in order to cover circumvention situations. According to this amendment, situations are also covered in which a related person within the meaning of Section 1(2) of the German CFC Act was interposed between the recipient resident in Germany and the company in the tax haven in the case of distributions or capital gains. Section 11 of the Combating Tax Havens Act does not apply insofar as the distribu-

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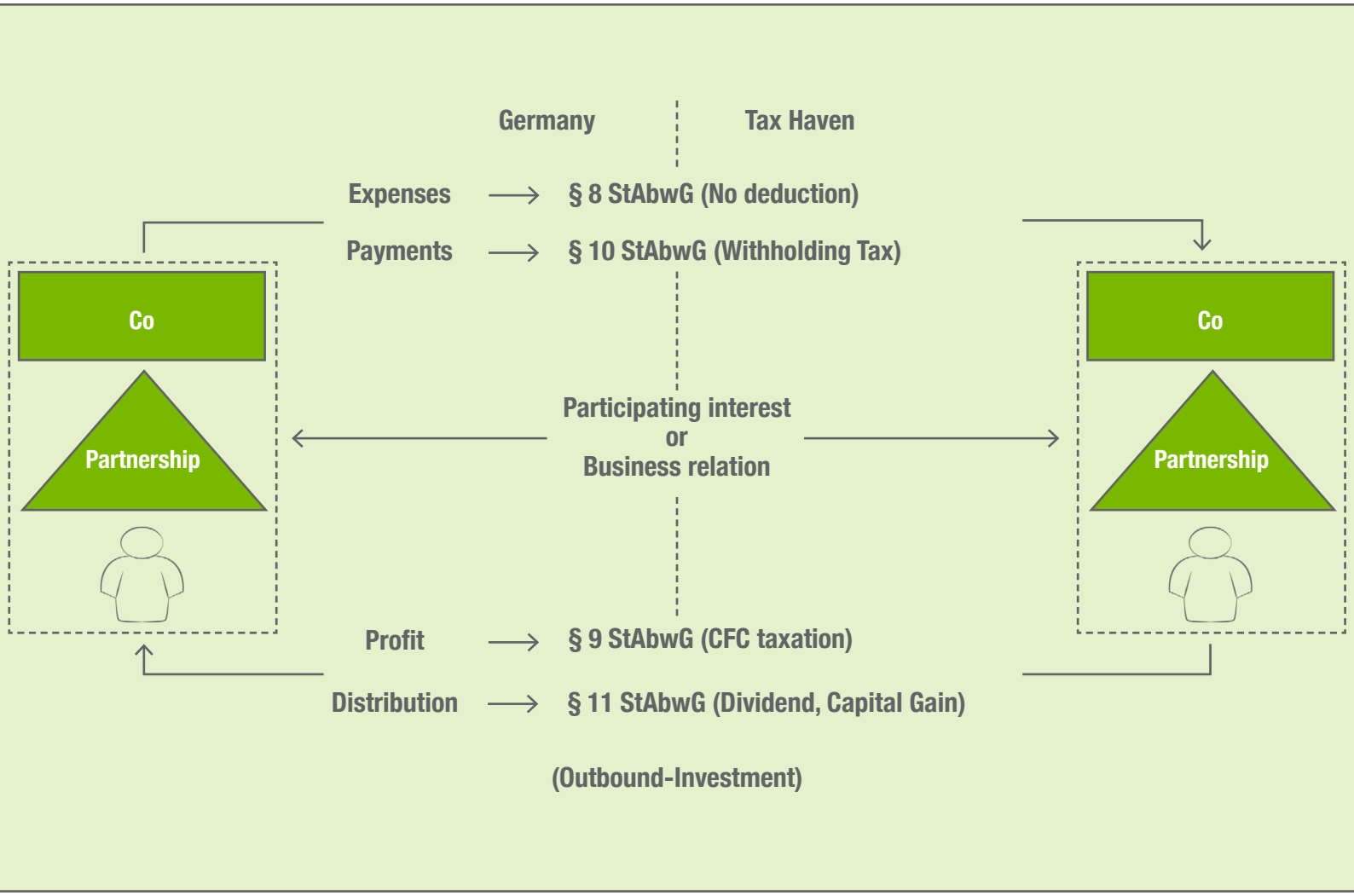
tions originate from amounts that are already subject to withholding tax pursuant to Section 10 or the prohibition on deductions pursuant to Section 8 of the Combating Tax Havens Act.



Source: (according to Euler/Maier/Schanz, DStR 2021, 1257)

Duty to cooperate

In addition to the four defensive measures, enhanced obligations to cooperate and record-keeping are prescribed. This duty to cooperate also includes taxpayers who are not materially affected, for example due to a tax exemption. Pursuant to Section 12 of the Combating Tax Havens Act, the record-keeping obligations include, for example, the type and scope of business relationships, assets used, business strategies or contracts. The records must be prepared and submitted unsolicited no later than one year after the end of the relevant business year.

As of today, the legal statutory instrument is likely to designate the following territories as tax havens: American Virgin Islands, American Samoa, Anguilla, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, and Vanuatu.

For the investment management industry, Panama alone is likely to be important as a popular holding location for investments in Central and South America.

The law will apply from 1 January 2022, and for countries blacklisted by the EU in 2021, the date of application will be 1 January 2023.

We will be happy to examine your structures for applicability of the Combating Tax Havens Act and support you in fulfilling the increased obligations to cooperate.

be in touch: Any questions? Please do not hesitate to contact us!

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