CONTENTS

GERMAN SOURCE-OF-INCOME RULE

- According to the mere wording of the law, IP income (licensing and disposal) qualifies as German source income if the underlying IP is either
  a. **exploited** in any German business premises or
  b. **registered** in a German register.

  } German IP

- German register
  - German Patent and Trademark Office (**DPMA**)
  - European Patent Office (**EPA**) only if protection is granted for Germany → *additional entry of IP in DPMA*
  - **Probably not:** EU Intellectual Property Office (**EUIPO**)

- Although the regulation has existed for almost 100 years, it has never been applied to foreign-to-foreign licensing of IP.

DEVELOPMENTS IN 2020

US public auditors were verifying tax reserves as regards German registered IP income.

Early 2020

Federal Central Tax Office "unofficially" indicates a possible German tax liability for foreign-to-foreign licensing of German registered IP.

Disclosure of non-reported German registered IP income vis-à-vis German tax authorities by multinationals.

During 2020

No clear guidance by German tax authorities!

Circular by Federal Ministry of Finance: Mere registration is a sufficient nexus for taxable income.

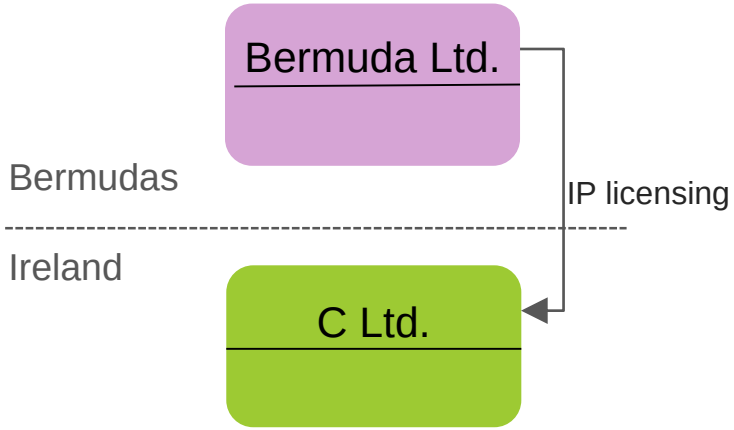
6/11/2020

Draft legislation by Federal Ministry of Finance: Proposal of retroactive repeal of the respective regulation.

19/11/2020

NEW CASES: FOREIGN-TO-FOREIGN LICENSING OF GERMAN REGISTERED IP

case 1: no treaty protection



- Bermuda Ltd. owns patents or trademarks which are **registered in Germany**, but exploited abroad only
- Bermuda Ltd. grants a royalty-bearing license to the Irish C Ltd. *(Alternatively, the IP is sold to C Ltd.)*
- No income tax treaty in place between Germany and Bermuda

➔ German limited tax liability of non-resident licensor/seller?

➔ German withholding tax obligation for non-resident licensee?

➔ How to calculate German share of the royalty/sale price?

NEW CASES: FOREIGN-TO-FOREIGN LICENSING OF GERMAN REGISTERED IP

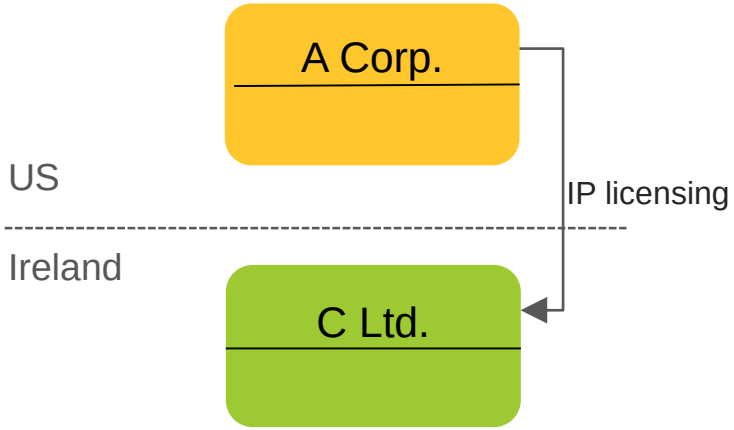
- Pursuant to the wording of the law, Bermuda Ltd. is subject to German limited income tax liability. However, there are good arguments why German income tax liability should not be assumed:
  - No sufficient *"nexus"* to Germany in case of mere foreign-to-foreign licensing
  - Constitutional, historical, systematical and purpose-based interpretation of the law

