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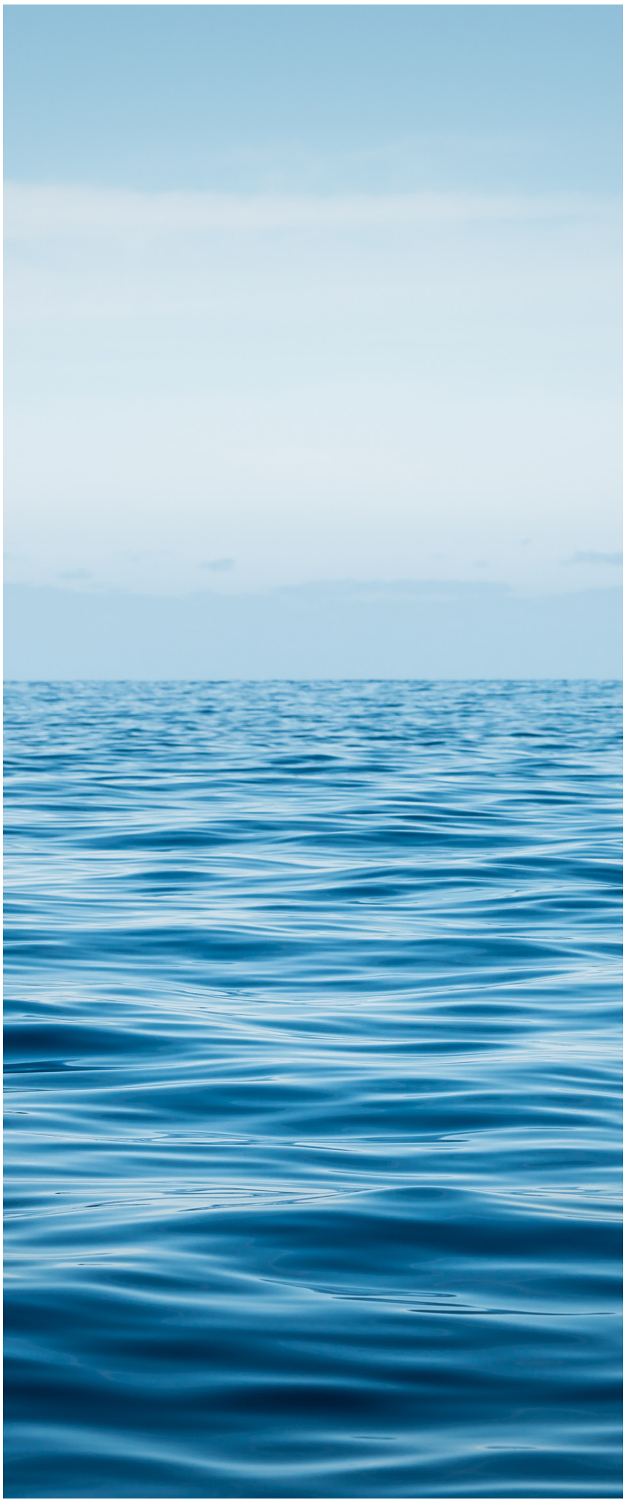
Measures against tax havens

An overview

The German Act Combating Tax Avoidance and Unfair Tax Competition (THDA) governs measures relating to business relationships with non-cooperative tax jurisdictions.



Classification as a non-cooperative tax jurisdiction has an impact not only on the German Act Combating Tax Avoidance and Unfair Tax Competition (Gesetz zur Abwehr von Steuervermeidung und unfairem Steuerwett-bewerb), also known as the German Tax Haven Defence Act, or THDA for short (Steueroasen-Abwehrgesetz), but also on the reporting requirements for cross-border tax arrangements ("DAC6"), public country-by-country reporting ("public CbCR") and coronavirus bridging assistance, among other things.

