Grant Thornton

Snapshot

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German revenue guidance on taxation of intellectual property registered in Germany

The German Federal Ministry of Finance issued guidance on November 6, 2020 addressing the taxation of income from intellectual property (IP) registered in Germany. The guidance articulates the tax authority's perspective that the registration of IP in a German register is sufficient to trigger taxation of royalty income and capital gains derived from such IP, and that no further German tax nexus is required.

Background

Section 49 of the German Income Tax Act (the Act) imposes a limited tax liability in the form of a withholding tax of up to 15.825% on domestic source income generated from IP. Income for this purpose includes royalty and license fees, as well as income arising on a sale or transfer of IP if the IP is considered to have sufficient nexus in Germany. Entities subject to the withholding tax include both resident and nonresident entities for German income tax purposes. Sufficient nexus in Germany includes (1) the mere registration of IP within Germany, or (2) the exploitation of IP within Germany even if the IP was not registered in Germany. IP that can be registered in Germany includes patents, brands and designs, and utility models, among other types of IP.

Entities, including U.S. multinational entities, have historically implemented various business-oriented, tax-efficient legal entity organizational structures to further develop, enhance, exploit, or otherwise utilize proprietary IP throughout the world.

Historically, the prevailing view in the accounting and legal community has been that IP transactions between parties with no physical presence in Germany are not subject to the limited tax liability provision included in the Act. However, in April 2020, the prevailing view had evolved so that it is now widely understood that certain transactions may give rise to sufficient nexus under Section 49 of the Act. As a result, entities have been evaluating potential exposure related to German-registered IP as of that financial reporting period.

Recent developments

On November 6, 2020, the German Federal Ministry of Finance issued a circular providing a statement of the tax authority's views, which does not comment on the complexities associated with determining nexus or measuring exposure. The German authority's circular provides that

- Royalties paid between nonresident persons are subject to tax in Germany under No. 2f and No. 6 of Section 49(1) in the Act if they are paid in relation to the permanent or temporary licensing of rights registered in a German register. The licensee is required to withhold taxes and remit such amounts to the tax authority. No further German nexus is required for this provision to apply.
- For applicable royalty or similar payments, the payor must withhold the tax in accordance with the Act and submit a tax declaration to the Federal

Central Tax Office for payments related to open periods beginning in 2013. The circular is silent on periods prior to 2013; however, any payments related to prior periods need to be made to the competent local tax office.

- Capital gains arising from the sale or transfer of a right registered in a German register are not subject to withholding tax in Germany. Further, if the underlying right has been licensed for an unlimited time period, it is considered a transfer of rights. However, in these situations, the licensor is generally required to file a German income tax return reflecting the capital gain to the appropriate German tax authority.
- Rights registered in the European Patent Register based in Munich pursuant to the European Patent Convention may be considered German-registered IP to the extent that the registration has a protective effect for Germany. Furthermore, other IP registered on an EU register may be sub-registered in Germany since that sub-registration may be the exclusive route to provide effective legal protection of IP in Germany.

Evaluating the applicability and measurement of the ultimate tax obligation is highly complex and fact-specific. Some considerations in the analysis might include the following questions:

- What types of IP are involved and where is each registered?
- How is the transaction characterized (for example, as a license, sale, or service)?
- Which entity is the legal owner and/or the beneficial owner of the IP?
- Is there sufficient contemporaneous documentation to support reductions to the revenue stream under current transfer-pricing or similar guidelines?
- How many periods of historical returns are required?
- What is the ultimate payment due to the German tax authority?
- Can refunds be requested under double-taxation agreements or other merits?

Generally, the withholding tax is not ultimately payable if a double taxation treaty applies; however, relief from double taxation commonly applies only when the licensor either (1) obtains confirmation from the tax authorities in advance of the transaction certifying that the requirements set out in the treaty are met and provides documentation of the pre-certification to the licensee, or (2) files the appropriate tax forms, remits the withholding tax, and applies for reimbursement of the amounts paid, with sufficient explanation of the reason for the refund request and whether the provisions of the applicable tax treaty have been met.

Ordinarily, the statute of limitations for nonpayment of income taxes does not begin until tax forms are filed; however, the general understanding is that the German tax authority will look back six to seven years and, in egregious cases, up to thirteen years. As a result, entities should evaluate the historical filing requirements and submit withholding tax returns and/or capital gain tax returns, along with payment of any taxes due, in order to avoid significant consequences for underreporting or underpayment of tax.

Application of tax treaties or double tax agreements

With respect to royalties, most German double tax agreements (tax treaties) provide for a zero rate of withholding tax. In situations covered by these treaties, a refund of remitted taxes for historical payments, or an exemption certificate for future payments, should be available if the licensor is entitled to a treaty benefit and complies with applicable anti-treaty shopping rules. If an exemption certificate has not previously been obtained for the historical royalty payments, withholding taxes would apply and should be declared and remitted to the tax authorities followed by a request for refund, absent an advance clearance from the German tax authority. With respect to capital gains arising from the sale or transfer of German-registered IP, the seller is required to file a tax return in Germany and report the capital gain, even in situations where there is no German tax owed on the transfer.

What's next?

Entities should evaluate whether payments made for the use of IP or for the disposal or transfer of IP create nexus in Germany. If necessary, entities should file withholding tax returns to the applicable tax office related to payments for the use of IP. Additionally, entities should file tax returns disclosing any capital gains on the sale or transfer of IP. Corresponding tax payments should be made in order to comply with the Act and the circular. If a double tax agreement (or tax treaty) applies, a refund of overpaid withholding tax may be claimed.

For future payments related to IP, entities may consider applying for a withholding tax exemption certificate in Germany. Once a valid exemption certificate is in place, future payments will be subject to a 0% withholding tax rate.

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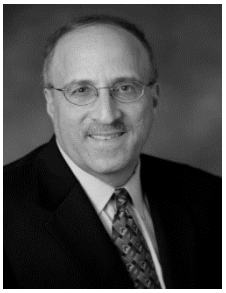

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