TRANSFER PRICING
ADMINISTRATIVE PRINCIPLES 2020

On 3 December 2020, the German Federal Ministry of Finance [Bundesfinanzministerium, "**BMF**"] issued the "Administrative Principles 2020" [Verwaltungsgrundsätze 2020, "**AP 2020**"], not yet published in the Federal Fiscal Bulletin at the moment of going to press), which replace the Administrative Principles Procedure (BStBl. 2005 I, 570) to the extent that they deal with questions of the application of sections 90 and 162 German Federal Fiscal Code [Abgabenordnung, "AO", cf. in detail para. 91 AP 2020]. On 25 pages, the VWG 2020 reflect the legal opinion of the tax authorities on questions that may arise in the examination of the attribution of income between internationally associated enterprises with regard to **obligations to cooperate as well as the estimation of tax bases and surcharges**. The publication is to be welcomed, as in particular the provisions of sections 90 and 162 AO as well as the Ordinance on the Documentation of Profit Attribution [Gewinnabgrenzungsaufzeichnungsverordnung, "GAufzV"], to which it also refers, had been revised and adapted in the meantime. The circular is informative insofar as it also goes into details that are not directly regulated in the law. Unsurprisingly, it is in many places pro-fiscal. The following is an overview of important contents.

OBLIGATION TO COOPERATE AND OBLIGATION OF OFFICIAL INVESTIGATION

The AP 2020 emphasize that the tax authority's obligation of official investigation and the taxpayer's obligation to cooperate, the extent of which depends on the individual case and is subject to the principle of proportionality, coexist. In cross-border cases, there is an extended duty to cooperate, section 90 (2) AO, which makes it necessary to prepare transfer pricing documentation if the preconditions of section 90 (3) AO are met. In the event of insufficient cooperation by the taxpayer, the tax authority may make estimates and impose surcharges on the basis of section 162 AO.

SCOPE OF THE EXTENDED OBLIGATION TO COOPERATE

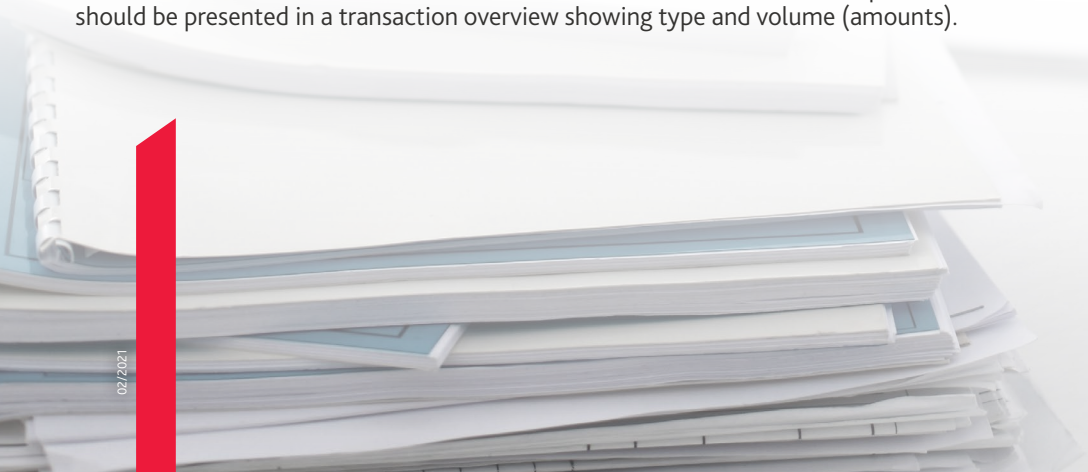
According to marg. no. 9 et seq. AP 2020, the taxpayer **has to take precautionary measures to be able to provide evidence** within the scope of his extended obligation to cooperate in the case of cross-border transactions (section 90 (2) AO). In the view of the German tax authorities, this can **extend to electronic communication** such as e-mails or messenger services, among other things, insofar as they have business content with a tax reference and are thus to be regarded in particular as a commercial or business letter. The BMF expects the taxpayer to ensure that he can also access evidence located abroad at a later date in order to be able to present it to the tax authority. To this end, according to the BMF, a proper business manager would contractually reserve the right to present documents, e.g.

