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By PwC Deutschland | 07. August 2012

Royalty withholding tax on net income of EU creditor

The ECJ has held that the withholding tax on a royalty paid to a corporation in another EU country may not be more than the corporation tax rate applied to the income less the directly related costs.

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The Income Tax Act allows the withholding tax on income paid to creditors in other member states of the EU for the performances of artists and athletes to be calculated on the payment less the direct costs incurred by the recipient (with the rate doubling to 30% if paid to a natural person), but does not contain any similar provision for royalty payments. This has now been challenged by a television station paying film royalties to a Luxembourg distributor. The station claimed that it should be allowed to base the withholding tax on the payment to the distributor net of the fees paid by the distributor to the owners of the film copyrights. These were directly linked to the receipts from broadcasters and were therefore direct costs of earning that income.

The Supreme Tax Court has now confirmed the position of the taxpayer in a judgment setting aside the relevant provision of the Income Tax Act in favour of the higher-ranking community law as first expounded by the ECJ in *Scorpio* (case C-290/04 of October 3, 2006) and subsequently followed in other decisions. On that basis, the Supreme Tax Court held a tax charge of more than that to be levied on the same income in the hands of a domestic recipient to be an unwarranted infringement of the freedom to provide services. Since a credit in the country of the recipient for the German tax deducted at source would not necessarily eliminate double taxation in all circumstances, taxpayers must be allowed the option of claiming relief in the country of source for the direct costs incurred in earning the income. Thus the maximum withholding tax that could be levied was the lower of standard rate corporation tax (currently 15.825%) on the net income and the royalty withholding tax on the gross revenue at the relevant treaty rate.

Supreme Tax Court judgment I R 76/10 of April 25, 2012 published on July 25

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