Deloitte.

URL: http://www.deloitte-tax-news.de/german-tax-legal-news/eu-adds-russia-to-the-list-of-non-cooperative-jurisdictions.html

02.03.2023

German Tax and Legal News

EU adds Russia to the list of non-cooperative jurisdictions

The addition of Russia might trigger significant German tax consequences starting from 2024.

On 14 February 2023, the EU added four new jurisdictions to annex I of the list of noncooperative jurisdictions for tax purposes: British Virgin Islands, Costa Rica, Marshall Islands, and Russia. Since the EU list was first published in December 2017, it has been subject to several updates, and annex I now consists of the following 16 jurisdictions: American Samoa, Anguilla, Bahamas, British Virgin Islands, Costa Rica, Fiji, Guam, Marshall Islands, Palau, Panama, Russia, Samoa, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands, and Vanuatu.

The EU list functions as a tool to improve tax good governance globally and to promote the EU's tax governance standards and values to other jurisdictions. Jurisdictions are assessed against criteria that relate to transparency, fair taxation, and implementation of the OECD's BEPS measures.

At the EU level, member states must implement into domestic law various tax and non-tax measures regarding jurisdictions included on annex I. The German Tax Haven Defense Act, which was implemented in 2021, is designed to impose specific penalties on jurisdictions included on annex I. When jurisdictions are newly added to annex I, the German list of noncooperative jurisdictions is updated (usually on an annual basis) for purposes of the Tax Haven Defense Act. The penalties apply to such jurisdictions generally in the year following the year the German list is updated (although some penalties apply in the third and fourth years following the year the German list is updated). As such, it is expected that the next update (likely at the end of 2023) will include the four jurisdictions that have been newly added to annex I, and the penalties will apply to these jurisdictions generally as from 2024.

With Russia now included on annex I, the importance of such measures has increased, as there are still significant relationships between German and Russian businesses, despite various EU sanctions introduced because of the war in Ukraine. This article discusses certain German tax and reporting measures that should be considered when doing business with entities and individuals residing in jurisdictions included on annex I.

<u>Controlled foreign company rules</u>

For German shareholders of companies located in jurisdictions included on annex I, the controlled foreign company (CFC) rules not only apply to passive income (as described in section 8 (1)-(4) Foreign Tax Act) but to all the low-taxed income of such companies. Low-taxed income for purposes of the CFC rules means income subject to an effective tax rate of less than 25%.

<u>Nonresident taxation of German-source income</u>

German-source income from services (including finance and insurance services), trade, and royalties and capital gains related to German-nexus intellectual property, which typically is not subject to tax in Germany if derived by a nonresident, may be subject to withholding tax at a rate of 15.825% if such income is derived by an entity or individual residing in a jurisdiction included on annex I.

<u>Tax treaties</u>

Benefits under a double tax treaty with a jurisdiction included on annex I are not available. For example, reduced withholding tax rates do not apply and foreign branch income is not exempt from German taxation.

<u>Transaction documentation</u>

For transactions with entities or individuals residing in jurisdictions included on annex I, taxpayers must prepare extensive documentation related to the type, content, and scope of the transactions, and the documentation must be made available to the German tax authorities within one year from the fiscal year end.

Reporting on certain cross-border tax arrangements

Arrangements with jurisdictions included on annex I may trigger a reporting requirement under DAC 6 (i.e., the EU directive for reporting on certain cross-border tax arrangements) if such an arrangement leads to tax deductible expenses in Germany.

Participation exemption and deductibility of certain expenses

The participation exemption is denied for entities located in a jurisdiction included on annex I Furthermore, the tax deductibility of business expenses paid to a recipient located in a jurisdiction included on annex I is disallowed. These penalties are applied in stages as from the third and fourth years following a jurisdiction's addition to the German list of noncooperative jurisdictions (i.e., as from 2026 and 2027 for the four newly added jurisdictions if the German list is updated in 2023).

Comments

Taxpayers should carefully review the impact of the updated EU list on their business relationships with entities residing in jurisdictions included on annex I and determine whether any action should be taken. Further developments regarding the EU list also should be monitored.

Your contacts

Andreas Maywald

Client Service Executive | ICE - German Tax Desk
anmaywald@deloitte.com
Tel.: +1 212 436 7487

Hannah Hildebrand

Senior Manager
hhildebrand@deloitte.de
Tel.: +49 89-29036 8120

www.deloitte-tax-news.de