

German Federal Ministry of Finance issues new circular on taxation of IP registered in Germany

TAXPAYERS RECEIVE FRAMEWORK FOR ACTION

Executive summary

- The German Federal Ministry of Finance (BMF) affirms the licensing of rights registered in a German register is subject to limited tax liability, even if no further German nexus exists.
- Taxpayers benefit from temporary procedural relief based upon double taxation agreements (DTAs).
- A thorough analysis of the relevant facts and, if necessary, prompt disclosure/application in accordance with the BMF circular is required.

History and practical legal background

The question of whether the licensing of intellectual property registered in Germany is sufficient to trigger limited tax liability in Germany has been the subject of much controversy since 2020 – not least due to the partly contradictory statements by the tax authorities and draft legislation. This controversy has particular consequences for multinational groups that do not exploit intellectual property (IP) in Germany, but the rights of which have been entered in a German register. In this context, rights registered in a domestic register also include, for example, patents that are registered in a German register as a result of an application to the European Patent Office in accordance with the European Patent Convention. In the BMF circular of 6 November 2020, the tax authorities upheld the view that the mere entry in a domestic register would be sufficient to trigger limited tax liability in Germany and that no further German tax nexus is

required. However, the draft bill of the so-called German Withholding Tax Relief Modernisation Act (AbzStEnt-ModG)

published two weeks later stated that the mere entry in a German register should no longer be sufficient to trigger limited tax liability. Nevertheless, this legislative amendment was not adopted in the government draft of the German Withholding Tax Relief Modernisation Act of 20 January 2021. As a consequence, no change in the law is to be expected on the current basis and the matter concerning the correct interpretation of the relevant provisions remains in focus.

This to-ing and fro-ing clearly shows the uncertainty surrounding the practical application of the law, which both tax advisors and those responsible for tax law in multinational groups have been facing and still face. Historical transactions have had to be reviewed in order to comply with the relevant reporting obligations to the tax authorities. Under current agreements, even in purely foreign cases (licensing of domestically registered right by a foreign licensor to a foreign licensee), a foreign licensee would be obliged to withhold taxes for the account of the foreign licensor. In addition, the treatment of any withholding in new agreements must be regulated.

This withholding obligation must also be seen within the context of potentially applicable double taxation agreements (tax treaties), where a German taxation right is often excluded. Nevertheless, it should be noted from a tax procedural point of view that a withholding of tax is initially required, which would be refunded later (subject to entitlement to treaty benefits).



In terms of tax procedure law, the new BMF circular of 11 February 2021 provides for certain procedural simplifications, although – as explained in more detail below – the simplified process is still subject to a number of obligations.

Licence payments up to and including 30 September 2021

With regard to remuneration that has already accrued to the licensor or will accrue up to 30 September 2021, the tax authorities have allowed for a simplified procedure similar to the so-called exemption certificate procedure, but which at the same time has a genuine retroactive effect in that all remuneration (including past remuneration) is included.

In such cases, the tax authorities allow tax withholding and the tax declaration to be waived under the following conditions:

- Foreign remuneration debtor: the licensee is neither domiciled nor has its place of management in Germany.
- DTA exemption of the remuneration creditor: the licensor being resident for tax purposes in a DTA country is entitled to relief from German taxes under the applicable DTA (in the case of partnerships the entitlement of, the partners of the partnership under the DTAs is relevant)
- Application deadline: the licensor (or the licensee, if so authorised by the licensor) must submit an application for exemption from withholding tax to the German Federal Central Tax Office (BZSt) by 31 December 2021 at the latest.
- Disclosure of relevant contractual relationships (where appropriate, a summary thereof as part of the application) and translation of the relevant passages into German.

According to the BMF circular, if there is any reasonable doubt' as to the entitlement to treaty benefits under the DTA or pursuant to Section 50d ITA, the tax deduction cannot be waived. The BMF circular sets out some cases of doubt, which should therefore be checked in advance. A case-by-case analysis is also conceivable, therefore a

sufficient explanation of the justification for the application under tax law is helpful. Should the application be rejected, the tax must be paid within one month after the rejection.

Licence payments after 30 September 2021

As a rule, if the licence payment is received after 30 September 2021, the tax must be withheld and an application for a refund subsequently filed. Nevertheless, the tax withholding obligation does not apply if a valid exemption certificate has been issued.

Tax assessment basis

For the first time, the new BMF circular of 11 February 2021 also provides guidance on how to determine the tax basis for the withholding tax, particularly in those cases where the total remuneration is paid for the use of the rights in several territories and, accordingly, the licensed rights are registered in several jurisdictions. It should be noted that according to this BMF circular, a simple cost-based approach (including profit mark-up on these (registration) costs, if applicable) is not acceptable. In this case, the total remuneration is to be 'apportioned taking account of the principle of causation' (the so-called top-down approach). Whether the latter is in line with general guidelines on transfer pricing is questionable.

Sale of rights registered in Germany

The sale of IP rights registered in Germany is not subject to withholding. However, the seller is nevertheless legally obliged to file a tax return. This is because even if Germany has no taxation rights under a double taxation agreement, a so-called zero tax return must be filed. In this case, too, according to the BMF circular of 11 February 2021, disclosure of relevant contractual relationships including a German translation of the relevant passage is required.



Conclusion and outlook

In summary, on the one hand, the BMF circular of 11 February 2021 can positively be viewed as having at least created a framework for action. On the other hand, within this framework many areas of doubt remain. In practice, determining the tax assessment basis will be difficult and it may only be possible to clarify this conclusively in the fiscal courts at a later date. Furthermore, it remains questionable whether the mere registration of a right in a domestic register is sufficient to trigger a German tax liability. With regard to the drafting of future licence agreements with German nexus, as in the case of licensing a right that is protected and registered in several countries, it may be advisable to contractually break down the licence fee per country (in the case of a lump-sum licence) or establish contractual parameters on the basis of which the share of the licence fees attributable to Germany can be determined.

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