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German Tax and Legal News

MOF issues draft bill that would significantly reduce scope of German ETT/ORIP rules

For German registered rights, limited German tax liability would be abolished as from 2023 and with retroactive effect for third party royalties

The German Ministry of Finance (MOF) on 28 July 2022 published the draft bill of the Annual 2022 Tax Act. The bill includes proposals to significantly reduce the scope of German extraterritorial taxation of royalty payments between nonresidents (referred to as offshore receipts in respect of intangible property or ORIP) or intellectual property (IP) transfers by nonresidents (referred to as extraterritorial capital gains taxation or ETT) where German-nexus IP exists solely as the result of the registration of rights in a German public book or register. The draft bill still must be approved by the government and then complete the legislative process before the lower and upper houses of parliament, which would be expected to happen before the end of 2022. If enacted, the proposals would be broadly welcomed by affected taxpayers.

According to the draft bill, income from royalty payments or the alienation of rights that are subject to limited German tax liability exclusively as the result of registration in a German public book or register no longer would be subject to German taxation as from 1 January 2023. For third party royalty arrangements (where the license agreement is concluded between unrelated parties), the limited German tax liability would be abolished with retroactive effect. In accordance with proposed new section 10 of the Tax Haven Defense Act, only in the case of so-called "haven structures," i.e., where the income is earned by a person resident in a noncooperative tax jurisdiction as defined by the act (which mirrors the EU list, see German Tax and Legal News dated 17 February 2021), would the limited German tax liability be upheld in the future.

As background, royalty income from the license of rights that are registered in a German public book or register or being exploited in a German permanent establishment or other German facility may give rise to a German limited tax liability subject to withholding. Tax must be withheld at the time of payment and remitted quarterly by the licensee even if the withholding tax (WHT) obligation may be mitigated under a relevant tax treaty, unless the licensor provides the licensee with a valid German WHT exemption certificate as required under Germany's domestic WHT rules, allowing the application of a reduced or zero percent royalty WHT rate. Where rights that are registered in a German public book or register or being exploited in a German permanent establishment or other German facility are transferred, this may result in German capital gains taxation at the level of the transferor if the transferor is not able to rely on protection from German taxation under an applicable double tax treaty.

Comments
Since the German ETT/ORIP issue emerged as a result of a new interpretation in 2020 of provisions in the income tax code enacted in 1925, it has proved controversial and has been the subject of much criticism and discussion among tax professionals and taxpayers. The German MOF published several decrees in 2021 and 2022 (see German Tax and Legal News dated 15 July 2021 and 30 June 2022) to provide taxpayers with administrative assistance and guidance to comply with the rules, and to file the required tax returns and applications to rely on relief from WHT under an applicable tax treaty. The MOF also presented a report evaluating the operation of the ETT and ORIP rules to the German parliament in June 2022 where legislative action to mitigate the impact of the provisions was recommended.

The draft bill, if enacted, would represent a significant relief for all affected taxpayers. Although the possibility of legislative action was mentioned in the MOF's June 2022 report, the speed of that action comes as a welcome surprise. For group internal license arrangements and transfers of German-nexus IP before 2023, disclosures and filings would still need to be made (where applicable) by 30 June 2023 following the simplified procedure described in the MOF decree of 29 June 2022. A further extension of the 30 June 2023 filing

deadline for previous periods should not be expected taking into account the latest development.

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