Deloitte.

URL: http://www.deloitte-tax-news.de/german-tax-legal-news/draft-guidance-issued-on-wht-on-outbound-payments-for-software-and-database-usage.html

06.06.2017

German Tax and Legal News

Draft guidance issued on WHT on outbound payments for software and database usage

Draft aims to clarify an area of uncertainty

On May 17, 2017, Germany's Ministry of Finance (MoF) issued the first draft of long-awaited guidance regarding the German withholding tax (WHT) treatment of payments made to nonresidents under software, cloud and/or database licensing arrangements. The draft, which is now open for comment until June 23, 2017, provides useful guidance and numerous relevant examples.

Background

German domestic tax law generally imposes WHT at the rate of 15.825% (which includes the solidarity surcharge) on royalty payments made to nonresidents, unless a reduced rate or an exemption applies under a tax treaty or relief from withholding tax is granted under the EU interest and royalties directive. Payments made to nonresidents that are properly classified as payments for services or for sales proceeds, on the other hand, generally are not subject to WHT in Germany.

For treaty or EU directive-protected payments, the recipient is required to obtain a royalty WHT exemption certificate from the German federal tax authorities before the payment is made to be able to benefit from a reduced WHT rate/exemption under a treaty or the directive. The process required to obtain the exemption certificate can be protracted and burdensome. The uncertainty and lack of guidance in this area has led to situations where German customers/recipients of software-based services have asked for royalty WHT exemption certificates even in situations where no WHT should be due, in order to mitigate their risk of bearing a secondary liability for the WHT.

The draft decree, which is divided into two parts – one part on software and the other on databases – aims to provide more clarity and certainty to taxpayers.

Payments for use of software

The draft decree provides that outbound payments for the use of software are royalties subject to German WHT only in cases where the user obtains a comprehensive right to economically exploit the software under the arrangement. Under the draft guidance, this comprehensive right would include the right to reproduce, modify, distribute or publish the software. The draft clarifies that the simple right to use a software program, without the right to further exploit or commercialize the software, would not be considered a royalty (and, therefore, should not create a WHT obligation in Germany); it is irrelevant for these purposes whether the software is provided via a physical data storage device or electronically by download or via a third-party server.

It also clarifies that German WHT should not be triggered if the arrangement for which the payment is made focuses only on the designated or intended use of the software (i.e. the installation of the software, the download of the software into the user memory, the application of the software and, if applicable, duplication activities that are required to run the software).

The draft decree states that German WHT should not arise if only the result produced from using a software program is commercially exploited by the user. To illustrate this point, the draft decree includes examples of (i) the use of slides that were created by a presentation software program during a commercial presentation; and (ii) the sale of calendars that were created by means of an image processing software, neither of which generally would trigger a German WHT obligation.

The draft decree then provides nine examples that describe circumstances where payments for the use of software would and would not be subject to German WHT:

- Example 1 describes a license of a standard word processing program where the user has the right to make 5,000 copies so its employees can use the program. German

WHT should not apply in this situation, since the license agreement provides only for the right to use the software, and the copies of the program are required to use the program under the contract.

