



German Tax Monthly

Information on the latest tax developments
in Germany

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German Federal Ministry of Finance: Non-Resident Tax Liability when Rights listed in Domestic Registers

The German Federal Ministry of Finance [BMF] has extended beyond 30 September 2021 the **simplification procedure** for non-resident tax liability arising from transfers of rights in cases where the right is merely entered into a German public register for consideration received before 1 July 2022.

By guidance dated 11 February 2021, the BMF granted a simplification procedure for non-resident tax liability arising from transfers of rights in cases where the right is merely entered into a German public register. If certain **conditions** are met, a withholding tax can be waived. The simplification procedure originally applied to consideration already received by the payment creditor (cases in the past) or was still to be received up to and including 30 September 2021. Among other things, the other requirements stipulate that an application to the German Federal Central Tax Office for exemption from tax deduction must be made until 31 December 2021.

The guidance dated 14 July 2021 has now **extended** this deadline. The simplification procedure can be used also for consideration received by the payment creditor after 30 September 2021 but before 1 July 2022. The deadline for application at the German Federal Central Tax Office for exemption from tax deduction has been extended until 30 June 2022 – for both consideration received before 1 October 2021 and consideration received after 30 September 2021. The other requirements of the BMF circular dated 11 February 2021 continue to apply without change.

The simplification rule covers cases which are subject to non-resident tax liability and withholding tax **solely** based on entry in a domestic register and for which, on account of a double taxation agreement (DTA), no German tax liability ultimately arises. No other domestic nexus (e.g. use of the rights in a domestic permanent establishment) may exist. The rule applies for considerations already received by the licensor (creditor) or still to be received up to and including 30 June 2022.

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In these cases, the withholding of tax, remittance of tax, and reporting of tax to the German Federal Central Tax Office [BZSt] may be waived if the following cumulative **requirements** are satisfied:

1. **Payment debtors:** no residency (residence or habitual abode or place of management) in Germany at the time the receipt consideration is received.
2. **Payment creditors:**
 - **Residency** in a country with which Germany has concluded a **DTA** at the time the consideration is received
 - **Eligibility and entitlement to relief** pursuant to the respective DTA
 - If a fiscally **transparent partnership** is a payment creditor, the key criteria are the partners' residency as well as eligibility and entitlement to relief under the DTA
 - **Allocation** of the consideration according to the respective DTA
 - Submission of **application** to the BZSt for exemption from withholding tax by 30 June 2022
 - Disclosure of relevant **contracts** to the BZSt along with the application. Important contract passages must be translated into German and

submitted with the application

If there is any doubt regarding eligibility or entitlement to relief of the payment creditor under the DTA or German law, the simplification rule cannot be applied.

The **sale of rights** entered in a public register in Germany also fulfils the condition of non-resident tax liability. For these sales transactions, which are not subject to withholding tax, tax returns must be submitted by the non-resident taxpayer (licensor). There need be no electronic submission unless the tax authority explicitly requests it. If a DTA accords the sole right to taxation for these capital gains to the country of residence, a nil tax return can be submitted.

German Federal Ministry of Finance: Administrative Guidelines Transfer Pricing

On 14 July 2021, the German Federal Ministry of Finance [BMF] published the new Administrative Guidelines – Transfer Pricing [Verwaltungsgrundsätze Verrechnungspreise, AG TP]. The AG TP refer to the OECD Transfer Pricing Guidelines (OECD TPG), which are now part of the AG TP, and therefore in future also reflect the German tax authorities' interpretation of German tax law in the area of transfer pricing. In addition, this new BMF guidance refers to the publications of the **EU Joint Transfer Pricing Forum (JTPF)** and to the **United Nations Practical Manual on Transfer Pricing for Developing Countries**. It is to be expected that in doing so the German tax authorities will continue to align with international transfer pricing standards. The BMF specifies in addition its interpretation of certain aspects of the arm's length principle by

largely following the OECD TPG in its guidance.

The AG TP deal, among other subjects, with principles of income correction, guidelines and other general principles.

The group of **related parties** has been expanded for income adjustment purposes to include networks and pyramidal organisations whose members are legally independent companies. They are considered to be related parties to the extent they have a presumed common commercial interest.

In the opinion of the tax authorities, the **arm's length principle** entails not only an arm's length comparison from a quantitative perspective (i.e. the appropriateness of the price), but also whether the other terms and conditions under which the related party transactions are arranged can be considered appropriate. This refers to all related party transactions and applies equally to inbound and outbound cases. It remains to be seen whether this uniform application will in practice also apply to permanent establishments for which the BMF suggests the application of different arm's length standards to same fact patterns in inbound and outbound cases.

