INTERNATIONAL TAX SERVICES

LIMITED TAX LIABILITY ON THE LICENSING OR SALE OF RIGHTS REGISTERED IN GERMAN REGISTERS

LETTER OF THE FEDERAL MINISTRY OF FINANCE DATED NOVEMBER 6TH 2020

In a letter dated November 6th, 2020, the Federal Ministry of Finance (BMF) commented on tax declarations/tax returns for German domestic income pursuant to section 49 (1) no. 2 lit. f and no. 6 German Income Tax Act (ITA). In the following, we outline its contents, which are important for internationally operating groups of companies, and explain any further steps that may be necessary.

BACKGROUND AND KEY MESSAGE OF THE LETTER

The central prerequisite for establishing a limited tax liability in Germany is the existence of a domestic tax connection. The provision of section 49 (1) no. 2 lit. f and no. 6 ITA includes, among other things, income from the licensing as well as the sale of assets in kind or rights which are registered in a domestic public register. The BMF clarifies that patents which are entered in the domestic register on the basis of an application to the European Patent and Trademark Office also fall within the scope of the regulation.

The intention of the German legislator is thus the general recognition of all income flows which are connected with a right registered in Germany. A further domestic nexus is not required. This means that the licensing or sale of an intangible asset may be taxable in Germany even if neither licensor nor licensee or neither seller nor buyer is resident in Germany.

It is noteworthy that the underlying legal regulation has already existed for some time, but in practice, especially in recent months, the tax authorities have increasingly taken up the issue. The version of the present letter by the BMF underlines the explosiveness of the regulation and should give all enterprises cause to examine the relevance for their own business.

CONTENT OF THE LETTER – DIFFERENTIATING BETWEEN TWO CASES

In the letter the BMF differentiates between the two following cases:

In the case of a **temporary** transfer of rights, the payment debtor must withhold tax in accordance with section 50a (1) no. 3 ITA. The debtor must pay the corresponding tax to the Federal Central Tax Office (BZSt) as well as file a tax return to the BZSt.

However, in the case of a **permanent** transfer of rights, a sale of rights is assumed. Therefore, according to section 25 (3) ITA a tax declaration must be filed to the responsible tax office.

APPLICATION OF DOUBLE-TAXATION TREATIES

In principle, the application of an existing double-taxation treaty (DTT) must be examined for each cross-border case. If a protection from double taxation exists due to the DTT the withholding tax outflow may be prevented in the case of licensing, if the licensor has sufficient substance and an exemption certificate is applied for at the BZSt. If the withholding tax has already been paid, the possibility of a refund must be examined on an individual basis. In the event of a sale article 13 DTT may lead to a restriction of the German taxation right if the seller is a resident of the DTT state. Remaining tax compliance obligations must nevertheless be observed.

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CASES OF SUBLICENSING

Special attention should also be paid to possible cases of sublicensing, which will be illustrated in the following example. A company based in Jersey develops IP, which afterwards will be registered into a German register. The use of the IP is granted to an active company based in Ireland upon payment of a licensing fee. The Irish company then again sublicenses the rights of use to a domestic (German) company.

The payment flow between Germany and Ireland falls within the scope of section 49 (1) No. 2 lit. f ITA. There is a double taxation agreement between Germany and Ireland, so that if the relevant conditions are met, an exemption certificate or refund of withholding tax can be applied for in Germany. According to the wording of the law, however, the flow of payments between Ireland and Jersey generally also results in a limited tax liability of the Jersey company in Germany, solely due to the registration of the rights for IP in Germany. A DTT protection cannot be claimed in this respect. Even if the holder of the rights is a resident of a DTT state, e.g. USA, either the exemption or the refund procedure must be followed in order to apply the protection under the agreement.

SALE OF RIGHTS

As mentioned above, not only the licensing of rights entered into domestic registers, but also their sale is subject to limited tax liability. According to the wording of the law, this may also concern cases of disposal of IP that have not been licensed but which are nonetheless considered to have value. It is particularly questionable in cases of sale how the determination of the capital gain is to be carried out in practice. The BMF does not comment on this matter in its letter. If in the example mentioned above the company in Jersey now sells the IP to the USA, the sale of Jersey to the USA is taxable in Germany.

NEED FOR ACTION

With regards to the clarification of the BMF, companies should examine possible tax implications. In the first step this includes an inventory of rights registered by the company in Germany or the EU, an analysis of their exploitation and possible value allocation. In the case of sublicensing, it must be clarified which party is the actual owner of the rights and what possible tax obligations may arise from this.

EFFECTIVE SUPPORT BY BDO

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