

German Federal Parliament resolves legislative changes to the taxation of payments for German-registered rights

December 6, 2022

In brief

The German Federal Parliament passed the Annual Tax Act 2022 on December 2. Among other provisions, the Act introduces (transitional) legislative changes to the taxation of payments for IP rights that are registered in a German register between foreign taxpayers. In a change from the government's draft bill, all non-treaty cases between related parties, for the time being, will remain subject to German nonresident taxation beyond 2022. The German Federal Council will deal with the law in its session on December 16.

Actions to consider: Taxpayers who may have potential German taxation under Sec. 49 of the German Income Tax Act in prior or future years should analyze the impact of these German law changes. Specifically, taxpayers with royalty payments related to German-registered IP, or who recognized capital gains on sales of such property to unrelated parties, no longer have potential tax liability under Sec. 49 of the German Income Tax Act (even for prior years). For taxpayers with these royalty payments (or capital gains) with a related party, it will be necessary to determine if the payor (or seller in the case of a capital gain) is entitled to claim a treaty exemption with Germany. Such a determination is not automatic in that treaty-shopping rules (both treaty-based and those under German domestic law) must be considered inapplicable. Finally, those taxpayers claiming a treaty exemption on prior-year related-party royalty payments (or capital gains on sales of IP to related parties) under the simplified filing procedure must complete such work before June 30, 2023. Failure to do so by then will require disclosure of much more detailed information in order to seek treaty exemptions.

In detail

On July 28, 2022, the German Federal Ministry of Finance published a draft bill containing far-reaching changes to the taxation of payments for IP rights that are registered in a German register between foreign taxpayers (see *PwC Insight: Germany releases draft bill on taxation of payments for German registered rights*). Those changes were included word-for-word in the German Government's draft bill for the Annual Tax Act 2022. However, the version of the law passed by the German Federal Parliament contains several changes:

(1) Royalties and capital gains between third parties are excluded from the catalog of German-source income, which is subject to limited taxation under Sec. 49 of the German Income Tax Act, both for the future and (retroactively) for all open cases in the past.

However, royalty payments and capital gains from sales between third parties received on or after January 1, 2022, trigger a limited tax liability pursuant to Sec. 10 of the German Tax Haven Defence Act, provided that the payment is made to taxpayers residing in tax havens within the meaning of that Act. Under an amendment to the Tax Haven Defence Regulation due in mid-December 2022, tax havens within the meaning of the Act are American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands, and Vanuatu.

(2) For royalties and capital gains from sales between related parties within the meaning of Sec. 1 para 2 German Foreign Tax Act, the tax consequences need to be distinguished as follows:

- Royalties and capital gains received and realized respectively until December 31, 2022, continue to qualify as German-source income, which is subject to limited taxation under Sec. 49 of the German Income Tax Act;
- Royalties and capital gains received from January 1, 2023, onwards are subject only to limited taxation if:
 - a tax treaty that precludes Germany's taxation right of the income does not exist (i.e., nontreaty cases) or, considering the provisions of the German Income Tax Act governing the application of tax treaties (e.g., German domestic anti-treaty shopping provisions pursuant to Sec. 50d para. 3 of the German Income Tax Act), cannot be claimed in the specific case (tax liability pursuant to Sec. 49 German Income Tax Act,) or
 - the payment is made to taxpayers residing in tax havens within the meaning of the Tax Haven Defence Act (tax liability pursuant to Sec. 10 German Tax Haven Defence Act).

The tax liability pursuant to Sec. 49 of the Income Tax Act was only included in the Act by the German Federal Parliament on the recommendation of its Finance Committee. According to the original draft bill, a limited tax liability was to apply to situations between related parties from 2023 onwards only if the remuneration creditor or transferor was resident in a tax haven within the meaning of the German Tax Haven Defence Act (for details see above).

The Finance Committee's report indicates that the list of the German Tax Haven Defence Act, which is based solely on the 'EU list of non-cooperative countries and territories for tax purposes,' is too narrow for purposes of the taxation of payments for German-registered rights. The German Federal Ministry of Finance shall examine the possibility of supplementing the list with a separate German list of tax jurisdictions and shall amend the Tax Haven Defence Act accordingly. Upon the introduction of such a national list, the tax liability pursuant to Sec. 49 of the German Income Tax Act for related parties shall cease to apply. However, the law itself does not specify a time limit for this tax liability. The tax liability pursuant to Sec. 10 German Tax Haven Defence Act then may effectively become relevant also for transactions between related parties.

Furthermore, for royalty payments received until June 30, 2023, the so-called 'simplified withholding tax procedure' for treaty cases according to the circular of the German Federal Ministry of Finance still applies (see *PwC Insight: Germany extends ability to claim exemption from IP withholding tax by one year*). Hence, provided that the tax treaty entitlement of the remuneration creditor, also considering particularly the German anti-treaty shopping rules, is not in doubt, the deduction, payment, and declaration of withholding tax on royalty payments can be waived in this procedure if the remuneration creditor applies to the German Federal Central Tax Office for an exemption

certificate based on the tax treaty and receives it. Within the scope of this exemption procedure at the German Federal Central Tax Office, a determination of the royalty income can then be waived.

Observation: The interaction between this simplified procedure and the newly introduced extension of the tax liability within the meaning of Sec. 49 of the German Income Tax Act is still unclear.

Let's talk

For a deeper discussion of how the German legislation might affect your business, please contact:

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