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Restriction of tax relief on royalty payments: draft bill released as part of the efforts to combat harmful tax practices

On 25 January 2017 the German government published a draft bill proposing a restriction of tax relief on royalty payments made to related parties from 2018 onwards.

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According to the proposal, the deduction of expenses for royalty payments made to related parties is to be restricted, where:

- the corresponding royalty income is subject to a preferential tax treatment (for example patent box or other IP regimes), in the hands of the related party; *and*
- the effective taxation of the royalty income is below 25%.

If these two foregoing conditions are met, relief will not be available to the extent the effective tax rate is below 25%.

Under the proposal the rules should not apply to royalty payments made to a licensor who has developed the underlying intangibles himself. This exception should not apply to trade marks.

The “self-development” exception corresponds to the Nexus Approach developed as part of Action 5 of the OECD BEPS Action Plan (Harmful Tax Practices). The Nexus Approach looks for a direct nexus between the income receiving benefits under an IP regime and the expenditure contributing to that income.

The proposed provision also includes rather wide rules intended to prevent the routing of license payments via a country with a non-preferential tax regime. In this regard the final related-party recipient of the royalty income is to be the point of reference.

The proposed rules should apply to expenses incurred after 31 December 2017.

According to the official government justification, the legislation has been proposed, because the grandfathering rules for existing preferential tax treatments foreseen by the OECD are regarded as being too beneficial by Germany.

Source: Ministry of Finance

https://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Referentenentwuerfe/2016-12-20-G-gegen-schaedliche-Steuerpraktiken-Rechteueberlassungen.html

Keywords

BEPS, Harmful Tax Practices, Royalty expenses