I. Non-cooperative tax jurisdictions

The Council of the European Union assesses countries' tax policy in terms of transparency, tax fairness, the implementation of anti-BEPS measures and the exchange of information. Any countries not complying are added to a "Blacklist" of non-cooperative tax jurisdictions. The EU first published its Blacklist in December 2017. There is also a second list, the "Greylist", which includes tax jurisdictions that do not yet meet all international tax standards but that have committed to implementing reforms. The EU updates both lists twice a year, in February and October. Following the update in February 2024, the Blacklist and the Greylist currently include the following tax jurisdictions:

EU Blacklist

American Samoa, Anguilla, Antigua and Barbuda, Fiji, Guam, Palau, Panama, Russia, Samoa, Trinidad and Tobago, U.S. Virgin Islands, Vanuatu

EU Greylist

Armenia, Belize, British Virgin Islands, Costa Rica, Curaçao, Eswatini, Malaysia, Seychelles, Turkey, Vietnam

The respective status (with timeline) can be viewed on the EU's website at:
https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/

II. The Tax Haven Defence Act

Background and history

The Tax Haven Defence Act (THDA) of 25 June 2021 represents the national implementation in Germany of a long-standing objective of the Council of the European Union to combat tax avoidance and aggressive tax planning that is detrimental to the EU Member States. The Council recommended that its Member States take "legislative measures" in respect of the countries on the Blacklist. The EU Member States were expected to implement at least one recommended legislative measure from a total of four.
The overview shows the extent to which the Member States have implemented the measures.

Maßnahmen der Mitgliedsstaaten

Country	Non-deductibility of costs	CFC	Withholding tax measures	Limitation of participation exemption
Austria		✓		
Belgium	✓	✓		✓
Bulgaria			✓	
Croatia		✓	✓	
Cyprus			✓	
Czech Rep.		✓		
Denmark	✓		✓	
Estonia		✓	✓	✓
Finland		✓		
France	✓	✓	✓	✓
Germany	✓	✓	✓	✓
Greece	✓			
Hungary		✓		
Ireland		✓		
Italy	✓		✓	
Latvia		✓	✓	✓
Lithuania	✓	✓	✓	✓
Luxembourg	✓			
Malta				✓
Netherlands		✓	✓	
Poland		✓	✓	✓
Portugal	✓	✓	✓	✓
Romania	✓			
Slovakia	✓		✓	✓
Slovenia	✓	✓	✓	✓
Spain	✓	✓	✓	✓
Sweden	✓			

Quelle: Tax defensive measures implemented by European states a – KPMG Global

With the THDA, Germany has implemented all four defensive measures. However, the EU Blacklist does not apply directly for the purposes of the THDA. A tax jurisdiction must first be included in the German Tax Haven Defence Ordinance (THDO) before the defensive measures relating to that jurisdiction become applicable. In April 2024, 16 non-cooperative tax jurisdiction were listed in the THDO („listed countries"): American Samoa, Anguilla, Antigua and Barbuda, Bahamas, Belize, Fiji, Guam, Palau, Panama, Russian Federation, Samoa, Seychelles, Trinidad and Tobago, Turks and Caicos Islands, U.S. Virgin Islands, Vanuatu. As the EU Blacklist and, subsequently, the THDO are continually updated, this represents a snapshot. The THDO is typically only updated at the end of the year to reflect the current status of the EU Blacklist, including the changes made in October (see below for information on the timing of application of the defensive measures with regard to tax jurisdictions newly added to or removed from the THDO).

Typical areas of application and sectors

The affected parties are domestic taxpayers who have business relationships or participation/ownership relationships with persons in a listed country. The economic reasons for this being the case are irrelevant. With regard to the countries listed in the THDO as of April 2024, this relates in particular (but not exclusively) to tourism, aviation and shipping companies. Following the inclusion of countries such as Russia and Panama on the list, the affected parties are likely to become less concentrated in specific business sectors.

In this context, monitoring the Greylist is always recommended, as this serves as a precursor to inclusion on the Blacklist and hence can be used by companies as an early warning system. As of April 2024, the Greylist includes countries such as Turkey, Vietnam and Costa Rica.

