

German extraterritorial taxation upheld without expected relief in approved government draft law proposal

Originally planned relaxation of extraterritorial taxation rules no longer included in government approved law proposal for the overhaul of German withholding tax rules.

Draft legislation published by Germany's Ministry of Finance (MOF) on 19 November 2020 had raised expectations that the potential German tax exposure for royalty payments between two non-German entities and intellectual property (IP) transfers related to rights that are registered in a German public book or register would be abolished (see [GTLN dated 11/23/20](#)). These hopes have been diminished by the release on 20 January 2021 of the government approved draft of the legislation which no longer addresses this aspect.

Under German rules for limited liability taxpayers, the transfer of rights registered in a German public book or register, together with royalty payments for such rights, are subject to German taxation. In addition, IP that is being exploited in a German permanent establishment or other German facility may give rise to a German limited tax liability. This tax is often referred to as ETT (extraterritorial transfer tax) or ORIP (offshore receipts in respect of intangible property), although these terms are not used in the legislation. In the case of ETT (i.e., on the alienation of the IP), the tax must be declared via the German tax return filed by the non-German transferor. In the case of royalty payments (ORIP), the tax must be withheld at the time of payment and remitted quarterly by the licensee even if the withholding tax (WHT) obligation may be mitigated under a relevant tax treaty, unless the licensor provides the licensee with a valid German WHT exemption certificate as required under Germany's domestic WHT rules, allowing the application of a reduced or zero percent royalty WHT rate.

Despite strong technical arguments that may be advanced as to why German extraterritorial taxation should not apply where the only German nexus is the existence of registered rights in a German public book or register, the MOF on 6 November 2020 issued a decree in which it confirmed its view that this is sufficient nexus, and that tax return filings or WHT declarations are required in such cases (see [GTLN dated 11/09/20](#)). Later that month, the MOF published draft legislation proposing significant amendments to the German WHT rules that would have abolished German extraterritorial taxation for German registered rights. These apparently contradictory announcements left many taxpayers confused and awaiting further clarification. The proposed relaxation of the rules has been removed from the government approved draft legislation, indicating that taxpayers should expect that the current legislation would continue to apply. There have been suggestions that there may have been some push-back during the governmental coordination process from German states (Laender) objecting to the relaxation of the German extraterritorial taxation rules.

The draft legislation is subject to the formal legislative process, requiring the approval of both chambers of the German parliament. Changes to the proposals may be introduced during this process; however, taxpayers are required to comply with the current rules, and file an income tax/WHT return (as appropriate) and make tax payments where German-registered rights are transferred or licensed between foreign parties. The MOF guidance published in November 2020 highlights these obligations and reminds taxpayers to comply with the rules.

Taxpayers potentially affected by the German extraterritorial taxation rules should carefully evaluate their filing strategy. The application of the rules – in particular the identification of the relevant rights and payments, and the determination of the tax base – can be very complex. Since previous filing deadlines may have been missed, taxpayers need to develop an individual strategy to mitigate the associated risks.

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