

German tax audit trend impacts withholding tax on fees for online advertising

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Executive summary

A recent tax audit trend in Germany has the potential to significantly impact the tax position of German companies who use online advertising as well as nonresident companies, offering online advertising services in Germany. In a number of tax audits, the tax auditors have recently taken the position that cross-border payments for online advertising should be treated as royalties/ payments for the use of know-how by German companies and should thus be subject to a 15.825% German Withholding Tax (WHT; 18.8% WHT if grossed-up).

This is - currently - not an agreed position by the German tax authorities, but rather an interpretation of tax law by various tax officers, which was recently supported by a technical paper written by the head of the Munich tax audit department and published in one of the leading German tax journals. Given the potential magnitude of the issue, this matter was put on the agenda of the Federal Ministry of Finance to agree on an official position. It is expected that such official position of the Federal Ministry of Finance will not be issued before summer 2019.

Detailed discussion

Implications for German resident taxpayers

The treatment of online advertising payments as royalties/ payments for the use of know-how may have a number of income tax consequences at the level of the German customer using the advertising services.

The most important one is that royalty payments/payments for the use of know-how would be subject to statutory WHT at a rate of 15.825% if paid to a nonresident service provider (18.8% in a gross-up scenario, i.e., if the WHT is borne by the licensee). If the German taxpayer failed to levy WHT on the payments, it would be secondarily liable for the WHT. From an economic perspective, this means that in the typical scenario where any withholding tax has to be borne by the customer of online marketing services, cross-border online advertising may become 18.8% more expensive for the customer.

If the marketing service provider was resident in a country with which Germany had concluded a double tax treaty, such treaty would typically provide for a lower or no WHT rate. However, a resident taxpayer could only apply the treaty rates if the service provider had presented a valid (partial) withholding tax exemption certificate at the time of payment of the remuneration. In addition, treaty claims are often barred by strict German domestic anti-treaty shopping rules.

Action points for German resident taxpayers:

- Resident taxpayers should review their past and current payments for online advertising services and should consider disclosing these payments to the tax authorities.
- Resident taxpayers should approach their services providers and ask for withholding tax exemption certificates.

Implications for nonresident taxpayers in Germany

Depending on the underlying contractual agreements with their German customers, nonresident taxpayers who engage in providing online marketing/advertising services may face a 15.825% tax on payments they receive from Germany given that German customers are likely to withhold tax upon payments (where contractually possible) given the

uncertainties surrounding the withholding tax obligations. Even if the financial impact is ultimately shifted to the customer because remuneration is agreed on a net basis, the potential withholding tax burden is still an important economic factor to consider.

It can also be expected that nonresident services providers will face large numbers of requests for withholding tax exemption certificates and/or support in connection with refunds of withholding taxes before the Federal Tax Office which may tie up resources at the level of the nonresident service provider.

Action point:

- Nonresident taxpayers should try to obtain withholding tax exemption certificates for their services even if they are of the view that their services should not qualify as subject to German WHT. Subject to the rules in the applicable tax treaty and the requirements of the German anti-treaty shopping rule, the Federal Tax Office may issue such (partial) WHT exemption certificates even if it was unclear whether the underlying service was subject to WHT at all. However, the process is likely to take significant time, due to the current workload at the Federal Tax Office.

Implications

It appears unlikely that a taxpayer-friendly solution will be identified in the short term. The situation appears similar to the uncertainties related to WHT on payments for the use of software which was ultimately eliminated by (taxpayer-friendly) guidance issued in October 2017 after discussions within the tax authorities (see EY Global Tax Alert, [Germany issues final guidance on classification of cross-border software and database use payments for withholding tax purposes](#), dated 2 November 2017). Sources report that there is currently a discussion going on within the tax authorities regarding which position should be taken officially, so it remains to be seen whether this discussion may lead to a (taxpayer-friendly) position in the future. However, it is not expected that such position would be published before summer 2019.

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