Defensive measures

The (four) defensive measures included in the Tax Haven Defence Act concern business transactions of German taxpayers with

- individuals if they are resident (Section 8 of the AO – German Fiscal Code [Abgabenordnung]) or have their habitual abode (Section 9 AO) and
- associations of persons and pools of assets (corporations, trusts, foundations) if they have a registered office (Section 11 AO) or their place of management (Section 10 AO) in a listed country.

A Inbound-Cases

The Tax Haven Defence Act provides for withholding tax measures (Section 10 THDA) or a prohibition on deducting business and income-related expenses in the case of expenses arising from business relationships in or relating to a non-cooperative tax jurisdiction (Section 8 THDA).

Under Section 10 THDA, the foreign person is assumed to have limited tax liability while the domestic taxpayer is assumed to be liable for the deduction of withholding tax. The limited tax liability of the person, association of persons or pool of assets resident in the listed country covers income (and corresponding business and income-related expenses) from financing arrangements, insurance or reinsurance premiums, trade in goods or services and – since 1 January 2023 – income from the granting or sale of rights that are entered in a domestic public record or register ("register cases").

The implementation of the withholding tax measures is determined on the basis of Section 50a of the Einkommensteuergesetz (EStG – German Income Tax Act). This means the domestic (German) contractual partner must deduct withholding tax of 15 percent plus solidarity surcharge on remuneration (business and income-related expenses) and transfer this to the German Federal Central Tax Office on a quarterly basis.

If it is agreed that the tax will be paid by the party liable to pay the remuneration ("net agreement"), the basis of measurement for the tax deduction and the tax deduction itself shall be based on a notional tax rate of 17.82 percent of the agreed net remuneration plus solidarity surcharge.

Specifics of tonnage tax

The requirement to deduct withholding tax in accordance with Section 10 THDA gives rise to the question of whether the relevant cash flows to a listed country must have reduced domestic profit in the form of business expenses or not. This is the case according to the wording of the legislation and the tax technical literature published to date, as such expenses are required to be "taken into account" in the assessment of such income. The question is relevant for non-deductible business expenses or businesses whose profit is taxed on the basis of the indicated tonnage in accordance with Section 5a EStG. Although business expenses exist in this case, they are not taken into account in the assessment of unlimited income tax or corporation tax. The amendment to Section 10 THDA in response to the 2022 Annual Tax Act, including the addition of a reference to the method of income determination, has not led to any changes regarding the requirement to "take into account" business expenses.

B Outbound-Cases

Tighter CFC rules (Section 9 THDA) and the elimination of participation exemptions (Section 8b of the KStG – German Corporation Tax Act [Körperschaftsteuergesetz]) and DTA exemptions for dividends and capital gains (Section 11 THDA) are set out in respect of investments in a company in a listed country and cash flows from a listed country.

Under the tighter CFC rules, a foreign entity is deemed to be a controlled foreign corporation (CFC) with all of its income that is subject to low taxation overall. This is the case irrespective of the activity giving rise to the income and whether the foreign entity satisfies the motive test or the exemption threshold for mixed income.

C Competing relationship between the four legislative measures under the THDA

Only one of the four measures is applied in each case. The competing relationship between the four measures is governed by the principle of subsidiarity and the timing of application of the measures. The relationship between the tighter CFC rules under the THDA and the CFC rules under the Außensteuergesetz (AStG – German Foreign Transaction Tax Act) can be described using the following rule of thumb: The rules that result in higher taxation are applied.

Timing of application of the defensive measures

If a tax jurisdiction is newly added to the THDO, the defensive measures and enhanced cooperation obligations relating to that tax jurisdiction generally apply from the beginning of the next year (or financial year). The timing of application for certain defensive measures is governed by a "phased model". The prohibition on deducting business and income-related expenses (Section 8 THDA) applies only from the beginning of the fourth year (or financial year) following the country's inclusion in the THDO, while the measures concerning dividends and capital gains (Section 11 THDA) apply only from the beginning of the third year (or financial year) following the country's inclusion in the THDO.

