The German Anti-Tax Haven Law[1]

- Description and Critical Notes -

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This law proposal, if implemented, would change dramatically the way Secrecy Jurisdictions could be used by those living in Germany. At the same time, however, it is in some respects weaker than comparable foreign legislation and leaves many substantial questions to be determined by governmental ordinances.

This commentary is divided in two sections. The first section (A) describes the legal innovations and the second section (B) critically appraises them.

A Description

The Anti-Tax-Haven Law would work in three ways:

1) Some features of the German (double) tax regime that are advantageous to international investors are going to be removed under certain conditions;
2) There are enhanced obligations to retain information and increased powers of the tax authorities to ask for information;
3) Customs authorities will enjoy broader powers to search for and enquire about bulk cash found at the borders.

1. Tax regime for international investors

The income tax act and the corporate tax law will be changed. All of the changes mentioned below contain an element of discretion left to the government. This is because it must trigger and specify the disallowances (and their extent) through ordinances in order for the changes to become effective. The Upper House (Bundesrat) must consent to each of the measures. The measures are all targeted at and may only apply to those jurisdictions that have not entered into information exchange mechanisms as specified by Article 26 of the OECD Model Convention of 2005. This Article 26 provides for information exchanged upon request (Rixen 2008: 75). The corresponding list of jurisdictions needs to be drawn up.

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[1] This work is based on the draft version of the German Anti-Tax-Haven Law (Version of 13 January 2009, 15:04); see http://www.bundesfinanzministerium.de/nn_82/DE/BMF__Startseite/Aktuelles/Aktuelle__Gesetze/Referentenentwuerfe/Ref__Steueroasen__anl,templateId=raw,property=publicationFile.pdf (22.1.2009).

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[3] The opinions reflect those of the Tax Justice Network International Secretariat and not necessarily those of all Tax Justice Network affiliate organisations.

a) Individuals will not be allowed to claim tax relief in Germany on payments to persons in the targeted territories [Art. 1 f)].

b) Foreign companies will no longer receive advantageous tax treatment through lower withholding tax rates as provided for in double tax agreements if any of its owners (both individual and corporate) are resident in one of the targeted territories. This is effectively a 'look-through' provision that requires access on ownership information that is currently not readily available to the German tax authorities [Art. 1 g)].

c) Passive income (at least dividends) remitted from an entity incorporated in any of these jurisdictions is going to be taxed at the (higher) personal income tax rate instead of the recently introduced flat tax rate on capital income and capital gains of 25% or the arrangements where only 60% of the taxable income is taxed (at personal income tax rates[4]). Instead tax will be payable on all the income if the paying agent is resident in a targeted tax haven. [Art. 1 h)].

d) The tax relief granted under many bilateral double tax agreements for dividends and capital gains paid to a German joint-stock or limited liability company is cancelled if the paying agent is located in one of the targeted countries. [Art. 2 e)].

In each case these measures are intended to make it unattractive to locate funds in tax havens.

2. Information retention and powers of tax authority

For the following changes, the "Abgabenordnung" (AO) is going to be amended. The AO is the general enforcement code for tax authorities. The proposed changes would become effective in 2010.

a) If the tax authority believes that a taxpayer might be maintaining economic relations with a financial institution (bank) from a targeted jurisdiction then the tax authority will be entitled to send that individual a standard questionnaire. The taxpayer will be required to fill out this form detailing the nature of the business relationship. The tax authority may require the taxpayer to give this information as an affidavit. The maximum penalty for non-compliance with the information regime will be €5000. Secondly, the taxpayer will be required to instruct the respective financial institution(s) to waive its confidentiality vis-à-vis enquiries by the German tax authority concerning her/his account. If the taxpayer fails to instruct his bank(s) as requested, the tax authority will be authorised to estimate the hidden income and assess it to tax. Furthermore, any failure to cooperate will entitle the tax authority to undertake onsite inspection (see point (c) below) [Art. 3, Phrase 3, 5, 6; and Art. 4].

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[4] The 60%-rule applies if: a) Dividends and capital gains do not add to private (=individual) wealth but to the equity of an enterprise instead (partnerships or self-employed); b) in case of dividends and if the individual recipient owns above a certain threshold of this company (voluntary); c) capital gains if the individual recipient owns more than 1% of the shares.

b) Individuals with an annual income exceeding €500.000 will be required to keep accounting records and supporting evidence of income and costs for 6 years. The same requirement is created for those refusing to fill in the form about foreign bank accounts (as mentioned above) [Art. 3, Phrase 4].

c) The tax authority is given increased powers to undertake onsite inspections of individuals with an annual income exceeding €500.000 or of those individuals that fail to answer targeted requests for additional information issued by the tax authorities (see point (a) above) [Art. 3, Phrase 6 a) and b)].

