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## tax + legal newsflash

Important changes in law and regulations

### German IP nexus rules: Ministry of Finance issues circular to simplify withholding tax and capital gains tax procedures in certain treaty cases

The circular dated 11 February 2021 covers royalty payments and capital gains in foreign-to-foreign cases where the German nexus is purely based on a registration of rights in a German public register

Based on the wording of long-standing German tax law, income generated upon the licensing of IP rights or the sale of IP rights may be considered to be in scope of non-resident German taxation if the underlying IP is registered in a German book or register. This may hold true even if foreign-to-foreign transactions do not include a German resident counterparty.

On 6 November 2020, the German Ministry of Finance issued a circular in which the Ministry confirmed its view that a mere registration of rights in a German register would be sufficient to establish a German tax nexus both for royalties and capital gains in foreign-to-foreign situations (see [newsflash](#) dated 6 November 2020). This interpretation results in extensive tax filing requirements and withholding tax duties for all open tax assessment periods during the last seven years.

The provision was initially intended to be abolished with retroactive effect as part of the modernization of the German withholding tax regime published in November 2020. The government draft of this bill, adopted on 20 January 2021, however, discarded the proposed repeal of these provisions (see [newsflash](#) dated 20 January 2021).

As a consequence, extensive compliance obligations apply both to cases where a German taxation right is excluded under an applicable double tax treaty, as well as in cases without treaty protection under German tax law (i.e. despite treaty eligibility, quarterly withholding tax returns for all open tax assessment periods

must be filed, the withholding tax must be paid by the licensee and a refund procedure initiated must be processed by the licensor).

In its circular dated 11 February 2021, the Ministry of Finance outlines a procedure that allows taxpayers to follow a simplified process for (unambiguously) treaty entitled royalties for a limited period of time. The simplified procedure is subject to specific preconditions and applies to taxable events realized up to and including 30 September 2021. Royalties paid after 30 September 2021 will be subject to the regular withholding tax rules. Moreover, the circular provides the Ministry of Finance's view on the expected approach to determine the German assessment basis for withholding tax and capital gains tax purposes.

### **Preconditions for and exceptions from participation in the simplified withholding tax procedure in royalty cases**

#### *1. Preconditions*

During the timeframe described above, a licensee can refrain from withholding tax at source if the following preconditions are met:

- a. At the time the royalty is received, a (corporate) **licensee** must not have its legal seat nor its effective place of management in Germany.
- b. The **licensor** must be entitled to benefits of a double tax treaty, having regard to domestic limitation on benefits / anti-treaty shopping provisions.
- c. The **licensor** or the **licensee on behalf of the licensor** must apply for the issuance of a (retroactive) withholding tax exemption certificate no later than 31 December 2021. Where the underlying agreement is no longer in place and the licensee can provide evidence that the licensor is not willing or able to file such application, the licensee is entitled to apply for a retroactive withholding tax exemption certificate in its own name and without power of attorney.
- d. The **underlying agreements** must be disclosed to the Federal Central Tax Office (partially in German language).

#### *2. Exceptions*

The simplified withholding tax procedure is not applicable if it is doubtful whether treaty entitlement applies, either under the treaty provisions or under German domestic anti-treaty shopping rules. In such cases, the licensee must file withholding tax returns and pay the tax and the licensor may then seek a refund through the normal process.

The obligation to verify the licensors eligibility could give rise to difficulties, especially in relation to third parties.

### **Procedure in the event of rejection of the application for an exemption certificate**

If the application for an exemption certificate is rejected, withholding tax returns must be filed and taxes are to be remitted within one month of announcement of the administrative act rejecting the application.

### **Determination of the assessment basis**

The Ministry of Finance Circular also provides guidance as to the approach to be followed to determine the tax basis for the withholding tax.

The assessment basis shall, in principle, be the gross remuneration for the rights registered in a German register. Such remuneration is to be determined based on the contractual provisions.

Where the remuneration attributable to the rights registered in Germany cannot be determined from the underlying contracts, the total remuneration paid shall be apportioned appropriately. The starting point for an appropriate determination shall be the so-called "top-down" approach.

The Ministry of Finance does not accept the so-called "bottom-up" approaches (i.e. where a fictitious percentage of sales or profits based on database studies is the basis for calculating the license fee). According to the circular, the approach of determining the income based on registration costs (including profit mark-up, if applicable) is also not appropriate.

If the tax authorities are unable to determine the relevant income, they can conduct an estimate .

### **Procedure for the sale of rights**

No withholding taxes are due on capital gains. Instead, an (annual) non-resident tax return must be filed. The circular stipulates that such non-resident tax return must also be filed if treaty benefits apply with respect to the capital gain.

### **Take away**

The new circular allows for the possibilities to follow a simplified procedure to file for foreign-to-foreign withholding taxes for a limited period of time. Non-resident taxpayers should make use of this possibility to reduce tax compliance obligations.

# Any questions?

For a deeper discussion of how this might effect your business, please reach out to your local PwC contact advisor or our following international tax experts:

Arne Schnitger  
+49 30 2636 5466  
[arne.schnitger@pwc.com](mailto:arne.schnitger@pwc.com)

Volker Käbisch  
+49 211 981 1527  
[volker.kaebisch@pwc.com](mailto:volker.kaebisch@pwc.com)

Madeleine Syré  
+49 69 9585 6927  
[madeleine.syre@pwc.com](mailto:madeleine.syre@pwc.com)

Torsten Schmidt  
+49 40 6378 1338  
[torsten.schmidt@pwc.com](mailto:torsten.schmidt@pwc.com)

Thomas Loose  
+49 211 981 7884  
[thomas.loose@pwc.com](mailto:thomas.loose@pwc.com)

Kais Mouldi  
+49 40 6378 8422  
[kais.mouldi@pwc.com](mailto:kais.mouldi@pwc.com)

You may also send us an e-mail.

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## Redaktion

Gabriele Nimmrichter  
PricewaterhouseCoopers GmbH  
Friedrich-Ebert-Anlage 35-37  
60327 Frankfurt am Main  
Tel.: (0 69) 95 85-5680  
gabriele.nimmrichter@pwc.com

Emma Moesle  
PricewaterhouseCoopers GmbH  
Friedrich-List-Str. 20  
45128 Essen  
Tel.: (0 201) 438-1975  
emma.moesle@pwc.com

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