23. November 2020

tax + legal newsflash

Important changes in law and regulations

Draft law on the modernization of the relief from and the certification of withholding taxes

German Federal Ministry of Finance publishes draft bill

On 20 November 2020, the Federal Ministry of Finance published a draft bill on the modernization of the relief from and the certification of withholding taxes. The amendments relate, among other things, to the withholding and refund procedure, the anti-treaty shopping regulations and the provisions on non-resident taxation for income arising from licensing or the disposal of rights which are entered in a domestic public register.

Abolishment of non-resident taxation for income from licensing or sale of rights *solely* because of their registration in a domestic public book or register

According to Section 49 (1) No. 2 Letter f and No. 6 of the German Income Tax Act (ITA), a German non-resident taxation results from the licensing or sale of rights if these rights are

(i) entered in a domestic public book or register (e.g. patent register) *or*
(ii) exploited in Germany.

If rights are licensed, the tax is levied by way of a withholding, if rights are sold the tax is levied by way of an assessment.

The draft bill provides for a limitation of the scope of the provisions to cases with a substantial German nexus. Under the proposed rules a non-resident tax liability arises only, if the licensed or sold right is *exploited* in a German permanent establishment or facility of the licensee (i.e. the registration in a German public book or register does not trigger a sufficient nexus anymore).

pwc

The proposal intends to narrow the scope of the German non-resident taxation taking into account the widespread practice nowadays that rights are registered in a country to achieve a protection even if no specific exploitation in that country occurs. Accordingly, the amended provisions are proposed to apply on a retroactive basis to all tax years and all open cases.

The proposal was not expected as the German Ministry of Finance had just very recently published a Circular on 6 November 2020 stating its position that the current provisions should be applied if a registration of rights in Germany is given even if both the licensee and the licensor are non-residents and the registration of the rights represents the only link to Germany.

Note: The circular dated 6 November 2020 has not been withdrawn so far. Furthermore, it is unclear if and when the new law will pass the legislative process. Therefore, the requirements to file WHT and tax returns for past and current periods still apply until the administrative guidance is withdrawn or the legislation is passed.

New version of the German anti-treaty-shopping rule

The draft bill also proposes substantial changes to the current German anti-treaty-shopping rule taking into account requirements under European Union law.

The proposed new anti-treaty-shopping rule contains elements which are already known from the current regulation. However, the law intends to introduce some significant changes to the provision. The changes intend to reflect the principles developed by the CJEU judgments in the “Danish beneficial ownership” cases and the requirements of Art. 6 ATAD:

Basic rule

The basic rule still limits treaty entitlement if none of the below mentioned tests are met:

1. Personal entitlement to relief

Under the test referring to the personal entitlement to relief it needs to be verified whether the shareholders of the foreign company seeking relief would be (hypothetically) entitled to treaty relief if they received the payments directly (“**look through approach**”).

However, the provision refers to the specific entitlement (i.e. the claim for relief under the specific Double Tax Treaty (DTT)). With this change the legislator intends to tighten the provision according to the explanatory materials of the draft bill. As a consequence, the shareholders’ entitlement to an equivalent relief under another Double Tax Treaty should no longer be sufficient to meet this test. This could have an impact on situations where the foreign entity claiming treaty relief and its shareholders are resident in different jurisdictions insofar the exemptions from the basic rule discussed hereafter are not applicable.

2. Substance: Material connection with the own activity

The substance test is not fulfilled if the source of income (e.g. in case of a dividend, the participation) has no material connection with an own economic activity of the foreign company. In other words, the underlying source of income needs to serve an economic function with regard to an economic activity of the foreign entity.

The explanatory materials of the draft bill indicate that it needs to be explainable why the foreign company receives the income in question in order to meet the “material connection with an economic activity test”. Going forward it needs, therefore, to be assessed on a case-by-case basis, whether the test is fulfilled.

Further, no economic activity of the foreign company is assumed if

a) income is generated and passed on by the foreign company to participating or beneficiary persons or

b) an activity is performed even though the company is not equipped with sufficient business premises, personnel etc.

Exemptions from applying the basic rule

Finally, the proposed new German anti-treaty-shopping rule contains two exceptions:

1. A provision similar to the "Principal Purpose Test" which grants treaty entitlement upon proof that none of the principal purposes of the foreign company's interposition is to obtain a tax advantage and

2. A "stock exchange clause", which grants treaty entitlement if the shares of the entity claiming treaty entitlement are traded regularly on a recognized stock exchange.

The latter exception is already foreseen in the current legislation. However, the materials of the draft bill include an important statement that the “stock exchange clause” should be only applicable going forward at the level of the foreign company claiming WHT relief (i.e. this clause would not apply anymore at the level of the (indirect) shareholder of the foreign company).

The currently existing exemption from the German anti-treaty-shopping rule for companies which are subject to the German Investment Tax Act will be deleted.

Scope of application of the revised anti-treaty-shopping rule

The revised German anti-treaty-shopping rule applies for benefits claimed under a DTT, the EU Parent/Subsidiary Directive, the Interest and Royalty Directive and the unilateral relief under Section 44a para. 9 German ITA.

According to the explanatory materials the new anti-treaty shopping regulations should also apply if a DTT contains a special provision to prevent treaty abuse such as the LOB-clause according to Art. 28 DTT USA/Germany. In addition, the

explanatory materials state that the German domestic GAAR is also applicable besides the anti-treaty-shopping provisions.

Miscellaneous

The draft bill foresees several other changes to the procedural provisions for obtaining an exemption certificate or getting taxes refunded and a higher level of digitalization of the procedure. According to these changes it would not be possible anymore to obtain exemption certificates retroactively; they would be valid only from the date of issuance (i.e. and not from the date of application anymore).

Further changes to the German reorganization tax act aim to prevent the use of losses via reorganizations with retroactive effect for tax purposes and other measures are also included in the draft bill.

What next?

The bill is only a draft law from the German Ministry of Finance and has not been decided to be submitted to Parliament by the German government yet. Therefore, further amendments to the draft bill are still possible. The further legislative process of the draft bill should to be closely monitored.

Any questions?

Then please contact your PwC advisor or send an e-mail.

SEND E-MAIL

The information contained in this newsletter was intended for our clients and correct to the best of the authors' knowledge at the time of publication. Before making any decision or taking any action, you should consult the sources or contacts listed here. The opinions reflected are those of the authors.

Subscribe/Unsubscribe

When you order a PwC newsletter, we store and process your e-mail address for the purpose of sending the newsletter you have subscribed to.

New interested parties can register as subscribers by clicking on the following link:

SUBSCRIBE

If you no longer wish to receive "tax+legal newsflash", please click here and send us an appropriate e-mail message:

UNSUBSCRIBE

You will also find this link in every e-mail with which we send you your newsletter.

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

Data protection

Data processing for the purposes of the distribution of the Newsletter is performed on the basis of your consent. You can unsubscribe from the Newsletter at any time with effect for the future and revoke your consent.

.