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Enhanced Transfer Pricing Documentation Requirements for Transactions Involving Non-Cooperative Tax Jurisdictions

The Anti-Tax Havens Act contains a number of defensive measures regarding business transactions involving uncooperative states. As of 1 January 2022, among other requirements, the taxpayer has to carry out certain enhanced transfer pricing documentation conditions in such business transactions. Specifically, this means transfer pricing documentation must be submitted at a particularly early stage and must also include transactions with third parties.

1. Background and Objectives of the Tax Haven Defence Act

The Act on the Prevention of Tax Avoidance and Unfair Tax Competition (hereinafter the Anti-Tax Havens Act or StAbwG) was enacted on 30 June 2021 and has been in force since 1 January 2022. Built on the Council of the European Union's conclusions on the EU list of non-cooperative jurisdictions and territories for tax purposes (known as "black listed" jurisdictions), as well as the measures negotiated since then by the Code of Conduct Group (Business Taxation) and later approved by the Council of the European Union, the Anti-Tax Havens Act stipulates counter-measures that apply in relation to tax jurisdictions that are included in the EU list of non-cooperative tax jurisdictions. EU Member States have agreed to implement the conclusions of the Council of the European Union on the EU list of non-cooperative countries and territories for tax purposes by 1 July 2021 at the latest. These counter-measures serve to pursue a coordinated approach among EU Member States and protect the internal market by ensuring that all EU Member States implement effective defensive measures and thus establish a minimum level of tax protection.[1] The aim is to encourage third countries to make adjustments to implement and comply with international standards in the tax area. To this end, German taxpayers should be "deterred through targeted administrative and substantive tax measures from continuing or entering into business relations with"[2] the non-cooperative tax jurisdictions on the EU list.

Under section 7, sentence 1 of the StAbwG, the defence measures provided for in the StAbwG are based on the existence of business transactions (business relationships and shareholding relationships) that German taxpayers maintain with persons who are resident in a non-cooperative tax jurisdiction. The decisive criteria for a non-cooperative tax jurisdiction are:

- non-transparency in tax matters within the meaning of section 4(2) of the StAbwG;
- unfair tax competition strategies within the meaning of section 5(2) of the StAbwG; or
- the failure to comply with the mandatory BEPS minimum standards (i.e. BEPS Action 5, 6, 13 and 14) pursuant to section 6(1) of the StAbwG.

The German Federal Ministry of Finance and the German Federal Ministry for Economic Affairs and Energy will issue a statutory order specifying the tax jurisdictions that are non-cooperative when they are included in the EU list of non-cooperative countries and territories for tax purposes published in the Official Journal of the European Union, which is amended from time to time.[3] Such statutory order was issued with the publication of a corresponding decree law (Steueroasen-Abwehrverordnung, StAbwV) in the Federal Law Gazette on 12 December 2021.[4] Accordingly, the relevant non-cooperating tax jurisdictions are determined on the basis of the respective current publication of the European Union.[5] Today, the following third countries are included, of which Panama has the highest practical relevance from the perspective of companies in Germany:

- American Samoa;
- American Virgin Islands
- Fiji;
- Guam;
- Palau;
- Panama;
- Samoa;
- Trinidad and Tobago; and
- Vanuatu.

In respect of time, one should bear in mind that the aforementioned lists are updated at irregular intervals. For preparing the enhanced transfer pricing documentation, the EU list valid at the time of the relevant business year should be used. Probably also for this purpose, according to section 2 of the StAbwV, the dates are also specified in each case from which a tax jurisdiction previously named

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1. *See* draft bill of the Anti-Tax Havens Act of 12 Feb. 2021, p. 16.
2. Draft bill of the Anti-Tax Havens Act of 12 Feb. 2021, p. 1.
3. *See* sec. 3(1) StAbwG.
4. *See* Tax Haven Prevention Ordinance of 20 Dec. 2021, Federal Gazette I 2021, p. 5236.
5. *See* Council Conclusions on the Revised EU List of Non-Cooperative Countries and Territories for Tax Purposes of 26 Feb. 2021, OJ EU 2021 No. C 66/40, Annex I.

as non-cooperative no longer fulfils the requirements of section 2(1) of the StAbwG.

In the following, enhanced transfer pricing documentation requirements under section 12 of the StAbweG are presented and subjected to an initial critical assessment. No further comments are made on what is, in the authors' view, the excessive character of a tax law explicitly intended to prevent German taxpayers from maintaining business relations with certain tax jurisdictions (including developing countries) by means of targeted measures.