The topic of **losses** in the case of routine companies is also addressed in the new BMF guidance. Based on a functional and risk analysis, transfer prices may be inappropriate according to the BMF, if a routine company does not earn an adequate cumulative profit over a period of five years. Other reasons could be business transactions that have yet to be identified and compensated or the assumption of business expenses in the interest of other group companies. In the opinion of the BMF, the

analysis period of five years may vary both upwards and downwards depending on the presence of special circumstances.

The extensive guidance provides for further statements regarding specific subjects, such as intangible assets, services and financial transactions.

The publication of the AG TP **repeals** several BMF guidances and further application regulations. The new AG TP apply to **all open cases**, i.e. also to past tax assessment periods. The Federal Ministry of Finance [BMF] is of the opinion that the interpretation of Article 9 (1) of the OECD Model Tax Convention (dynamic vs static) is irrelevant. Instead, the arm's length principle is to be considered depending on time and context. Amendments to the OECD TPG should be taken into consideration without any further legislative measures.

Interest Rate of 6% for Back Taxes and Tax Refunds is Unconstitutional as from 2014

With its decision dated 8 July 2021 (file ref. 1 BvR 2237/14, 1 BvR 2422/17), the German Federal Constitutional Court ruled that the interest on back taxes and tax refunds of 6% annually (0.5% per month) is **unconstitutional** for interest calculation periods starting as from 2014. However, the current legislation remains applicable for interest calculation periods up through 2018. The regulations are no longer applicable for interest calculation periods as from 2019. The German Federal Constitutional Court has stipulated that the legislator must pass an amendment by 31 July 2022. The interest rate's unconstitutionality generally applies in both directions: in the case of both

interest on back taxes as well as interest on reimbursements, both to the benefit as well as the disadvantage of the taxpayer.

The interest on back taxes and tax refunds in accordance with § 233a of the Fiscal Code of Germany [AO] concerns income, corporate income, value added and trade tax. This generally encompasses the period between when the tax arises and its assessment ("full interest"). However, the interest calculation period commences only after the end of an **interest-free grace period** of 15 months, calculated starting from the end of the calendar year in which the tax arose: for example, the interest calculation period for the 2018 corporate income tax assessment period begins on 1 April 2020. On account of the coronavirus, the interest-free grace period for the 2019 assessment period was extended by six months to 21 months (start of the interest calculation period generally as from 1 October 2021) and for the 2020 assessment period by three months to 18 months (start of the interest calculation period generally as from 1 July 2022). The interest rate is 0.5% per month (6% per year).

As a result, those affected by the interest are those whose taxes are assessed or amended after the end of the interest-free grace period. In practice, this concerns especially the amended tax assessments after a tax audit, where there is also typically a longer interest calculation period.

The Federal Constitutional Court does not question the interest charged on back taxes and tax refunds as such. However, the prevailing interest rate of 6% annually revealed itself no later than in 2014 – on account of the **structural low interest level** following the financial crisis in

2008 – as being clearly unrealistic. Even though there was already a discrepancy to the market interest rates for interest calculation periods until 2013, the low interest level had not become so entrenched until 2013, so that it then became apparent that the legal rate of interest was clearly unrealistic and, thus, unconstitutional.

The German Federal Constitutional Court considers the legal rate of interest on back taxes and tax refunds to be unconstitutional for interest calculation periods starting as of 2014. However, such interest on arrears and reimbursements affects only those amounts to be paid for interest calculation periods starting 2019. This is because the court has ordered for interest calculation periods up through 2018 that the prevailing law, i.e. the interest rate of 0.5% per months, continue to apply. Thus, different interest rates could be applicable in cases where the interest calculation period encompasses both periods. The ruling covers all legally collected tax types: income, corporate income, value added and trade tax.

The legislator is now obligated to adopt a **new constitutional regulation** by 31 July 2022. This can but need not necessarily affect interest calculation periods before 2019. According to the Federal Constitutional Court, it is at the legislator's discretion to select either a fixed interest rate or a floating rate linked to a suitable reference interest rate. It can be expected that a corresponding draft law will be put in motion only following the German general elections on 26 September 2021. Courts and administrative authorities may no longer use the unconstitutional interest rate for interest calculation periods starting in

2019. Ongoing proceedings are to be suspended for all administrative acts that are not yet final and conclusive until the legal amendment is enacted.

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