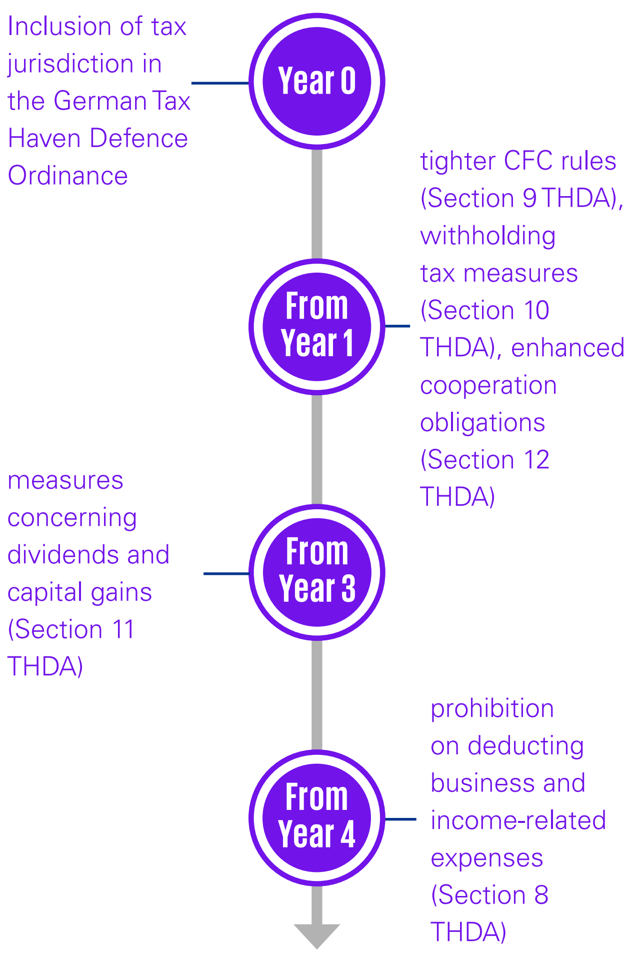
Compliance requirements and tax record-keeping obligations

The THDA sets out cooperation obligations that go beyond those set out in Section 90 AO. Section 12 (2) THDA includes record-keeping obligations in a total of eight categories. Implementing these obligations with the required scope and degree of detail and integrating them into the existing compliance obligations and systems in accordance with section 90 (3) AO will likely place an additional administrative burden on the affected persons and companies. Under Section 12 (3) THDA, when requested to do so by the tax authorities, the taxpayer must

a. affirm the correctness and completeness of the information in its records in accordance with Section 12 (2) THDA and

b. authorise the tax authorities to enforce potential rights to information in respect of the foreign contractual partners on its behalf, whether in or out of court.

Example of the timing of the defensive measures



Failure to comply with the enhanced cooperation obligations

If the taxpayer fails to comply with its duties of cooperation, there is a rebuttable presumption that taxable income in Germany relating to the countries listed in the THDO

a. has not yet been declared but does effectively exist, or

b. has already been declared but is effectively higher than declared.

A surcharge is also levied in the amount of EUR 5,000 but in any case no less than five percent and no more than ten percent of the excess income. A failure to comply with the duties of cooperation in accordance with Section 12 THDA may therefore lead to the tax authorities assuming a higher basis of assessment. This can be problematic for any necessary disclosures and supplementary tax returns, as bases of assessment must be fully declared in supplementary tax returns (completeness requirement) if the supplementary tax return is to have the effect of exempting the taxpayer from punishment.

Conclusion on the Tax Haven Defence Act

Although the THDA may appear to have a limited scope of application at first glance, the fact that the THDO refers indirectly to the EU Blacklist means it has a highly charged dynamic. For instance, this was illustrated by the addition of Russia to the EU Blacklist and the THDO in December 2023. Companies should also keep abreast of developments on the EU Greylist, as this serves as an early warning system. This dynamic should be incorporated into and reflected in the existing compliance systems. Parties falling within the scope of the THDA are confronted not only with extensive record-keeping obligations and duties of cooperation, but also with potentially contentious legal issues. The draft BMF circular on the application of the Tax Haven Defence Act that was published on 30 November 2023 leaves many questions unanswered.