2. Overview of Defensive Measures against Uncooperative States

If a German resident or non-resident taxpayer falls within the scope of the Anti-Tax Havens Act, this triggers a series of "defensive measures":

- Section 8 of the StAbwG codifies a comprehensive limitation on the deduction of business expenses. Specifically, expenses from business transactions with uncooperative jurisdictions may not be taken into account for tax purposes. Exceptions apply only if the income corresponding to the expenses is subject to domestic taxation.
- An aggravated CFC taxation applies pursuant to section 9 of the StAbwG. This concerns the case where a German tax resident controls a foreign company in a non-cooperative tax jurisdiction. In these cases, the entire low-taxed income of the foreign company becomes subject to CFC taxation, irrespective of any active-income test, the substance test and the de-minimis rule.
- The counter-measure of section 10 of the StAbwG extends the catalogue of income subject to limited (non-resident) taxation and withholding taxes. This relates to the income of persons resident in a non-cooperative tax jurisdiction derived from financing relationships, insurance benefits, services or trade, which is eligible for deduction of business expenses in the case of a person subject to unlimited (resident) taxation in Germany. Such income is to be subject to withholding taxes of 15%.
- Under section 11 of the StAbwG, profit distributions and sales proceeds that directly or indirectly originate from a corporation domiciled in a non-cooperative tax jurisdiction are not tax exempt but fully subject to tax. This also applies in "pass-through" cases.

In addition, under section 12 of the StAbwG, resident taxpayers, but also taxpayers with limited tax liability, are subject to an enhanced obligation to cooperate in the case of business transactions in relation to non-cooperative tax jurisdictions going beyond the regular transfer pricing documentation requirements. For business relationships or shareholding relationships in or with respect to a non-cooperative tax jurisdiction, enhanced transfer pricing documentation must be prepared, essentially corresponding to "general" documentation requirements of a German Local File. However, the scope of that documentation requirement is much larger (i.e. encompassing third-party transactions). Enhanced documentation must be prepared and submitted to the German tax authorities no later than one year after the end of the relevant calendar year or financial year.

3. Enhanced Transfer Pricing Documentation

3.1. Scope of enhanced documentation requirements

Enhanced transfer pricing documentation requirements apply in principle to all business transactions in or with respect to a non-cooperative tax jurisdiction. In this respect, the question arises as to whether only business transactions concerning related parties and permanent establishments are covered or also those with third parties. There can be no such restriction or differentiation discerned in the Anti-Tax Havens Act. The wording of the law refers solely to the general obligation to cooperate. According to the explanatory memorandum, "enhanced obligations to cooperate [...] are already contained in principle today in Sec. 1 (4) of the Anti-Tax Havens Act," which in fact has not yet been applicable.[6] Under this not-yet-applicable regulation, the taxpayer had to prepare enhanced documentation "for business relations with a foreign country with a person who is not a related person".[7] As a result, this means that enhanced transfer pricing documentation most likely includes any business relations concerning non-cooperative tax jurisdictions. In other words, the documentation must also be prepared for business relationships with third parties.

3.2. Covered information

The enhanced transfer pricing documentation of business transactions with reference to a non-cooperative tax jurisdiction should include detailed information on specific business relationships with other persons (related parties and third parties) and permanent establishments in or with reference to a non-cooperative tax jurisdiction. The description of these business relationships is limited to documenting the facts and circumstances, and includes records on the type (e.g. purchase of goods, licensing, granting of loans), content and scope of the taxpayer's business relationships.

In addition, the contracts and agreed contractual terms on which the business relationships are based must be listed. In this regard, any changes in the course of the documented business year must also be presented. Agreements relating to intangible assets (e.g. licence agreements, cost allocations, R&D agreements) must be listed separately, as must all intangible assets that the taxpayer uses or transfers for use within the scope of the business relationships concerned.

In addition, a function and risk analysis is required, stating the functions performed and risks assumed by the parties involved in the business relationship as well as the material

6. *See* BR-Drucks. 272/2 of 4 Jan. 2021, p. 26.
7. SteuerHBekV of 18 Sept. 2009, BGBl. I 2009, p. 3046.

assets used. Here, too, any changes in the financial year must be shown. Furthermore, the chosen business strategies as well as those market and competitive conditions that are relevant for taxation must be presented.

Finally, those individual persons, direct or indirect partners or shareholders of a company in the non-cooperative tax jurisdiction with which the taxpayer has a business relationship must be named in the sense of "ultimate beneficial owner". An exception occurs if a company is listed on the stock exchange and the shares are traded or admitted to trading in the European Union/European Economic Area.

The scope of these duties to cooperate corresponds in large parts to those of the factual documentation of a German local file.[8] However, the enhanced obligations to cooperate are to be criticized insofar as the required information relates to business relationships with third parties. For example, a domestic taxpayer will not have insight into the intangible assets used by a third-party contracting party, the functions and risks exercised by the third party and its business strategies. Likewise, it cannot necessarily be assumed that the individual persons at the end of a chain of shareholdings of the third-party contracting party are known to the German taxpayer. Thus, German taxpayers seem to run the latent risk of having to violate these duties outright because certain information is simply not available to them. In this context, it is doubtful whether there is a duty to provide evidence in any case. The question is whether the taxpayer should have agreed to be provided with such information when concluding a business transaction (with related parties as well as with third parties). In the authors' opinion, this should be rejected. Nevertheless, it cannot be ruled out that the German tax authorities could adopt a more extensive interpretation in this respect.