3. Customs

Customs is to be given the task of checking bulk cash found at the borders, not only for terrorist financing and money laundering, but of checking this cash also for tax offences and social security fraud. Customs will be entitled to confiscate any additional information and supporting evidence (e.g. account statements) and to forward these to the relevant tax authorities.

B Comments – Critique

1. Tax regime for international investors

In general information exchange upon request as included in the OECD Model Convention of 2005 (Art. 26) poses problems and is limited in scope. This limits the scope of the proposed reforms because to succeed an Article 26 request potentially requires a significant amount of prior information that is seldom available (Rixen 2008: 75) and opens doors for discretionary treatment of requests by foreign tax authorities (Spencer 2005). Ideally, automatic information exchange with a broad range of data should be the applicable standard.

A second problem arises out of the aforementioned weaknesses of the provisions of Article 26 OECD MC. If the formal adherence to and bilateral applicability of this Article 26 is a necessary condition for enforcing most of the proposed measures, a risk arises in cases in which notorious secrecy jurisdictions and tax havens do have Article 26 provisions with Germany in place. It should be expected that in such cases formal adherence to the OECD Article 26 standard (information exchange upon request) is too narrow to provide for timely and effective information exchange. Therefore, the Ministry of Finance should make sure that the measures can be targeted at some jurisdictions irrespective of them formally adhering to Article 26 unilaterally or in bilateral provisions with Germany. As a suggestion as to which jurisdictions to include, the Ministry of Finance might want to look at the review process of the EU-Savings Directive and the proposal submitted by Tax Research LLP during this review process (see Annex 1 for this list).

In any case (including automatic information exchange), all tax information exchange mechanisms require a strong monitoring regime, if possible by an internationally oriented institution composed of both governmental and civil society experts and groups. This regime should provide for a public and ongoing review process of the frequency, circumstances and results of such information exchange provisions in order to implement, facilitate and enforce effective

information exchange. Appropriate fora might be the UN-Committee of Experts on International Cooperation in Tax Matters (or another agency at the UN-ECOSOC), the Initiative for an International Tax Compact and the Task Force on Financial Integrity and Economic Development.

a) Although it is true that refusing tax relief for expenses paid to targeted states does not improve any situation in which no income or payment is reported at all, it is clear that the deductibility of such payments is easily abused, especially by self-employed persons. However, even if such payments (for whatever services provided) would be no longer tax deductible, it would be important to clarify what sort of treatment the future stream of income of these assets would receive under German tax laws. It is likely that many companies in these secrecy jurisdictions are actually beneficially owned by the same German resident person that claims the tax relief. In that case, it would be important for the tax authorities to record these outflows to establish a firm basis for future lawsuits. If there are significant and ongoing transfers of funds to any of the targeted jurisdictions, the tax authority should be mandated to undertake additional enquiries. For instance, the taxpayer could be sent a form requiring him to state as an affidavit that she is not the ultimate beneficial owner of any legal entity in this jurisdiction. The proposed anti-tax haven legislation in the US (Stop Tax Havens Abuse Act, STHAA) requires the US-taxpayer under similar circumstances to prove to the IRS that he does not own any legal entity formed in this targeted jurisdiction. It could significantly reduce political and administrative cost if the German Ministry of Finance coordinated early on with their US-counterpart on the technical and administrative details of implementation.

b) It is not clear how the German tax authorities would collect the corresponding ownership information to ensure that the provisions noted in paragraph A1(b) could be enforced. Correspondingly, it is not clear what happens if the foreign company for some reason fails to report ultimate beneficial ownership. Failure to report ownership information should automatically trigger higher withholding tax rates than agreed upon in double tax treaties. This can be justified on grounds of the same assumption indicated above (1a) that the ultimate beneficial owner of this company can be expected to be a German tax resident. However, if this assumption is going to be taken, it would follow that it is reasonable to tighten this measure and not only apply a 20% withholding tax rate (instead of lower bilateral provisions), but to increase the withholding tax rate until reaching the top personal income tax rate (45%). Furthermore, it is not clear to the author if interest and royalties are included in the provisions noted in paragraph A1(b). If they are not in the law as currently drafted then it would be important to amend this to include them.

c) It is not clear to the author if interest and royalties are included in the provisions noted in paragraph 1(c). If they are not in the law as currently drafted then it would be important to amend this to include them.

d) Again it is not clear to the author if interest and royalties are included in the provisions noted in paragraph 1(d). If this was true, it would be important to include them.

