

Germany:

Draft decree released on withholding tax treatment of software and database licensing arrangements

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

Background

German domestic tax law generally imposes WHT at a 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 WHT 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 royalty payments that are subject to a reduced rate or are exempt from WHT under a treaty or the directive, the recipient is required to obtain a WHT certificate from the German federal tax authorities before the payment is made; otherwise, the tax must be withheld at the standard rate. The process required to obtain the certificate can be protracted and burdensome. The uncertainty and lack of guidance in this area have led to situations where German customers/recipients of software-based services have requested royalty WHT certificates even in situations where WHT should not be applicable (*e.g.* because the payment should be considered a payment for services), to mitigate the risk of incurring secondary liability for the WHT. The draft decree aims to provide more clarity and certainty to taxpayers in this area.

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, under the arrangement, a comprehensive right to economically exploit the software. A comprehensive right for these purposes would include the right to reproduce, modify, distribute or "publish" the software. The right to use a software program only for its "designated or intended use," without the right to further exploit or commercialize the software, would not be considered a royalty subject to WHT in Germany. A software program's designated or intended use would comprise:

- Installation of the software;
- Download of the software into user memory;
- Application of the software; and
- Necessary duplication of the software (*e.g.* so that a company's employees can use the software).

It would be irrelevant whether the software is provided via a physical data storage device or electronically by download or via a third-party server.

The draft decree provides that German WHT would not arise if only the result produced from using a software program is commercially exploited by the user. Nine specific examples describe circumstances in which payments for the use of software would and would not be subject to German WHT under the comprehensive right and designated or intended use principles.

Where, for example, a foreign company provides data storage capacity and data transfer capacity, as well as software (*i.e.* a "mixed" contract), the draft guidance clarifies that the various parts of the arrangement would have to be analyzed separately to determine the correct WHT treatment.

Payments for use of databases

The second part of the draft decree addresses the tax treatment of licenses to use databases, and provides four more examples illustrating when WHT would and would not apply. 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 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).

Comments

The draft guidance provides a welcome clarification of the WHT treatment of outbound payments for the use of software and databases. If approved, the guidance should allow taxpayers to avoid the lengthy and burdensome process that is required to obtain a WHT certificate in cases where it is unnecessary, by making clear in which situations German WHT will apply to software and database use payments. The MOF has not announced a timeline for finalizing the decree.

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