Germany:

Taxation of advertising services on the occasion of sports events

BY DR. HARALD GRAMS[1]

Introduction

In the media age, the sectors of sports and advertising cannot be treated as being separated from each other from an economic point of view. Both sectors form a symbiosis because the remunerations paid for advertising in the broadest sense also serve to finance the sports events themselves. In this light, the so-called sports marketing has been well established during the last few years. The corresponding increases in turnover in this sector are striking and speak for themselves, because the relevant statistical surveys reveal that 57.2% of the German companies with the highest turnovers are operating in the sector of sports sponsoring.[2] Large companies consider, in particular, the image transfer and the improvement of their degree of brand awareness by means of an engagement in popular sports to be a valuable tool for brand placing. Furthermore, sports sponsoring is also an "*effective instrument for customer acquisition, or respectively customer loyalty and for increase in sales*".[3] Not only the big players are active in the sector of sports sponsoring because also smaller and medium-sized companies frequently attach importance to the regional increase of brand recognition and the so-called employer branding, that is, the development and the maintenance of companies as employer brand.[4]

These commercial activities, of course, attract the attention of the German tax authorities. If monies flow off abroad these should at least go only to such countries which do not have any status as a tax haven. For this reason, the German tax laws include a number of regulations which shall serve for control purposes of flowing off compensations. Against this background, the tax framework and the legal risks involved are described in this article so that the framework conditions and the related income tax effects can be complied with for the planning of cross-border activities in the field of remunerations for advertising in the sports sector. The interest to avoid financial disadvantages, but also for the other economical plannings, is applicable to both the recipient of the remuneration and to the party to whom the compensation for the advertising is owed. It is possible that the amount of tax affects the tax credit scheme in the country of residence. The correct amount of tax withholding on the level of the German debtor of remuneration prevents financial disadvantages for him because possible mistakes may lead to a claim irrespective of his fault.

The tax framework in Germany

The comprehensive regulation of par. 49 EStG[5] determines under which preconditions revenues of non-resident creditors of remuneration are subject to taxation in Germany. Only such revenues shall be taxed, that are generated in Germany, and, for this reason, one refers to the so-called limited tax liability. Different regulations of par. 49 EStG may be applicable for the approach to be evaluated here in relation to the taxation of remunerations for advertising services.

For one thing, par. 49 clause 1 no. 2d EStG must be focused. This provision stipulates that such revenues of a non-resident creditor of remuneration are subject to taxation which were achieved by artistic, sporting, entertaining or similar performances carried out or exploited in Germany, including revenues from any other services *connected* with these services, irrespective of to whom these revenues accrue.

On the basis of par. 49 clause 1 no. 6 EstG, the so-called income from letting and leasing will be taxed within the meaning of par. 21 EstG, if, for example, rights are exploited at home at a domestic place of business or in another establishment. This includes, in particular, income from the timely limited granting of authorial, artistic and commercial copyrights and of commercial experiences. The term in particular makes clear that this is not a conclusive catalogue/list.

If, in principle, it is determined that a non-resident company operating in the field of sports achieved income in Germany

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2 Ariane Bagusat, *Sponsoring Trends 2012* (Ostfalia University for Applied Sciences, Salzgitter 2013), p. 13 and 17.

3 André Bühler and Gerd Nufer, "Marketing im Sport", in: Gerd Nufer, André Bühler (Hrsg.), *Marketing im Sport – Grundlagen und Trends des modernen Sportmarketing*, 3. Aufl. (Erich Schmidt Verlag, Berlin 2013), p. 54.

4 Sponsoo at www.sponsoo.de (accessed 2 March 2017).

5 EstG = *Einkommensteuergesetz* – income tax legislation.

subject to limited tax liability, the further question must be pursued in which form the German State realizes its entitlement from the tax debt obligation. In principle, two alternatives may apply: for one thing, the non-resident company itself could be obliged to meet its tax obligations in Germany, which will, for example, be the case if the relevant company maintains a permanent business establishment in Germany (par. 49 clause 1 no. 2a EStG). On the other hand, the possibility should always be taken into consideration that the domestic debtor of remuneration is obliged to withhold tax by way of tax deduction. Par. 50a EStG is important which includes standardisations for this purpose.