3.3. Affirmation in lieu of an oath and power of attorney

The Anti-Tax Havens Act stipulates that the German taxpayer must affirm the correctness and completeness of its information in lieu of an oath upon request by the competent tax authority. In this regard, it should first be noted that the tax authorities already have the option of having the taxpayer affirm the accuracy of facts in lieu of an oath. Nevertheless, it is noteworthy that the newly stipulated request for affirmation in lieu of an oath is not subject to the proviso that other means of ascertaining the truth are not available, are unproductive or involve disproportionate effort. This suggests that the hurdle for the German tax authorities could be set lower in this respect and that the affirmation in lieu of an oath is probably not intended as a "last resort".[9] It is also worth noting that a (false) affirmation in lieu of an oath can have considerable consequences under criminal law.[10]

Furthermore, the German taxpayer must, upon request, authorize the German tax authorities to assert possible claims for information in its name, both out of court and in court, against the persons named by the tax authority with respect to whom business transactions in or with respect to a non-cooperative jurisdiction exist. This duty to cooperate is also noteworthy and underlines the seriousness with which the tax authorities' requirement for information is to be enforced regarding business transactions the taxpayer maintains in or with reference to a non-cooperative tax jurisdiction.

3.4. Timing and frequency of documentation

Enhanced transfer pricing documentation must be submitted by each individual taxpayer who maintains business transactions with a non-cooperative tax jurisdiction. Such documentation must be prepared and submitted to the locally competent tax authority no later than one year after the end of the relevant calendar or business year. In addition, such documentation must be also transmitted to the Federal Central Tax Office in cases where the country-by-country report (CbCR) requirements are met. This probably means that (only) domestic ultimate parent companies that are required to prepare a CbCR must also transmit enhanced documentation to the Federal Central tax Office. In contrast, German subsidiaries "merely" included should not be affected by this obligation.

In practice, this means that, for example, the factual documentation of a German group company with regard to its business relations with a Panamanian company for the fiscal year 2021 must be prepared and submitted by the end of 2022 at the latest. Thus, the obligation to prepare and submit this factual documentation on a regular, annual basis would possibly even have to be fulfilled prior to the submission of the relevant tax returns. The legislator leaves it open whether this deadline of one year can be extended. It is completely open what conclusions the tax authorities expect to draw from this significant tightening of the time limit for submission. After all, the appropriateness of transfer prices is usually discussed together with the local file, which does not have to be submitted in advance, and only in the subsequent tax audit.

3.5. Sanctions for non-compliance

In the case of non-compliance with enhanced transfer pricing documentation, also as regards third-party transactions, by failure to submit documentation at all or to submit documentation in a timely manner, it is rebuttably presumed that income subject to tax in Germany with respect to non-cooperative tax jurisdictions has either not been declared to date but actually exists, or has been declared to date but is actually higher than declared, i.e. there is a shift of burden of proof. Penalty surcharges are also stipulated. The imposition of a penalty surcharge will

8. GAufzV of 12 July 2017, BGBl. I 2017, p. 2367.
9. *See also* Seer, in Tipke/Kruse, sec. 95 Fiscal Code of Germany (AO) marginal number 3 et seq. (as of Feb. 2019); Schuster in H/H/Sp, sec. 95 AO marginal number 26 ff. (as of Aug. 2019).
10. *See* Seer, in Tipke/Kruse, sec. 95 AO marginal number 13 (as of Feb. 2019).

only be waived if the failure to comply with the duty to cooperate appears excusable or the fault is only minor.

4. Conclusion

For many years, there have been international efforts to combat tax avoidance strategies of international shell companies. This involves tightening up substantive tax law, with the aim (among other issues) of safeguarding tax bases and making economic activities in alleged tax havens unattractive. At the same time, regulatory efforts are aimed at encouraging taxpayers to be more transparent about their international business activities. The Anti-Tax Havens Act now focuses on business transactions in certain non-cooperating tax jurisdictions such as Panama. The deduction of business expenses will be restricted, there will be stricter CFC taxation, the obligation to withhold taxes at source will be expanded and the profit distributions and sales proceeds will be fully taxable.

In addition, the German legislator has enacted measures for enhanced transfer pricing documentation, whereby the business activities of a German taxpayer with persons in the non-cooperating tax jurisdictions are to be made transparent to the German tax authorities. Such documentation must be submitted to the German tax authorities no later than one year after the end of the relevant calendar year. The tax authorities may require the taxpayer to make a declaration in lieu of an oath and to authorize the tax authorities comprehensively with regard to the clarification of the facts. This increased obligation to cooperate is most likely not limited to business transactions with related parties but should also concern transactions with third parties.