- If income tax liability is assumed (cf. circular), licensee (C Ltd.) will be obliged to withhold taxes at a rate of **15.825%** on the gross amount of royalties. *(No WHT on sales price)*

- The German share should preferably be determined by a **cost based approach.**
  - German tax authorities tend to an income/revenue based approach, but no clear statement in the circular.

NEW CASES: FOREIGN-TO-FOREIGN LICENSING OF GERMAN REGISTERED IP

case 2: treaty protection



- A Corp. owns patents or trademarks which are **registered in Germany**, but exploited abroad only
- A Corp. grants a royalty-bearing license to the Irish C Ltd.

➔ Tax treaty protection for non-resident licensor?

➔ Notwithstanding any treaty protection, German withholding tax obligation for non-resident licensee in the first instance? How to obtain a refund of the withholding taxes?

NEW CASES: FOREIGN-TO-FOREIGN LICENSING OF GERMAN REGISTERED IP

- In general, licensee (C Ltd.) would be obliged to withhold taxes **regardless** of an applicable tax treaty.
  - Reduction of WHT is generally only available after a refund procedure has been successfully completed or an exemption certificate has been issued by Federal Central Tax Office.

- However, we see good arguments why the licensee **should not be obliged to withhold taxes retroactively** in case of mere foreign-to-foreign licensing and treaty protection.
  - Previous guidance by tax authorities did not indicate an obligation for the foreign licensee to withhold German taxes.
  - Taxes can be assessed against both licensor and licensee. If the taxes are assessed against the licensor, treaty benefits are directly available (no refund procedure necessary, no additional administrative burden).
  - However, circular is silent on that issue.

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GOING FORWARD

GOING FORWARD

- The statements of the Federal Ministry of Finance seem to be contradictory
  - **Circular letter**: mere registration is a sufficient nexus
  - **Draft legislation**: deletion of the legal requirement (German registration) with retroactive effect as the current applicable law covers cases in which domestic taxation is "inappropriate"

- However, at this point in time, taxpayers **cannot rely** on the draft legislation
  - No legitimate expectation on the basis of the draft
  - The outcome of the legislative procedure is currently uncertain

GOING FORWARD

- With the circular, German tax authorities have clearly expressed their **opinion** that a German register entry is a **sufficient nexus to determine taxable income**.
  - Expectation that taxpayers will fulfill their obligation to cooperate.
  - Taxpayers should now take action regardless of the draft legislation.
    - Past: e.g. disclosure letter
    - Present: e.g. filing quarterly WHT returns?
    - Future: e.g. filing application for exemption certificate?

- It is uncertain if the responsible tax offices (Federal Central Tax Office resp. Tax Office Munich) will suspend the tax assessment.

GOING FORWARD

- In principle, tax claims of non-reported IP income become time-barred after 7 years, i.e. disclosure letters in 2020 have normally covered years from **2013 onwards**.

- Since the official tax authorities' point of view is published and commonly known – at least since November 2020 – it can no longer be ruled out that tax fraud or gross negligence is given in case of non-compliance. In such case, tax claims become time-barred after
  - 8 years in case of **gross negligence** resp.
  - 13 years in case of **tax fraud**.

- Further administrative and criminal consequences may arise in case of tax fraud resp. gross negligence.

CONCLUSION

- Taxpayers should take action regardless of the published draft legislation.
- Since 6 November 2020 (i.e. publication of circular), failure to comply may give rise to assume gross negligence resp. tax fraud with further legal and criminal consequences.
- It is uncertain if the responsible tax offices will resume their work-up soon or if they wait until there is some more clarity in the legislative process.

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