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Tax Haven Defense Act

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On February 14, 2023, the Council of the European Union amended the EU list of non-cooperative jurisdictions for tax purposes (the so-called EU blacklist) making it more relevant, in particular by adding Russia. Once adopted in the Tax Haven Defense Ordinance the EU blacklist is the foundation for the various defense measures implemented in the Tax Haven Defense Act ("Steueroasenabwehrgesetz").

Background and Scope

The Tax Haven Defense Act, also known as the Combating Tax Havens Act, aims to change the behavior of jurisdictions that are deemed to be non-compliant with international tax standards by discouraging individuals and companies from doing business in the non-cooperative jurisdictions.

To achieve this goal, the scope of the Tax Haven Defense Act is very broad. Thus, the Tax Haven Defense Act applies to all individuals, corporations, but also associations of persons (e.g. cooperatives) and trusts. Partnerships also fall within the scope of the Tax Haven Defense Act.

The Tax Haven Defense Act generally applies to all taxes, including tax refunds that are subject to German federal law or European law and are administered by federal, state or local authorities, in particular (corporate) income tax and trade tax. Specifically excluded are VAT, including import VAT, and import and export duties, and excise duties.

The defense measures under the Tax Haven Defense Act apply whenever a taxpayer maintains business relations or investments in or with reference to a non-cooperative jurisdiction. A jurisdictions is considered to be non-cooperative if the state is listed in the tax haven defense ordinance which is based on the EU blacklist.

Defensive Measures

First of all, the Tax Haven Defense Act does not only provide for a **treaty override** for the defensive measures; rather, German taxation rights are not affected by double tax treaties with non-cooperative jurisdictions as long as the defensive measures apply.

Furthermore, **business expenses** from business transactions with individuals or companies resident in non-cooperative jurisdictions are **non-deductible**. Unless the corresponding income is subject to unlimited or limited taxation in Germany or CFC taxation in Germany.

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Moreover, the **CFC-Rules** are enhanced for companies resident in non-cooperative jurisdictions under national control. Under the stricter CFC rules, both active and passive income are relevant. The motive test and the exemption limit do not apply. For a permanent establishment or partnership in a non-cooperative jurisdiction the Switch-Over-Clause of Sec. 20 para. 2 FTA ("Foreign Tax Act") applies accordingly.

In addition, the nonresident tax liability is extended to income from financing activities, insurance or reinsurance services, other services or trade in goods or services, and royalties or capital gains on rights entered in a German register. Such income is subject to **15.825 % WHT** (incl. solidarity surcharge).

Furthermore, dividends or capital gains of corporations resident in a non-cooperative jurisdiction are generally **not tax exempt under the participation exemption** acc. Sec. 8b para. 1 CITA ("Corporate Income Tax Act") or similar provisions in double tax treaties. However, in order to avoid double taxation, the participation exemption applies if the dividends result from income that has already been subject to WHT or if the deduction of expenses has already been denied.

Last but not least, the Tax Haven Defense Act increases the **cooperation obligations**. The taxpayer must keep the following records and submit them to the tax authorities within one year of the end of the fiscal year: a description of business relationships, contracts, a list of agreements concerning intangible assets, the functions performed and risks assumed, the main assets used, the business strategies chosen, any market- and competition-related circumstances, all individuals that are directly or indirectly shareholders of the company in a non-cooperative jurisdiction.

An English version of the Tax Haven Defense Act can be found here.

Amendment of the EU blacklist

Recently the EU Council updated the EU blacklist by adding the British Virgin Islands, Costa Rica, the Marshall Islands, and most importantly, Russia. The EU blacklist now consists of 16 jurisdictions. In addition to the four already mentioned, American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands and Vanuatu are on the list.

If the amendments to the EU blacklist are adopted in the Tax Haven Ordinance in 2023, as expected, the defensive measures of the Tax Haven Defense Act will generally apply to the newly added jurisdictions as of 2024 (a different timing may apply if the fiscal year differs from

the calendar year). However, the denial of the tax exemption for dividends and capital gains of a corporation resident in a non-cooperative tax jurisdiction would be deferred to 2026. The denial of business expenses from business transactions with residents of non-cooperative jurisdictions would apply beginning 2027.

The EU blacklist is also relevant for reporting obligations under the EU's mandatory disclosure rules (MDR/DAC 6), as cross-border arrangements must be reported if they involve deductible payments to a recipient resident in a blacklisted jurisdiction. In addition, the current draft of the public CbCR contains additional disclosure requirements for blacklisted jurisdictions icompared to other third countries.

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