- evidence of sales prices of a related sales company to unrelated third parties when applying the resale price method,
- calculation documents of a foreign service company when applying the cost-plus method,
- evidence of contributions made by the cooperating companies when participating in a cost contribution arrangement,
- evidence of the revenue generated by the licensee from intangibles in the case of the transfer of such assets in return for revenue-based royalties; or
- documentation of the total profit or loss and the allocation formula when applying the transaction-based profit split method.

SPECIAL DOCUMENTATION OBLIGATIONS

Special documentation obligations apply **in transfer pricing cases** pursuant to section 90 (3) AO. The records should enable an expert third party to determine within a reasonable period of time which facts the taxpayer actually realizes and whether and to what extent he has observed the arm's length principle in doing so (marg. no. 25 et seq. AP 2020).

Margin no. 41 AP 2020 contains **examples of information** that can be included in a factual documentation with regard to activity, functions exercised, assets used and risks assumed. The business relationships conducted with the individual respective related parties should be presented in a transaction overview showing type and volume (amounts).



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The AP 2020 do not specify **which point in time should be decisive for the determination of comparative data** (price setting vs. outcome testing approach). The economic and factual circumstances at the moment of the conclusion of a business relationship are decisive for the documentation. Therefore, among other things, it should be recorded when a transaction was concluded and the transfer price was determined. The appropriateness of the business relations actually carried out is to be reviewed, whereby the time of the conclusion of the contract is decisive (ex-ante view). Nevertheless, according to marg. no. 49 AP 2020, external arm's length data can also be used ex-post, as long as they relate to the time of the agreement of the respective business transaction (type).

The "correct" transfer pricing method for the analysis of the appropriateness of a cross-border intra-group business transaction (type) is selected by the tax administration itself, namely the method that proves to be the most appropriate (marg. no. 46 AP 2020). The application of an alternative method could lead to an adjustment "if the results of the alternative method are more likely". The taxpayer is supposed to provide the information required. Whether, apart from cases in which the method applied by the taxpayer was obviously wrong, a request for submission is proportionate seems questionable.

In the case of a hypothetical arm's length comparison, the taxpayer is expected to conduct **sensitivity analyses** that show how the determined value of the valuation object changes depending on alternative assumptions and parameters.

ESTIMATION OF TAX BASES AND SURCHARGES

Marg. no. 67 et seq. AP 2020 deals with the burden of establishing facts and the admissibility and implementation of estimates pursuant to section 162 (1) to (4) AO in the event of violations of the obligation to cooperate. It is made clear that estimates must be **within the bounds of a range** and **must not be punitive in nature.** Estimation results must be plausible, economically possible and reasonable. In the case of violations of the documentation obligations under section 90 (3) AO, the taxpayer has the burden of proof that there has been no reduction in income.

In case of gross violations, the tax authority shall generally be entitled and obliged to determine the tax bases according to the most unfavourable, but still possible, facts for the taxpayer. According to the BMF, **no exaggerated requirements** shall be required for the evidence that the tax authority has to provide in the case of an estimate of transfer prices. Thus, methods and data whose evidentiary value is not sufficient for an income adjustment outside of such an estimate may be used, e.g. tax authorities' reference rates or industry averages. The BMF points out that an estimate does not require that the tax authority has previously made use of international legal and administrative assistance.

According to marg. no. 82 AP 2020, **examples of unusable documentation** that allow for estimates and surcharges are the lack of documentation of facts or economic analysis or the fact that the application of the selected transfer pricing method is not presented. It is emphasized that for the usability of arm's length data, it is not the quantity but the quality that is decisive. The BMF also points out that the legal consequences of violating the obligation to keep records pursuant to section 90 (3) sentences 1 and 2 AO occur in relation to individual (aggregated) business transactions (cf. section 3 GAufzV).

The submission of usable records shall not preclude the tax authority's power of estimation pursuant to section 162 (1) and (2) AO. However, the prerequisite for an income adjustment shall be that the transfer prices applied are highly unlikely to be in line with arm's length principle and that the transfer price determined by the tax authority is at least more likely. According to the AP 2020, this could be the case if, for example, the tax authority applies a different transfer pricing method than the taxpayer and chooses a database study as the estimation method. Whether such a power of estimation exists in the case of the submission of usable records appears questionable.

BDO CONTACTS

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