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German Tax and Legal News

Lower House of parliament approves bill that would significantly reduce scope of German ETT/ORIP rules

For German registered rights, limited German tax liability would be abolished with retroactive effect for 3rd party payments and for related party payments for periods after 2022 in case treaty protection is available.

The German lower house of parliament (Bundestag) on 2 December 2022 approved the Annual Tax Act 2022, which includes a significant reduction of the scope of German extraterritorial taxation of royalty payments between nonresidents (referred to as offshore receipts in respect of intangible property or ORIP) or intellectual property (IP) transfers by nonresidents (referred to as extraterritorial capital gains taxation or ETT) where German-nexus IP exists solely as the result of the registration of rights in a German public book or register.

The bill must still be approved by the upper house of parliament (Bundesrat), which is expected to happen on 16 December 2022. It is not expected that the upper house of parliament will veto or amend the rules as approved by the lower house of parliament. The bill then must be signed by the president and published in the federal gazette before becoming effective (which are seen as mere formalities).

Since 2020, ORIP and ETT cases have been a concern for many companies. Based on administrative guidance provided by several Ministry of Finance (MOF) decrees, some procedural relief became available in certain cases where double tax treaties applied ((the most recent decree is dated 29 June 2022, see [GTLN dated 30 June 2022](#)).

The version of the Annual Tax Act 2022 approved by the lower house of parliament includes some last-minute changes amending the tax rules for ORIP and ETT cases, which deviate from the original version of the bill (for a description of the originally proposed changes please see [GTLN dated 1 August 2022](#)), as follows:

- For royalties and capital gains from transactions between unrelated parties, tax liability would be eliminated retroactively, which would be the same as in the original version of the bill. The only exception would be that for periods as from 1 January 2022, the ORIP/ETT rules would still be applicable in transactions between unrelated parties where the licensor or transferor is resident in a noncooperative tax jurisdiction as defined in a proposed amendment to section 10 of the Tax Haven Defense Act. The list of noncooperative tax jurisdictions would mirror the so-called EU blacklist. The current EU blacklist is composed of American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands, and Vanuatu. Based on these countries, it is not expected that this would be of much relevance. However, changes in the EU blacklist (and any future domestic blacklist) would need to be constantly monitored in this regard. The EU blacklist is updated twice a year in February and October.
- For related party transactions, taxation generally would be maintained (which is significantly different from what was proposed in the original version of the bill). However, as from 1 January 2023, a tax liability would no longer apply in related party transactions if a double tax treaty prevents such taxation, taking into account German anti-treaty shopping and other relevant treaty-related provisions. Furthermore, related party licensors would no longer be required to obtain a royalty withholding tax exemption certificate in order to rely on such treaty protection.

Comments

The final adoption of the ORIP/ETT rules as contained in the lower house of parliament's approved version of the Annual Tax Act 2022 would still provide considerable relief for affected taxpayers; in particular, for payments between unrelated parties. For related party payments, there would still be significant relief compared to the current situation, but the

last-minute changes to the MOF's original version of the bill may result in significant complexities for affected taxpayers. Such related party payments, as from 1 January 2023, would still require a comprehensive analysis as to whether the recipient of a payment can rely on treaty protection. This assessment would include an analysis of the limitation on benefits treaty provision, German anti-treaty shopping rules, and domestic rules dealing with hybrid entities. Once such an analysis establishes eligibility for treaty protection, the ORIP/ETT rules would not apply. Even though from a procedural perspective a withholding tax exemption certificate would no longer be required, the continuing existence of the ORIP/ETT rules in related party situations would still require attention and a technical analysis for purposes of confirming treaty eligibility. Furthermore, the German anti-treaty shopping rules were amended and tightened in 2021 (see [GTLN dated 24 November 2020](#)) and include significant complexity and uncertainties, which also may lead to uncertainties in the application of the revised ETT/ORIP rules.

Related party transactions are going to remain taxable until the end of 2022 under current rules, so that appropriate compliance efforts must be undertaken to either obtain exemption certificates under the simplified procedure available until 30 June 2023 per administrative guidance (for treaty protected cases) or file tax returns and withholding tax declarations as soon as possible (for non-treaty protected cases). It also should be noted that the rules for German-nexus IP where rights are being exploited in a German permanent establishment or other German facility are unchanged and would not be affected by the amended rules as described above.

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