

NEW GERMAN ADMINISTRATIVE PRINCIPLES - **TRANSFER PRICING**

Summary of significant changes

On 14 July 2021, the German Federal Ministry of Finance (hereinafter: "BMF") published the Administrative Principles Transfer Pricing – Principles for the correction of income in accordance with section 1 Foreign Tax Act (ref.: IV B 5 - S 1341/19/10017 :001; hereinafter: "VWG 2021") which are to be applied with immediate effect in all open cases.

The VWG 2021 replace various previously relevant BMF circulars in the area of transfer pricing and explicitly refer to the OECD Transfer Pricing Guidelines 2017 (hereinafter: "OECD GL") in several places. Even though the VWG 2021 only reflect the view of the tax authorities and are solely binding for them, they should in principle also be observed by taxpayers for reasons of legal certainty.

In the following, we summarize the most important contents of the VWG 2021 from our ongoing consulting practice.

COMPARISON OF BUDGET WITH ACTUAL FIGURES

The relevant point in time for an arm's length comparison should generally be the conclusion of a contract. If a taxpayer determines his or her transfer prices on the basis of internal planning data and return ratios, the actual development of the underlying data and ratios should be reconciled during the year and needs to be carried out at least by the end of a fiscal year.

If the actual result is outside the range of appropriate results of the respective return indicator, a retrospective adjustment needs to be made.

INTRODUCTION OF THE RISK CONTROL APPROACH AND DEMPE FUNCTIONS

According to the OECD GL, within the context of the risk control approach of an arm's length comparison it should be analyzed which party or parties to the transaction have the human resources and the actual ability to control risks, as well as the financial resources to bear them.

Also, when allocating income from intangible assets, it should be analyzed and documented who is in a position to control the risks associated with the so-called DEMPE functions performed, i.e. which person performs the relevant functions regarding development, enhancement, maintenance, protection and exploitation of intangible assets.

USE OF CORPORATE IDENTIFIERS AND TRADEMARKS

The transfer as well as the surrender of use of corporate identifiers and trademarks within a multinational group of companies are being dealt with separately in the VWG 2021. On the one hand, reference is made to the comments on the transfer of intangible assets in the OECD GL, on the other hand, the explanations of the BMF regarding the merits and levels of a fee (for the use of names and trademarks within a group) are being specified. Whether this means that in practice the price comparison method, i.e. the use of external data (e.g. agreed license rates among third parties), will be pushed into the background, remains to be seen.

REMUNERATION FOR FINANCING RELATIONSHIPS

The legislator had already made an attempt to legally regulate the arm's length principle regarding financing relationships within multinational groups of companies in the context of the legislative process for the ATAD Implementation Act (German: "Gesetz zur Umsetzung der Anti-Steuervermeidungsrichtlinie der EU", i.e. a law implementing the EU's "Anti Tax Avoidance Directive"). The VWG 2021 contain, among other things, the following statements regarding intra-group cross-border financial transactions:

- ▶ In the case of loans, it should first be examined whether these should also be considered as debt capital for tax purposes. A loan must be needed economically and used for the company's purpose for the associated interest payments to be recognized for tax purposes.
- ▶ The remuneration of financing companies that do not exercise risk control or risk-bearing capacity is to be limited to the amount of a risk-free rate of return based on the cost-plus method without including refinancing costs in the cost basis.
- ▶ If, for reasons outside the loan relationship, instead of a required injection of equity capital, an interest-free or low-interest loan is granted instead, the interest-free or low-interest loan as such shall not result in a partial write-down of the value of the loan.
- ▶ Group retention is seen as a legally unenforceable security. Nevertheless, it should be considered when measuring the subjective probability of default.
- ▶ Collateralizations are generally considered to be at arm's length. Whether a non-collateralization happens to be at arm's length exceptionally, needs to be assessed based on a catalog of criteria.
- ▶ The advantages of an increased creditworthiness through a guarantee, surety or other collateral shall be compensable, if an actual risk position is assumed.
- ▶ As for cash pool structures, it is assumed that the cash pool manager regularly provides a low-function and low-risk service which in turn should be remunerated by means of the cost-plus method. In the case of ex post non-short-term deposits, base amounts shall be treated as long-term loan relationships.

CORRESPONDING ADJUSTMENTS WITHOUT MUTUAL AGREEMENT PROCEDURES OR ARBITRATION PROCEEDINGS

If transfer prices are adjusted by a foreign tax administration, in cases where a provision corresponding to Art. 9 of the OECD Model Tax Convention is applicable, a subsequent corresponding adjustment may be recognized without prior mutual agreement procedure or arbitration proceedings (if it is permissible under domestic substantive and procedural law). In doing so, the VWG 2021 refer to the application of domestic tax deduction limitations.

LOSS-MAKING ENTITIES

The VWG 2021 generally assume that independent companies would discontinue the operation of loss-making enterprises or activities, if a total profit does not appear to be achievable within a foreseeable period (regularly five years). As a qualification, it is stated that it may be advantageous from a group point of view to continue the uneconomical business operations of a group company. In such case, the entity with the loss-making activity is to be compensated by the group companies benefiting from the continuation of such activities.

EFFECTIVE SUPPORT FROM BDO

Please do not hesitate to contact your BDO representative for a quick check to identify the need for action. We will be happy to support you in analyzing and, if necessary, adapting your transfer pricing system with respect to the provisions of the VWG 2021.

BDO CONTACTS

The **international tax services department** of BDO in Frankfurt am Main would be pleased to support you in planning, documenting and defending the agreed transfer prices.



Dr. Dirk Elbert
International Tax Services Partner
Transfer Pricing
Phone: +49 (0) 69 95941 438
dirk.elbert@bdo.de



Dr. Arwed Crüger
International Tax Services Partner
Transfer Pricing
Phone: +49 (0) 69 95941 548
arwed.crueger@bdo.de



Lars von Jesche
International Tax Services Partner
Transfer Pricing
Phone: +49 (0) 69 95941 464
lars.vonjesche@bdo.de



Richard Wellmann
International Tax Services Partner
Transfer Pricing
Phone: +49 (0) 69 95941 263
richard.wellmann@bdo.de

WirtschaftsWoche

TOP
Steuerberatung
Internationales
Steuerrecht
— 2020 —
BDO AG

In Kooperation mit:
Handelsblatt Research Institute
Ausgabe 32/2020

We have compiled the information in this publication with due care. However, they are of a general nature and can naturally lose their currentness over time. Accordingly, the information contained in our publications does not replace individual professional advice, taking into account the specific circumstances of the individual case. Accordingly, BDO assumes no responsibility for decisions taken on the basis of the information contained in our publications, for the currentness of the information at the time it is made available, or for errors and/or omissions.

BDO AG Wirtschaftsprüfungsgesellschaft, a German stock corporation, is a member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO member firms.

Copyright © BDO