With regard to income within the meaning of par. 49 clause 1 no. 2d EStG, par. 50a clause 1 no. 1 EStG rules the obligation of tax collection by tax deduction. Referring to par. 49 clause 1 no. 6 EStG, par. 50a clause 1 no. 3 EStG stipulates tax deduction on remunerations for rights in the broadest sense. In accordance with par. 50a clause 2 sentence 1 EstG, the rate of tax withholding amounts, in both cases, to 15% of the revenues (plus solidarity surcharge in the amount of 5.5% on the calculated profit tax). According to par. 50a clause 3 EstG, costs which are directly economically linked to the revenues can be deducted from the revenues, if the creditor of remuneration can prove the nationality and he is a resident of a member State of the European Union or of the EEA. Then, the tax will be reduced to 15% of the profit for corporations and to 30% for natural persons (par. 50a clause 3 sentence 4 EStG).

If one looks more precisely at the legal regulations, any deduction of directly connected business expenses will not be possible in the field of rights. This statement can be derived from the finding that the regulation of par. 50a clause 1 no. 3 EstG, prescribing the tax withholding on rights, is not indicated in par. 50a clause 3 sentence 1 EstG, under which the legal admissibility for the deduction of business expenses is outlined. The Federal Fiscal Court realised this flaw on the basis of a decision of the European Court of Justice in the legal matter *Gerritse*[6] and ruled that – contrary to the legal directive – the deduction of expenses would be possible in the field of rights also for sub-licences.[7] Therefore, the legislator is required to make a legislative amendment: the more so as the Federal Ministry of Finance ordered upon the publication of the stated decision by the Federal Fiscal Court by means of a decree[8] that the stated Federal Fiscal Court judgment should be applied beyond the particular case decided on, even for cases after issuance of the Annual Tax Act 2009, under which the deduction of business expenses for other income groups became statutory for the first time, after the decision of the European Court of Justice in the legal matters *Gerritse and FKP Scorpio Konzertproduktionen GmbH*.[9]

The domestic debtor of remuneration must state and pay the tax withheld to the Federal Central Tax Office each quarter (par. 73e EStDV[10]).[11] If tax at source is not withheld, the domestic debtor of remuneration will be liable for the omitted tax withholding (par. 50a clause 5 sentence 4 EStG in conjunction with par. 73g EStDV).

If a Double Taxation Convention concluded between Germany and another country limits the national right of taxation, either a refund of the tax withheld and paid can be achieved in Germany by the application of par. 50d EStG (par. 50d clause 1 EStG), or else the exemption and payment without tax withholding from the outset by means of a so-called exemption certificate can be applied, in case such a certificate is submitted to the domestic debtor of remuneration prior to the payment of the remuneration (par. 50d clause 2 EStG). Such a procedure can be taken into consideration, for example, in connection with the assignment of rights in the field of advertising measures (art. 12 OECD Model).

Jurisdiction of the Federal Fiscal Court

The preceding explanations reveal that the form of taxation of services chosen by the German State can be described definitely as being complex. Contemplated in an overall context within Europe, but also worldwide, this system is probably quite unique. Complexity leads to mistakes in tax collection and thereby to a possible liability of the domestic debtor of remunerations in the event he makes a mistake on the difficult form of taxation and is held financially accountable by the German State. The Federal Fiscal Court[12] had to judge in such a case in connection with the sponsoring of Formula 1 races in Germany.

