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German Tax and Legal News

MOF publishes draft law proposal to implement anti-avoidance measures in relation to noncooperative jurisdictions

Deduction for payments to recipients in jurisdictions on EU “black list” may be denied, among other measures.

The German Ministry of Finance (MOF) published a draft law proposal on 15 February 2021 regarding the implementation of anti-tax avoidance measures and additional documentation requirements in relation to certain jurisdictions on annex I of the [EU list of noncooperative jurisdictions for tax purposes](#) (i.e., the EU “black list”). The draft “Tax haven defense act” is a response to the European Council’s guidelines issued at the end of 2019 encouraging all EU member states to implement legislative measures designed to impose specific penalties on jurisdictions placed on the EU black list (“defensive measures”), and it is noteworthy that the defensive measures proposed in the German draft law are more extensive than the minimum that is required under the guidelines.

Under the guidelines, EU member states must apply at least one of the following tax measures with respect to jurisdictions on the EU black list:

- Controlled foreign corporation (CFC) rules;
- Expense deduction limitations or disallowance;
- Limitation of any participation exemption on profit distributions; or
- Withholding taxes.

The draft law proposal published by the MOF aims to implement each of these types of measures into German domestic law. Once implemented, the rules generally would be applicable as from 1 January 2022 with regard to countries that are on the EU black list on 1 January 2021; for countries that are added to the EU black list at a later date, the rules would apply as from 1 January 2023.

Noncooperative jurisdictions

For the defensive measures to be applicable, a German taxpayer would have to engage in a business transaction related to a noncooperative jurisdiction. A noncooperative jurisdiction for purposes of the German defensive measures would be defined as a jurisdiction that is listed on the EU black list if, in addition, the jurisdiction:

- Does not provide for sufficient tax transparency;
- Is engaged in unfair tax competition; or
- Does not fulfill certain minimum standards, as provided under the October 2015 final reports relating to the [OECD/G20 BEPS project](#).

A jurisdiction that does not provide for sufficient tax transparency would be defined as a jurisdiction that:

- Does not participate in the automatic exchange of information (AEOI) regarding financial accounts with Germany and all other EU member states based on the [Common Reporting Standard](#) (CRS);
- Has not sufficiently implemented the OECD standard for transparency and the effective exchange of information upon request; or
- Has not ratified or acceded to the 1988 [Multilateral Convention on Mutual Administrative Assistance in Tax Matters](#), as amended by the 2010 protocol; however, for tax jurisdictions with limited sovereignty, it would be sufficient if the tax jurisdiction provides for an effective exchange of information upon request and the AEOI with Germany and all other EU member states based on other agreements.

A jurisdiction that is engaged in unfair tax competition would be defined as a jurisdiction that applies tax measures—including legal measures, administrative guidance, and administrative practices—that provide for a significantly lower effective level of taxation (including zero taxation) than the level that generally applies in the jurisdiction in question.

Such measures, in particular, would qualify as unfair tax competition under the following circumstances:

- Tax advantages are granted only to nonresidents or in respect of transactions carried out with nonresidents;
- Tax advantages are “ring-fenced” from the domestic market, so they do not affect the national tax base;
- Tax advantages are granted even for taxpayers without a real economic activity and a substantial economic presence in the jurisdiction offering the tax advantage;
- The rules for determination of profits in respect of activities within a multinational group of companies depart from internationally accepted principles, notably, the rules agreed upon at the OECD level; or
- The tax measures lack transparency, in particular, where such measures are unpredictable or insufficiently documented, including where legal provisions are relaxed at an administrative level to achieve advantages that are not provided by the law.

In the case of a tax jurisdiction with no corporate income tax regime or a corporate income tax regime with a tax rate of zero (or near zero), stricter rules would apply.

A jurisdiction would be considered not to have fulfilled certain minimum standards as provided under the final OECD BEPS reports in a case where it has not implemented the minimum standards described in the reports for [action 5](#) (“Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance”), [action 6](#) (“Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”), [action 13](#) (“Transfer Pricing Documentation and Country-by-Country Reporting”), and [action 14](#) (“Making Dispute Resolution Mechanisms More Effective”). A jurisdiction also could be considered as being noncooperative based on a failure to fulfill minimum standards in a case where it does not provide for a mechanism to exchange country-by-country (CbC) reports with Germany and all other EU member states or if its rules deviate significantly from the minimum standard described in the OECD report for action 13 with regard to confidentiality, data protection, and the appropriate use and timely and sufficient exchange of CbC reports.