- Example 2 describes a situation where a German company is granted a license for the group-wide use of a word processing program. The German company on-licenses the right to use the software within the group to domestic and foreign related parties and makes back-up copies of the software. The costs for the software license are charged to the relevant group companies. No German WHT applies in this situation, because the rights granted do not exceed the intended use of the software.
- Example 3 involves a German subsidiary of a US software development company. The US parent company grants its German subsidiary the right to further develop the software provided by the parent company and to distribute the software to third parties. The software distribution agreement includes the right for the German subsidiary to reproduce, modify and distribute the software. In this situation, the draft decree confirms that German WHT applies to the payments from the German subsidiary to the US parent entity since the rights granted go beyond those needed for the intended use of the software.
- Example 4 involves a situation where software is distributed by a German distributor. A foreign related party provides copies of the software to the German distributor in return for a one-time license payment, and grants the German distributor the right to distribute these copies. The German distributor does not have the right to make additional copies, or to modify or alter the software in any way. The draft decree provides that no WHT applies to the payments to the foreign related party, as this arrangement qualifies as a mere sales transaction.
- Example 5 describes an “Infrastructure as a service (IaaS)” fact pattern where a US company provides data storage capacity and a specific data transfer capacity on its US-based server to a German company, as well as archiving software. The German company has the right to (sub-)lease the data storage capacity to its customers, and to further develop this software and provide the enhanced software to its customers. The draft guidance confirms that in case of a mixed contract, the various parts have to be analyzed separately. In the described scenario, the remuneration has to be split, and German WHT applies only to the part of the payment that is allocated to the use of the software.
- Example 6 refers to the use of software in an ASP (“Application Service Providing”) or SaaS (Software as a Service) scenario. A foreign software company provides accounting and ERP software to a German customer, and the software is stored on a centrally located server. The employees of the German customer use the software without actually downloading the software. In addition, the foreign software company provides regular updates of the software, data back-up services, hotline support, etc. No German WHT applies since the rights do not go beyond the intended use of the software.
- Example 7 is a variation of the preceding example. Under this scenario, the foreign software company provides services and software to the customers via a German resident ASP. The ASP has the right to distribute, market and service the customers, as well as the right to distribute the software and to make the software accessible to its customers. The draft guidance provides that German WHT applies to the relevant payments to the foreign software company.
- Example 8 describes a US-based SaaS provider that offers cloud-based applications for distribution, marketing and customer services. The distribution activities in Germany are provided through a German company that holds the distribution rights for the software, including the rights to reproduce, modify, distribute, lease and publish the software. The payments made to the US-based SaaS provider are subject to German WHT.
- Example 9 describes a Swiss-based SaaS provider that offers software applications for multiple work stations of a German customer. The software is provided via the internet, with access granted through the computers at each work station. The SaaS provider also offers maintenance and updates for the software. The German customer does not have the right to modify the source code of the software or to pass the software on to other group companies. In this scenario, German WHT would not be applicable since the rights do not go beyond the intended use of the software.

Payments for use of databases

The second part of the draft decree looks at the tax treatment of licenses to use databases. Similar to payments for the use of software, German WHT would apply to payments made to nonresidents for the use of databases and database content only in cases where, as part

of the arrangement, the user receives a comprehensive right to economically exploit the database, regardless of whether the right applies with respect to the entire database or is limited to specific content. German WHT would not apply where the rights of the payer are limited to typical rights of a database user, e.g. access, reading and printing rights.

The draft guidance provides four more examples that illustrate the government's view of the tax treatment of payments for the use of databases:

- Example 10 is based on a fact pattern where a US-based publishing company offers e-journals (online versions of printed magazines) to its customers. A German-based pharmaceutical company subscribes to an e-journal, and its employees are able to read and print the e-journals. In such an arrangement, the payment to the foreign publishing company would not be subject to WHT in Germany.
- Example 11 involves a US rating agency that provides market data (stock and foreign exchange data and ratings) to a German resident bank. Under the agreement, the German resident bank has the right to view data in real-time and to research historic data in a database. Data access is provided online via the internet. The draft decree provides that there should be no German WHT in this case.
- Example 12 is a modification of example 11. The German bank now has the additional right to grant its customers access to the database of the rating agency (i.e. under a sublicense arrangement). German WHT would be triggered in this case.
- Example 13 is based on the preceding example. The German bank has the right to provide certain data from its research in the database to its customers to enable the customers to make their own analysis. However, the bank does not have the right to grant its customers access to the database or to provide substantial information regarding the content of the database. No German WHT would be imposed in this scenario.

Comments

The draft guidance is a welcome clarification regarding the WHT treatment of outbound payments for the use of software and databases, and should help to provide for more certainty in this area. If approved, the guidance hopefully will allow taxpayers to avoid the lengthy and burdensome process that is required to obtain a WHT exemption certificate where it is unnecessary, by making clear in which situations German WHT will apply to software and database usage payments. It currently is unclear when the draft decree will be finalized.

www.deloitte-tax-news.de