In that case, a German company concluded contracts with a non-resident corporation (A) on the sponsoring relationship of both companies with regard to Formula 1 races for a period of several years. The non-resident corporation A was a motor sport racing team which participated with two drivers in a racing series. In accordance with the contract concluded, A had to display the logotype of the German company on the racing cars of the current racing season, on the helmets and overalls of the drivers and of the racing team during the races and the promotion events. Furthermore, the company logo for brand development had to be affixed *i.a.* also on the pit covering and the transporters. Apart from that, advertising was agreed upon in the press folders, in A's racing journal and on A's website. In exchange, A permitted the (worldwide) use of its

6 ECJ judgment of 12 June 2003, C-234/01, Gerritse.

7 FFC judgment of 27 July 2011, I R 32/10, BStBl 2014 II, 513.

8 FMF letter of 17 April 2014, IV C 3 – S 2303/10/10002:001, BStBl 2014 I, 887.

9 ECJ judgment of 12 June 2003, C-234/01, Gerritse and ECJ judgment of 3 October 2006, C-290/04, FKP Scorpio Konzertproduktionen GmbH.

10 EStDV = *Einkommensteuer-Durchführungsverordnung* – income tax implementing regulation.

11 ECJ considered the collecting of tax at source by means of tax withholding as being compatible with Community law. See ECJ judgment of 6 Ocober 2006, C-290/04, FKP Scorpio Konzertproduktionen GmbH; ECJ judgment of 18 October 2012, C-498/10, X and critique Molenaar/Grams, European Taxation 2011, 358.

12 FFC judgment of 6 June 2012, I R 3/11, BStBl 2013 II, 430.

name, its logo and of photos of the racing cars, the drivers and the team to the German company for promotional purposes outside racing times for the term of the contract period. The German company paid an annual total amount and also provided own products free of charge.

The German tax authorities considered that the individual services of the contractual agreement had to be assessed separately, because of their tax classification. In their opinion, a part of A's services would not be subject to taxation and to tax withholding (*e.g.* A's participation on behalf of the plaintiff in promotion events, the affixing of plaintiff's logo on the pit coverings, press folders, transporters, etc.). Other issues, however, were considered differently, such as the remuneration and the affixing of the company logo on the racing cars, the drivers' suits and on the overalls of the team, insofar as these measures would relate to domestic races, because these would be considered as services *connected* with the sports performance and, therefore, also be subject to taxation according to the legal directive (par. 49 clause 1 no. 2d EStG). Insofar as A grants the right to the German company to use its name, its logo, as well as photos of the racing cars for promotional activities outside the races, a limited tax liability, in accordance with par. 49 clause 1 no. 6 in conjunction with par. 21 clause 1 no. 3 EstG, would exist obligating also the execution of a tax withholding in accordance with par. 50a EstG, because these rights were transferred for the use in a domestic permanent establishment. The total remuneration agreed upon should be split by estimation on the revenues according to par. 49 clause 1 no. 2d EStG, to par. 49 clause 1 no. 6 EStG and to the services not subject to tax withholding. The German tax authorities estimated the share of the remuneration pertaining to the affixing of plaintiff's company logo on the racing cars and the drivers' suits during all races and promotional events finally to 67% of the total remuneration (both for the payments made and for the contributions in kind), and the share pertaining to the granting of rights by A to the German company for the use of the name, the logo and of photos of the racing cars for promotional activities outside the races to 23% of the total remuneration and the share (not subject to tax withholding) of the remaining services to 10% of the starting amount. The first two shares were in each case subject to reductions because it could not be excluded that foreign sections of the German companies could use those rights.

The Federal Fiscal Court, as well as the Tax Court Munich[13], being the competent court of first instance, shared the legal position of the German tax authorities as for the outcome. The Federal Fiscal Court explained that A, being resident abroad, realised taxable income within the meaning of par. 49 clause 1 no. 2d EStG from its promotional activities for the German company, such income being subject to tax at source by means of tax withholding, according to par. 50a clause 1 no. 1 EStG, insofar as it pertains to races which took place in Germany. Therefore, a uniform remuneration is to be split initially into domestic and foreign events – as was done – which can be oriented towards the number of the performances to be rendered in total. Thereby, the Federal Fiscal Court found, incidentally, that one cannot distinguish between the granting of rights for the use of the name, the logos as well as of the photos of the racing cars for promotional activities and the remuneration share for the affixing of the company logo of the German company on the racing cars and the drivers' suits during the races and the promotion events. The Supreme German Tax Court summarizes all services owed by A as (uniform) taxable income according to par. 49 clause 1 no. 2d EstG, because it represents (in overall terms) a compensation for services which were connected with the revenues achieved by domestic sports performances. As an exception, only services in the amount of 10% were excluded, because these were indisputably not subject to German taxation.

