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German Tax and Legal News

Federal tax authorities considering applicability of royalty WHT to payments for online advertising

Several recent tax audits have shown an increased interest from tax inspectors in business expenses incurred for online advertising. The tax authorities' preliminary position is that such payments to nonresidents might attract royalty withholding tax under the domestic rules.

The German federal tax authorities confirmed in February 2019 that they are working on a position paper regarding the applicability of royalty withholding tax to cross-border payments for online advertising. The issue has come up in several tax audits and could have a significant impact on German businesses.

The focal point of the tax authorities' deliberations is whether the contractual specifics of online advertising agreements could mean that payments made by resident taxpayers to nonresident service providers under the agreements may fall within the scope of the definition of royalties under the domestic withholding tax provisions. If that is the case, payments made to a nonresident for online advertising would be subject to a 15.825% withholding tax (including the solidarity surcharge), which would increase to 18.8% where tax is not allowed to be deducted from the remuneration due under the relevant contract (under a "gross-up clause").

It is important to note that any reduction or elimination of withholding tax under a tax treaty (if the recipient is eligible for treaty benefits considering, *inter alia,* the German anti-treaty shopping rules) or the EU interest and royalties directive (for payments to EU/European Economic Area/Swiss recipients) may be applied to the payment only if the recipient provides an exemption certificate issued by the Federal Central Tax Office to the payer. Otherwise, if a payment is subject to withholding tax, tax must be withheld at the standard rate and a refund may be claimed by the recipient of the payment.

Detailed technical discussions are ongoing at the level of the tax authorities and among tax practitioners, and the outcome currently is uncertain (although arguments made thus far in favor of withholding tax do not seem to be particularly strong). While tax officials have confirmed that no formal tax audit findings will be issued prior to the matter being decided at the federal level, both resident taxpayers and foreign service providers should monitor developments:

- Resident taxpayers should determine if they have made online advertising payments during periods for which tax has not yet been finally assessed, and if so, analyze whether the proactive disclosure of such payments to the tax authorities is warranted. In any case, the relevant agreements should be checked for tax clauses, and taxpayers may wish to ask their service providers to provide exemption certificates, where applicable.
- Nonresident service providers should be aware of potential reductions to their net service income, as well as that they may receive requests to provide exemption certificates to their customers. Applications for certificates by the number of service providers that potentially could be affected likely would require significant resources, both at the level of the applicants (i.e. foreign service providers) and of the Federal Central Tax Office, so the processing time for obtaining such certificates could be extended to months, rather than weeks.

Until the tax authorities issue final guidance (not expected before summer 2019), taxpayers will face uncertainty and need to consider how best to handle the situation based on their individual facts and circumstances.