III. Additional (tax) measures in relation to non-cooperative tax jurisdictions

Reporting obligation for cross-border tax arrangements (DAC6)

Cross-border tax arrangements are only reportable in Germany if at least one of the prescribed "hallmarks" is satisfied. One of these hallmarks relates to certain cross-border payments between two or more affiliated entities if the payment recipient is resident in a tax jurisdiction included in the list of third countries that are classified by the EU Member States or the OECD as non-cooperative jurisdictions (Section 138e (2) no. 1 a) bb) AO). Unlike the THDA, this provision refers directly to the EU Blacklist, which becomes valid when it is published in the Official Journal of the European Union. This means it is not necessary for newly listed countries to be included in a national "German" list. In the opinion of the German Federal Ministry of Finance (BMF), the aforementioned hallmark is satisfied if, at one of the points in time set out in section 138f (2) AO – i.e. when the tax arrangement is prepared for implementation, the tax arrangement is ready for implementation or the first step has been made in implementing the tax arrangement – the country of residence of the payment recipient is included in the respective list of non-cooperative third countries as issued by the EU or the OECD (BMF circular dated 29 March 2021, marginal no. 163). The BMF regularly

publishes a current list of countries ("List of DAC6 countries") that can be viewed on the website of the German Federal Central Tax Office at: https://www.bzst.de/DE/Unternehmen/Intern_Informationsaustausch/DAC6/Vorschriften/vorschriften_node.html

The relevant date for the hallmark is the date on which the country was added to the DAC6 list of countries. Accordingly, tax arrangements originating prior to the respective relevant date should not entail a subsequent reporting obligation.

Public country-by-country reporting

To implement Directive (EU) 2021/2101, German legislators adopted the Act on the Disclosure of Income Tax Information by Certain Companies and Branches (Public CbCR), which came into force on 22 June 2023. This essentially affects standalone companies and ultimate parent companies domiciled in Germany with global revenue or consolidated revenue of more than EUR 750 million in each of two consecutive financial years. The obligation applies for the first time for financial years beginning after 21 June 2024. The disclosures in the public CbCR must be made separately for each EU/EEA Member State. For third countries, however, disclosure is performed on an aggregated basis unless the third country is either on the EU Blacklist on 1 March of the reporting period or on the EU Greylist on both 1 March of the reporting period and 1 March of the financial year immediately preceding that reporting period. In these cases, the disclosures must also be made separately. The public CbCR also refers directly to the EU Blacklist or the EU Greylist. As above, this means there is no need for the country to be included in a national "German" list.

Coronavirus bridging assistance

In applying for coronavirus bridging assistance, applicants had to declare, among other things, that

- the bridging assistance provided would not end up in tax havens included in the current list of relevant countries, and

- over the next five years, no licensing and financing fees or insurance premiums in the corporate group would be transferred to companies or permanent establishments located in tax havens included in the current list of relevant countries.

The current list of relevant countries can be found on the BMF's website at: www.bundesfinanzministerium.de/steueroasenliste.

It comprises the tax jurisdictions included in the EU Blacklist and jurisdictions with a nominal income tax rate of lower than 9 percent.

IV. Application guidance

Potentially affected taxpayers should keep abreast of developments concerning (tax) measures against non-cooperative tax jurisdictions. The matter at hand is further complicated by the fact that different lists – the EU Blacklist, the EU Greylist, the THDO, the list of DAC6 countries, and the list of bridging assistance countries – need to be monitored depending on the extent to which the respective party is affected. Developments should be integrated into the existing compliance systems. Taxpayers should currently be examining how Russia's inclusion in particular impacts the aforementioned areas, i.e. the THDA, DAC6, public CbCR and coronavirus bridging assistance.

V. Ideally positioned for you

Take advantage of fully integrated, hand-in-hand advice from our tax experts, Corporate and International Tax, as well as the lawyers of KPMG Law Rechtsanwaltsgesellschaft mbH specializing in procedural law. Together, we can help you to avoid or eliminate risks efficiently and in line with the legal requirements.

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