2. Information retention and powers of tax authority

Apart from some specific problems arising here, there is a general problem with enforcement and tax administration that needs mentioning. It is notorious that many tax authorities and specialist prosecutorial departments in some German "Bundesländer" lack sufficient staff or independence from political interference[5] for ongoing investigations. Under these conditions it can be hardly expected that tax authorities will be able to make widespread use of newly conferred powers. While tax administration and collection is delegated to the "Länder" and thus staffing policy cannot be directly influenced by the Ministry of Finance, it could be worth for the Ministry of Finance to deliberate on any other solutions to prevent "harmful tax enforcement competition" within Germany. If an agreement among "Länder" on minimum staffing and performance requirements of tax authorities was reached, the equity of taxation in Germany could be enhanced.

a) First, it is not clear on what grounds the tax authority may require that a person fill out a form in the first place. Although the law seems to give enough flexibility to the tax authority ("if there is enough reason for presuming on the grounds of general experiences or concrete evidence…") it could be useful to introduce a negative formulation ("prior concrete evidence is not necessary"). Second, it is not clear why the taxpayer would fill out the form on foreign bank accounts in the first place. The tax authority is only entitled to estimate the hidden income for tax purposes if the taxpayer has already stated that he has a bank account on the form but then fails to instruct its bank to lift secrecy. Although these enhanced tax payments might face challenge in the courts, the tax authorities look to be on safe ground as the existence of the account has already been agreed. However, assuming that the taxpayer wishes to evade tax, she still has the choice of either not answering at all and not giving an affidavit (for which she faces €5000 penalty and potentially an onsite inspection and) or she might give a false affidavit. This certainly increases pressure and raises the awareness that what he is doing may be illegal but it is unclear what further power the tax authority has in that case. Unilaterally, there is not much more leverage available to incentivize the taxpayer to put his accounts on record.

b) It is not clear what additional obligations this requirement creates. When looking at §147 of the AO, it seems as if the general record keeping obligation amounts to between six and ten years anyway. However, the novelty might be that individuals are required to keep such records whereas beforehand it might have been applicable only to businesses.

3. Customs

The power to confiscate and forward supporting information such as bank statements with regard to tax offences is potentially a powerful tool if taken together with the other increased powers of the tax authorities. It does however assume that people still smuggle money and it is not at all clear that this is commonplace.

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[5] http://taxjustice.blogspot.com/2008/12/trouble-in-liechtenstein-case.html (28.1.2009); http://www.stern.de/politik/deutschland/:Steuerfahndung-Frankfurt-Eiskalt/649420.html (28.1.2009).

Sources

Rixen, Thomas 2008: The Political Economy of International Tax Governance, Basingstoke.

Spencer, David 2005: Automatic exchange of tax information, in: Tax Justice Focus 1: 4, 8-10.

Annex 1

List of jurisdictions outside the territorial scope of the EU-Savings Directive that should be targeted by unilateral action irrespective of them having Article 26 OECD MC information exchange provisions in place (List by Tax Research LLP).

- Anjouan
- Antigua and Barbuda
- The Bahamas
- Bahrain
- Barbados
- Belize
- Bermuda
- Brunei
- Canada
- Cook Islands
- Costa Rica
- Djibouti
- Dubai (UAE)
- Dominica
- Fiji
- French Polynesia
- Ghana
- Grenada
- Guam
- Guatemala
- Hong Kong (China)
- Kiribati
- Labuan (Malaysia)
- Lebanon
- Liberia
- Macao (China)
- Macedonia
- Maldives
- Montenegro
- Northern Marianas Islands
- Marshall Islands
- Mauritius
- Micronesia

- Nauru
- New Caledonia
- New Zealand
- Niue
- Panama
- Palau
- Philippines
- Puerto Rico
- Ras Al Khaimah (UAE)
- Saint Kitts and Nevis
- Saint Lucia
- Saint Vincent and the Grenadine
- Samoa
- Sao Tome e Principe
- Seychelles
- Singapore
- Solomon Islands
- Somalia
- South Africa
- Tonga
- Tuvalu
- United Arab Emirates
- United States of America (Delaware)
- US Virgin Islands
- Uruguay
- Vanuatu