To begin with, the Federal Fiscal Court states that an essential element for the legal applicability of par. 49 clause 1 no. 2d EStG to define a sports performance is an activity which can be allocated to the term sports[14], which seems uncomplicated with regard to car races.[15] The regulation in question, however, requires also a performance of the sports activity in public, which can be done either by the performer himself (the sportsperson) or by a third party.[16] Thus, such a performance requires an outside-effective activity or rather an activity which can be perceived in public; that is, this will, in particular, be the case if the sports activity takes places in front of an audience or in a competition.[17] In our specific case, the Federal Fiscal Court determined – contrary to the finding of the Tax Court Munich[18] – that the non-resident company A itself renders a sports performance, (too). This approach is justified by an inseparable connection between the sports activity of the racing driver and the racing team, such connection being due to competition consultations (driver rating and constructor rating). In the legal opinion of the Federal Fiscal Court, the tax liability in accordance with par. 49 clause 1 no. 2d EStG is not affected by the fact that A is not paid explicitly by the German company with regard to the mere sports performance.

For the services performed by A the Federal Fiscal Court ruled specifically that these were *services connected* with the sports performances within the meaning of par. 49 clause 1 no. 2d EStG/par. 50a clause 1 no. 1 EStG. In accordance with the relevant case-law of the First

13 Tax Court Munich judgment of 13 December 2010, 7 K 1593/09, EFG 2011, 708.

14 Gosch in Kirchhof, EStG, 11. Aufl., par. 49 Rdnr. 26).

15 Hidien in Kirchhof/Söhn/Mellinghoff, EStG, par. 49 Rdnr. E 275.

16 Hidien in Kirchhof/Söhn/Mellinghoff, EStG, par. 49 Rdnr. E 263, 288 ff., especially Rdnr. 295, Maßbaum in Herrmann/Heuer/Raupach, par. 49 EStG Rdnr. 532, Holthaus, Ausländische Künstler und Sportler im Steuerrecht, 2011, p.. 22 f.

17 Hidien in Kirchhof/Söhn/Mellinghoff, a. a. O., par. 49 Rdnr. E 289 and 294 „Autorennen", Maßbaum in Herrmann/Heuer/Raupach, par. 49 EStG Rdnr. 531.

18 Tax Court Munich judgment of 13 December 2010, 7 K 1593/09, EFG 2011, 708.

Chamber of the Federal Fiscal Court adjudicated so far, one can always presume a service connected with a sports performance within the meaning of par. 49 clause 1 no. 2 d EStG/par. 50a clause 1 no. 1, if a material connection and a personnel connection with the sports main service can be ascertained.[19] At the same time, both the sports main service as well as the ancillary service being explicitly included in the provision must be rendered by the same contractor, consequently from one source. An overall performance of the performer (here A) compensated by a total remuneration is required which justifies that the connected[20] ancillary services are also included as remuneration liable to tax deduction. With regard to the taxation case of A, a direct (objective and temporal) connection between the sports performance on the one hand and the promotional services on the other hand exists.

According to the legal view of the Federal Fiscal Court, the German company was consequently legitimate. Any certificate of exemption within the meaning of par. 50d clause 2 EStG was not submitted and, as a result, the complaining German company should have withheld tax obligatorily.

Recommendations concerning the drafting of contracts

The evaluations of the Federal Fiscal Court to be discussed certainly give reasons to think about the question of drafting contracts and of the corresponding tax planning. Against this background, this approach is of particular importance considering that the principles of the outlined jurisdiction also affect other sports, because sports events, such as football and other team sports, such as handball, are dependent on sponsoring. Therefore, the crucial question should be considered how discussions with the German tax authorities on the allocation of individual taxable services can be reduced or even avoided. The case of the non-resident company A reveals that the legal viewpoint taken should be thought through early enough so that the line of arguments remains cogent. In this context, the author of this article would remind you that, in the case of the company A, the German tax authorities assumed initially that the allocation of the total remuneration into (1) non-taxable remunerations related to a foreign country; (2) the assignment of rights as described; and (3) to promotional services in connection with the races could be done by an even allocation of 1/3 in each sector. Only in the course of the legal dispute, the German company made the mistake to doubt this allocation made by the authorities. As a consequence, the taxable share and thereby the financial liability was increased significantly. The approach providing the result that only 10% of the total remuneration should be allocated to a foreign country is difficult to understand. In 1998, for example, one of the years under dispute, a total of 16 Formula 1 races took place.

