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**MONEY PAGES**

**OFFSHORE MATTERS - Offshore Demystified**

**OFFSHORE TAXATION DEMYSTIFIED, PART 1 OF 2**  
**By Dr. Ulrich Eder**

"Basically, if fewer smart thirty-something's, educated in business and law schools and fluent in five languages, were engaged to pour over German tax legislation and amendments with a fine-tooth comb in order to find ways of avoiding tax, if this did not happen, then I could reduce tax rates." (Germany's Minister of Finance, Peer Steinbrueck, in a speech on a tax conference in September 2009).

**A FRIENDLY WORD**

Convinced by strong economic pressure of the G8-countries and a clever exploitation of the recent financial, political and religious disruptions, the Caribbean offshore countries could not resist to "be committed to international standards of anti-money laundering legislation and practice, counter terrorist financing legislation and financial regulation and international efforts to combat financial crimes."

As a result, the black list of uncooperative tax havens is currently empty. All 84 Caribbean and non-Caribbean jurisdictions on the radar screen of the OECD agreed to implement the standard.

However, the OECD regularly updates which tax havens and other jurisdictions implemented them and which are in delay, although they agreed to the standards. The later ones will be good candidates for a new black list. The OECD's viewpoint is obvious: A friendly word and a gun will get you a lot further than a friendly word alone.

The OECD itself has no power to implement sanctions against any blacklisted country. However, its member states have already opened and shown their toolbox of countermeasures.

Typically, they have three options: First, the tax environment for blacklisted countries can be damaged by changes in the domestic tax laws of OECD member states. Second, a review, repeal and/or refusal of bilateral tax treaties may occur. As a third measure, aggressive tax audits and non-tax measures like an embargo, the cancellation of free trade agreements or punitive tariffs and customs might frighten and discipline offshore jurisdictions.



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The future of the Caribbean offshore business depends on the ability to revaluation, adjustment and assimilation. The coming years will see winners and losers in the Caribbean offshore arena. Therefore, it is essential to be prepared for the next moves.

Case study: The German Anti-offshore Legislation

Although the black list is empty, Germany continues to combat offshore jurisdictions by tough new legislations and new black list mechanisms. Tax experts and oppositional politicians pointed out, that this new legislation is therefore untimely, redundant and unnecessary.

In spite of massive criticism, the government made it clear that from their viewpoint there is a need for such regulations until the promises of the gray list states are kept and the respective information exchange agreements are concluded. Otherwise, the intention to prevent tax evasion resulting from an insufficient tax information exchange cannot be fulfilled.

The new German legislation might provide for an excellent lesson how an implementation of the OECD's strategy will work in other G8 states as well. It is coming soon to legislation near you.

The "Act for Combating Tax Evasion" ("Steuerhinterziehungsbekämpfungsgesetz") modifies the basic tax laws of Germany. These are, above all, the Income Tax Law, the Corporation Income Tax Law and the Fiscal Code.

In September 2009, the Federal Government enacted an implementing ordinance ("Steuerhinterziehungsbekämpfungsverordnung") which aims to clarify how the taxpayer has to implement the new law in his business dealings. Generally the new legislation will be applicable for the first time in the tax year 2010.

From a constitutional point of view it is doubtful whether the ordinance is legally valid. It shifts accountability for the legislative enactment procedure from the parliament to the executive bodies.

Under generally accepted constitutional principles an ordinance made by the executive is null and void, if the underlying law does not define the content, purpose and scope of the ordinance in detail. Tax lawyers are currently in a wait-and-see mode for the outcome of the case. However, no one should expect that the ordinance will be rejected by the German constitutional court in later years retroactively.

It is the basic concept of the new legislation to impose sanction on the tax payer, if he enters into business relationships with specific jurisdictions and does not comply with specific duties. Both conditions have to be met before any negative tax effect occurs.

It is a trivialization and belittlement to argue, that just some tax benefits are denied. These measures, including a shoot-to-kill policy, result in tough sanctions and a substantial economic downside for any offshore legislation affected.

#### **Area of Application**

The legislation is applicable to all German tax payers with cross-border business relations to offshore countries. This includes individuals as well as corporations. The same rules apply for offshore entities with a permanent establishment in Germany and for German taxpayers maintaining a permanent establishment in





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the offshore country.

The law excludes "cooperative" offshore jurisdictions from its area of application. It is decisive whether the offshore business entity is resident in a foreign country with a tax treaty in line with article 26 OECD Model Convention.

Article 26 of the OECD Model Convention provides the most widely legal basis for bilateral exchange of information for tax purposes. It creates an obligation to exchange information that is foresee-ably relevant not only to the correct application of a tax convention but also for general purposes of the administration and enforcement of domestic tax laws of the contracting states.

Article 26 was updated in July 2005, at which time additional paragraphs were added. These paragraphs make it clear that a state cannot refuse a request for information solely because it has no domestic tax interest in the information or solely because it is held by a bank or other financial institution.

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If no such tax treaty exists or the tax treaty deviates from this OECD standard, it is sufficient that the country typically provides information in a type and scope comparable with the OECD Model Convention.

Even if it is not yet the common practice to provide information, the law sees it as sufficient, that the country is willing to do so. Reviewing the legislative history and introductory statement shows that timely measures of the offshore legislations to introduce this OECD standard are required.

From a practical point of view there are three options. Either there has to be a qualified clause in a tax treaty or tax information exchange agreement ("TIEA"), or it has to be the common practice without having the qualified tax clause. Or, as a third possibility, the country has to be ready to follow this practice by implementing article 26 soon.

In practice it cannot be expected that the area of application of the anti-offshore legislation will be determined on a case-to-case basis. Instead the German government, respectively the Federal Ministry of Finance will publish a list and request each local tax office to follow this guideline. The list will contain three categories.

1. First, the countries which entered into a tax treaty in conformity with the OECD Model Convention.
2. Second, a list of countries which follow the wishes of the OECD without having formally a clause similar to article 26.
3. At third, the list will contain the countries which are at least willing to cooperate.

The list will be reviewed and updated on an irregular basis. Germany's tax lawyers are already familiar with such countries' lists, for example with respect to the cross-border VAT refund procedure.

It should be noted that the regular tax rate of the offshore country will have no impact on the applicability of the new legislation. The willingness to exchange tax information is the only criterion.

Part 2 of this column continues next month.




**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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