As mentioned above, in addition to having a basis for considering a jurisdiction to be noncooperative (insufficient transparency, engagement in unfair tax competition, or failure to fulfill minimum standards), the relevant jurisdiction would have to be included on the EU black list for defensive measures to apply. The draft law proposal authorizes the German tax authorities to publish their own black list based on the criteria described above; however, the list would have to mirror the black list at an EU level and the German tax authorities would not have the ability to deviate from the EU black list.

Defensive measures

The draft law proposal includes all four types of defensive measures provided for in the European Council’s guidelines, even though the guidelines provide an obligation for EU member states to implement only one of these types of measures. The defensive measures provided for in the draft law proposal are the following:

- Payments to recipients that are resident in a noncooperative jurisdiction would be nondeductible for German tax purposes;
- Significantly tightened CFC rules would apply for German taxpayers that directly or indirectly hold shares in a company that is resident in a noncooperative tax jurisdiction;
- Reduced or zero percent withholding tax rates based on an applicable tax treaty or unilateral relief would not apply for payments to a recipient that is resident in a noncooperative tax jurisdiction, and the domestic German withholding tax rate would be the final rate; and
- The German domestic participation exemption rules or an exemption based on an applicable tax treaty would not apply for dividends from a subsidiary or gains from the sale of shares in a subsidiary if the subsidiary is resident in a noncooperative jurisdiction.

Documentation requirements

In addition to the defensive measures described above, the draft law proposal includes extensive documentation requirements for business transactions related to a noncooperative jurisdiction. Noncompliance with these documentation requirements would trigger a penalty of the higher of EUR 20,000 or 10% of the additional income

triggered by the rules.

The draft law proposal also includes expanded information and documentation rules for account holders with a German domestic financial institution.

Next steps and additional comments

The draft law proposal still must be approved by the government and then must go through the formal legislative procedure. There is no information currently available regarding the anticipated timing.

The draft law proposal would give practical effect in Germany to inclusion on the EU black list and would introduce efficient tax measures for dealings with noncooperative jurisdictions that are on the EU black list. The impact of such measures may be limited at the moment, as the 12 jurisdictions that currently are on the list (American Samoa, Anguilla, Barbados, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands, and Vanuatu) generally have limited significance with respect to structures of multinational enterprises; however, the introduction of defensive measures at the level of individual EU member states makes the EU's actions more significant when it comes to the future composition of the list and the monitoring process. The EU black list is updated twice a year; the next update is due on 17 February 2021. In this regard, it should be noted that the EU member states agreed not to include Turkey on the updated EU black list, although some EU member states have claimed that Turkey has not been complying with its obligations to exchange financial information. This example, however, indicates that a future update could increase the significance of the EU black list.

Based on the consensus at the level of the EU member states to implement local country defensive measures to support the black list, the German draft law proposal should not come as a surprise; however, the approach taken by the MOF includes certain points that are noteworthy:

- The draft law proposal defines noncooperative tax jurisdictions by imposing additional conditions beyond simply being a jurisdiction on the EU black list. However, most of the additional conditions are in line with the risk indicators that are used by the EU in the “scoreboarding” process for the black list, so it seems to be unlikely that a jurisdiction that is on the EU black list would not fulfill at least one of the additional conditions to be treated as a noncooperative tax jurisdiction in Germany.
 - The proposed defensive measures go beyond the obligation as agreed on at an EU level: rather than simply implementing one type of defensive measure, the draft law proposal includes all types of defensive measures provided for in the European Council's guidelines. However, as noted above, the practical relevance of this approach seems to be rather limited at the moment, based on the jurisdictions included on the current version of the list.
 - The proposed imposition of rather onerous documentation and information-related obligations for taxpayers that are engaged in business transactions with noncooperative jurisdictions deserves particular consideration, as noncompliance would trigger a hefty penalty.
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