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## MONEY PAGES

### OFFSHORE MATTERS - Offshore Demystified

#### OFFSHORE TAXATION DEMYSTIFIED, PART 2 OF 2

*By Dr. Ulrich Eder*

##### *What are the Documentation Obligations?*

The anti-offshore legislation provides for the following eight transfer pricing documentation requirements:

1. Nature, content and scope of business relationships.
2. Contracts and agreed contractual arrangements including any later modifications.
3. The usage of intangible assets, disposed by the tax payer or his business partner in connection with the business concerned.
4. The functions exercised and risks assumed by the parties, including later modifications.
5. The assets involved.
6. The business strategy used.
7. The significant market situation and competitive relationship.
8. The ultimate shareholders and beneficiaries of the parties.

These documentation requirements are not applicable, if the total amount of sales and services to a person does not exceed Euro 10,000 in each business year.

All these documentations have to be prepared and delivered promptly. Promptly means prepared within six months of the end of the relevant business year and to be submitted within 30 days of the date on which the authority demands to do so.

#### **Additional Obligations to be Considered**

Business relations with a financial institution in a offshore jurisdictions are a



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further point of attack by the new legislation. The ordinance expects that the tax authorities lodge a claim for information directly against the offshore bank. On request the tax payer is obliged to grant a power of attorney to the tax authorities for all such judicial and extrajudicial measures.

In addition, the new legislation would request that the tax payer signs a sworn declaration that the declared financial income earned through or from offshore banking institutions is complete and correct. It will give the tax payer cold comfort to know that he cannot be punished with penalty payments or prison if he rejects to give such affirmation in lieu of an oath.

In principal, the law requires hard evidence on an existing business relation with an offshore banking institution or at least a clear indication for the existence of a specified relationship with an offshore bank. However, in practice this will be a toothless limitation of the tax authority's proceedings, as soon as the assumed name of a bank is disclosed.

Another question is whether any non-cooperation of the financial institution vis-a-vis German tax authorities would result in sanctions for the tax payer. A bank in a blacklisted country might not be very carefully with respect to the know-your-customer-requirements. As a result, the requested information might be not available for the bank. At least it would be an uphill battle for the German tax authorities to convince a non-cooperative court that the required background information is available.

#### **What are the Sanctions and Downsides?**

As a general rule, any expenditure to offshore countries shall be non-deductible for tax purposes. The wording in the ordinance "in connection with activities" is broad and vague. It would be nothing but fair to allow a deduction at least in cases where it is proven or obvious that the expenditure has been subject to offshore taxation. However, the German government implemented the new legislation with a shoot-to-kill intention and will not listen to such arguments.

Transfer pricing documentation requirements typically result in the possible downside that the fair market price is in the worst case estimated by the tax authorities. However, under the new legislation the tax payer faces the risk that the offshore payments will be fully non-deductible. This means the tax authorities have the power to completely deny the deduction of corresponding expenses. This is the most alarming nature of the beast.

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Another part of the sanction package deals with withholding tax obligations. As a general rule any relief from withholding taxes are denied under the new legislation in case of investments from or through offshore countries.

As last part, the de facto 95% exemption of dividend revenues in a German limited-liability company will not be applicable for offshore dividends. This will make offshore subsidiaries less attractive from the tax planning point of view.

### How to Deal with Anti-offshore Legislation

In a nutshell, what is the overall conclusion after reviewing the new legislation for combating tax evasion? The mouse that roared - or the empire strikes back? The stopping power against effective tax planning seems to be not very impressive.

The new law, enhanced by the new ordinance, has three weak and three strong points: The weakness merely comes from a diplomatic dance than from an ignorance of law and practice.

1. The tax authorities will have to go a long way to fight against constitutional and practical hurdles. Is it really possible to overrule the individual bilateral tax treaties? Is it constitutional to authorize the government - and not the legislator - to specify the black list of offshore countries?

2. The black list is empty and the whole legislation obsolete. The government has the power and authority to name and shame certain offshore jurisdictions independently from the OECD and other G8 countries. However, in a common European market this seems to be non-cooperative with respect to the EU member states.

3. The new legislation does not allow any dragnet operations and, luckily for the tax payer, resigns from the only powerful and effective weapon.

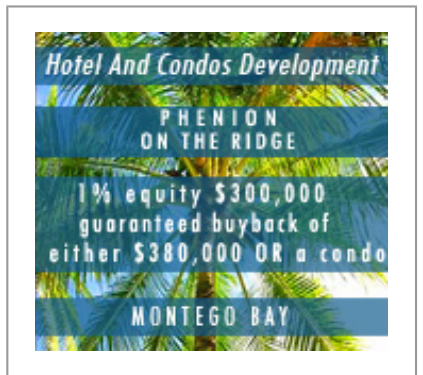
Seeing these deficits it is easy to say that the German legislator brought a knife to a gunfight. However, the other side of the coin is primarily the shoot-to-kill policy of the new legislation. The deductibility of expenses, the relief from withholding obligations and the preservation of tax exemptions will either survive the battle or not. It is a black-or-white approach with no grey areas accepted.

The second aspect is the substantially increased cooperation and retention obligation of the taxpayer. It can be expected that any offshore bank account number disclosed and any other sensitive information leaked, will result in a comprehensive tax audit.

The third and may be most alarming aspect is the fact that the new legislation has not to be qualified as the high-water mark of the anti-offshore initiative. It is merely the starting point for more.

Anyway, tax planning is a precise business. The restrictions and requirements of the OECD model convention, the European and U.S. tax legislation, and the increasing experience of the international tax authorities have to be integrated and implemented in the future cross-border tax structuring and the business relations with Caribbean offshore jurisdictions.

Should you have any questions or if I can provide further information please



don't hesitate to contact me.

**Author : Dr. Ulrich Eder** studied German law at Friedrich-Alexander-Universität in Erlangen, Bavaria and Westfälische-Wilhelms-Universität in Münster, North-Rhine Westphalia. He received his Doctor of Jurisprudence in 1990 from Westfälische-Wilhelms-Universität in Münster. He is a German lawyer (Rechtsanwalt) and a Certified Tax Advisor (Steuerberater).

Over many years, Dr. Eder has advised entrepreneurs and corporations independently and unbiased with respect to tax-driven structures, international tax structuring, cross-border company reorganizations and offshore jurisdictions. In addition, his advice relates to outbound investments, expatriate taxation, and limited and unlimited tax liability. He lives and works in Düsseldorf, Germany and Bangkok, Thailand. Phone: 0049.2112481800

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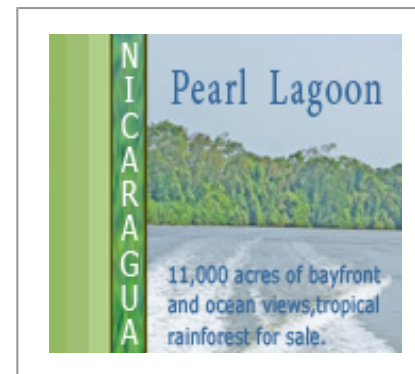
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