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URL: http://www.deloitte-tax-news.de/german-tax-legal-news/mof-grants-another-extension-of-the-filing-deadline-for-certain-extraterritorial-taxation-of-royalty-payment-related-filings.html

30.06.2022

German Tax and Legal News

MOF grants another extension of the filing deadline for certain extraterritorial taxation of royalty payment-related filings

The current 30 June 2022 deadline is extended to 30 June 2023. In addition, the MOF publishes its ETT/ORIP report to the German parliament.

The German Ministry of Finance (MOF) on 29 June 2022 published a decree that extends (for a second time) the deadline for certain filings that are required in connection with the extraterritorial taxation of royalty payments derived by nonresidents (referred to as offshore receipts in respect of intangible property or "ORIP") from 30 June 2022 through 30 June 2023. In addition to the extension of the filing deadline, the MOF published its report to the finance committee of the German parliament on the evaluation of nonresident taxation of royalty income and capital gains relating to rights that are registered in a German public book or register.

As background, royalty income from the license of rights that are registered in a German public book or register or being exploited in a German permanent establishment or other German facility may give rise to a German limited tax liability subject to withholding. 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.

In an earlier decree published on 11 February 2021, the MOF provided some procedural relief (available as from 2013) relating to royalty WHT filings and payments in relation to certain nonresidents that qualify for benefits under an applicable tax treaty with Germany, which requires that an application for a royalty WHT exemption certificate be filed by 31 December 2021 (later extended to 30 June 2022 by a decree dated 14 July 2021, see GTLN dated 15 July 2021).

The MOF's 29 June 2022 decree now allows necessary disclosure documents to be filed until 30 June 2023 regarding all royalty payments made until that date. It is important to understand that this extension does not cover situations where there is no clear and unambiguous treaty protection available for the licensor on its royalty income. It also does not cover filing obligations related to a capital gain from the alienation of German-nexus intellectual property (IP). Capital gains derived from the transfer of such IP also may be subject to a German tax that often is referred to as extraterritorial transfer tax or "ETT." The original filing and disclosure obligations where German-nexus IP is being transferred remain unchanged (i.e., the original 30 September 2021 filing deadline for nil-tax returns for treaty-protected periods has not been extended).

Tax return filings related to nontreaty-protected ORIP cases (WHT filings) and ETT cases (annual income tax return filings) are in many situations already overdue and should be filed as soon as possible to avoid noncompliance with German tax filing and payment obligations.

On 28 June 2022, the MOF published its report dated 16 June 2022 to the finance committee of the German parliament on the evaluation of the ETT and ORIP cases . The report provides a summary of the rules and the MOF's view on the application of the extraterritorial taxation rules. It also describes the issues that have proved controversial to taxpayers and their advisors. The report results in three conclusions:

- The current ETT/ORIP rules for registered rights should be abolished, except for taxpayers resident in jurisdictions included in the European Union (EU) list of noncooperative tax jurisdictions. The report does not suggest the abolition of the rules with retroactive effect;

- The existing 30 June 2022 deadline for applications for a retroactive exemption from royalty WHT should be extended through 30 June 2023 (in line with the 29 June 2022 decree); and
- The MOF recognizes that license transactions between third parties cause an additional layer of complexity for taxpayers and the tax authorities and is seeking alternative measures to find a solution for these cases (no specific measures are mentioned in the report).

The report recognizes the difficulties and the compliance burden related to the application of these rules for both taxpayers and the tax authorities. It also highlights that notwithstanding highly controversial technical points of view, taxpayers and their advisors are cooperating and working together with the tax authorities to comply with the filing obligations. By May 2021, nearly 3,300 WHT returns had been filed by 238 different taxpayers. More than 4,000 applications for WHT exemption or a WHT refund have been filed to date and the MOF expects this number to increase significantly before the expiry of the original 30 June 2022 filing deadline for retroactive exemptions. To date, 105 WHT exemption certificates have been issued; 32 with retroactive effect. The report mentions that the expectation is that exemption certificates will be issued more swiftly in the near future as it took some time for the tax authorities to establish the necessary internal resources to deal with these cases.

Even though the MOF is expecting significant tax revenue for nontreaty protected taxpayers for previous periods, the report also mentions that significantly less revenue is expected for future periods due to an adjustment of the affected structures. In this context, the report refers to global tax developments such as the EU Anti-Tax Avoidance Directives (ATADs) and the OECD/G20 Base Erosion and Profit Shifting (BEPS) project.

The MOF report also highlights the legal uncertainties about the interpretation of the rules around extraterritorial taxation and the expectation that some of these issues may need to be resolved in court. The report mentions the intention of the tax authorities to adjust income determinations and allocations prepared by taxpayers substantially upwards based on different approaches adopted by the tax authorities.

Comments

Even though the additional extension of the filing deadline is a welcome and much needed development for affected taxpayers, it highlights again the requirement to analyze the fact pattern for each taxpayer and to take action immediately if an ORIP or ETT situation exists. The analysis of this issue can be highly complex and required filings must be prepared properly. In this regard taxpayers should be reminded that the filing extension neither applies in ETT situations (capital gain upon transfer of German nexus IP) nor in ORIP situations (royalty payments with regard to German nexus IP) where treaty protection for the licensor is not entirely clear.

The MOF report provides valuable insight into the view of the tax authorities and the magnitude of the issue. It recognizes the difficulties and the required effort to comply with these rules for affected taxpayers but at the same emphasizes that the tax authorities expect strict compliance with the existing rules. Whether the conclusion of the MOF that the ETT/ORIP rules for registered rights should be abolished for the future (other than for taxpayers resident in jurisdictions included in the EU list of noncooperative tax jurisdictions) is going to result in legislative action is now a decision for the German parliament. It remains to be seen whether the legislator will follow the recommendations of the MOF. Legislative action may be taken in conjunction with the implementation of Pillars One and Two in German domestic law, which is not expected to happen before 2023.