In Germany, the Hockenheimring was used for racing (Grand Prix of Germany) and besides the Nürburgring in a second race (Grand Prix of Luxemburg).[21] During the subsequent years (from 2000),[22] the number of races in foreign countries increased to 17, whereas the number of races in Germany remained constant at only two races.

Before going into more detail for the approach mentioned above, the author of this article would like to summarise the basic statements of the judgment of the Federal Fiscal Court as follows:

- advertising services rendered during international sports performances by non-resident sports companies for German companies are subject to tax liability in Germany only if the performances take place in public in Germany;
- an allocation to the domestic and to the foreign country can be effected by means of the number of the relevant performances;
- advertising services in connection with sports performances are considered as revenues connected with the sports performance and are, therefore, subject to tax liability in accordance with par. 49 clause 1 no. 2d EStG;
- if a certificate of exemption, according to par. 50d clause 2 EstG, is not submitted the domestic debtor of remuneration must withhold tax obligatorily. If he refrains from withholding tax, he can be held liable for the omitted tax withholding.

In the first instance, one should bear in mind to include an allocation of the remuneration to different countries already in the contracts concluded between the parties involved. In the case of the foreign company A, an allocation of the contractual total remuneration to Germany and to other countries was made by a numerical allocation in accordance with the number of events. This approach was not rejected by the Federal Fiscal Court. It should be mentioned, however, that an allocation can be made also on the basis of other criteria. Therefore, an allocation based on the number of events is not mandatory. On the occasion of promotional services of a German automobile manufacturer performed by a well-known foreign artist group, the Tax Court Hamburg approved also other allocation possibilities.[23] Besides an allocation in conformity with the number of performances, the Tax Court Hamburg states the following possibilities:

- allocation in relation to seating capacity available;
- allocation in relation to the local advertising for the relevant performance;
- allocation in relation to the ticket

19 FFC judgment of 16 May 2001, I R 64/99, BStBl 2003 II, 641, BFH judgment of 17 November 2004, I R 20/04, BFH/NV 2005, 892, FFC judgment of 28 July 2010, I R 93/09, BFH/NV 2010, 2263, FFC judgment of 16 November 2011, I R 65/10, BFH/NV 2012, 924.

20 Hidien in Kirchhof/Söhn/Mellinghoff, EStG, par. 49 Rdnr. E 395.

21 https://en.wikipedia.org/wiki/1998_Formula_One_season (accessed 2 March 2017).

22 https://en.wikipedia.org/wiki/2000_Formula_One_season (accessed 2 March 2017); https://en.wikipedia.org/wiki/2001_Formula_One_season (accessed 2 March 2017).

23 Tax Court Hamburg, Ruling of 17January 1997, II 97/96, IStR 1997, 177; see also comment on this judgment by Grams, IStR 1997, 183.

sales for the performances;
– or, for simplification purposes, in relation to the number of inhabitants of the countries in which performance series take place, which corresponds with an allocation according to the economic productivity of a country.

The contractual parties involved can finally determine the allocation. A certain creative freedom is quite possible, by which a solution can be found in the course of an individual review. It is important, however, that the allocation result is not effected arbitrarily, but is economically justifiable.

With regard to the German tax legislation, it should be taken into consideration for the contractual drafting that, by allocating a share of the remuneration to rights of use, as *e.g.* for a logo, an exemption of this part of the revenues can be initiated on the basis of the relevant double taxation conventions. Insofar as reference is made to the tax treatment of royalties in the source country and the country of residence, as incorporated in art. 12 OECD, granting the final right of taxation as a general rule solely to the country of residence. Germany, for example, applies this approach in a great number of double taxation conventions, but has agreed upon other allocations in various double taxation conventions, too.[24] For the prevailing number of double taxation conventions concluded by Germany, it is not allowed to tax the licence share finally in the source country. Therefore, it is possible for this share of the remuneration that the exemption procedure as defined in par. 50d clause 2 EStG can be initiated. If the non-resident contractual partner of the German company submits said certificate upon payment of the remuneration, the German debtor of remuneration may refrain from tax withholding. If he, however, does not submit a certificate of exemption, there will remain only the possibility of a refund according to the regulation of par. 50d clause 1 EStG.

It must be clarified, finally, how to treat, under contractual aspects, the relevant share which can still be taxed in Germany. For the purpose of clarification, contractual agreements should be entered into between the parties. With regard to this, it should be borne in mind that, on the basis of the jurisdiction of the European Court of Justice,[25] Germany was forced to change its national legislation. In order to avoid any infringements of the freedom of services guaranteed under Community Law, Germany was obliged to adjust its national legislation and to permit that, prior to tax collection, such business expenses can be deducted that are directly economically connected with the taxable revenues, provided that the non-resident company has its tax domicile in another member State of the European Union, or in a member State of the European Economic Area. As already mentioned above, this approach is reflected, at least partly, in par. 50a clause 3 EStG. In consideration of this entitlement, it should be stipulated in the contract that the domestic debtor of remuneration is obliged, under civil law aspects, to co-operate for the net taxation described above, because the deductible costs can only be taken into account by means of the tax statement of the domestic partner. The tax statement of the domestic company in accordance with par. 73e EStDV includes, in particular, an assessment of its own payable tax debt, thereby assuming the limited tax liability of the non-resident creditor of remuneration (= tax debtor). In line with the remedy raised by the non-resident creditor of remuneration, the statement must be verified only in respect of whether it could be made by the debtor of remuneration, but not whether, for example, there is actually such a limited tax liability.[26] For this reason, the non-resident creditor of remuneration himself (unfortunately) cannot introduce this deduction of costs independently in a procedure before the German authorities.[27] It must be mentioned that, pursuant to this net approach, the non-resident creditor of remuneration is obliged, on his part, to withhold tax from those remunerations which he forwards to sportspersons with limited tax liability. If, for example, a non-resident football player receives for an appearance in Germany a share from the revenues from promotion, tax must be withheld on this share of the remuneration, too (par. 50a clause 4 sentence 2 EStG). As for his taxation procedure, this football player can be considered in the same context, as explained above, for non-resident sports companies.

Summary

The system of taxation of advertising activities for sports performances in Germany is very complex. All services connected with the sports performances can be taxed. The same applies for revenues from sponsoring services which are rendered by a non-resident sports company for a domestic company.

Given these facts, it seems reasonable that contractual agreements are included in civil contracts for advertising/promotional services, where it is specified which share concerning the advertising/promotion can be attributed to Germany respectively to other countries.

In addition, it should be ruled and verified whether the possibility of an exemption, based on the relevant double taxation convention and, accordingly, the monetary estimating of this share, seems reasonable for the assignment of rights of the non-resident company from the sports sector. And last, but not least, the possibility of a tax reduction by the commitment of the German contractual partner for assistance in performing the nex taxation should be emphasized, too.

24 *E.g.* art. 12 DTC Japan or art. 12 DTC Canada, acc. to which Germany can tax at 10%. For these countries only a reduction from 15% (plus solidarity surcharge) to 10% is possible.

25 ECJ judgment of 12 June 2003, C-234/01, Gerritse and ECJ judgment of 3 October 2006, C-290/04, FKP Scorpio Konzertproduktionen GmbH; see also Grams/Molenaar, DStZ 2003, 761 and Molenaar/Grams, SWI 2007, 58.

26 FFC Ruling of 7 November 2007, I R 19/04, BStBl 2008, 228.

27 Critique Harald Grams, RWI 1997, 55.