TP Perspectives - Newsflash

Dear Readers,

On July 14, 2021, the German Federal Ministry of Finance (hereinafter: "MoF") published on its website new **Administrative Principles Transfer Pricing - Principles for the Adjustment of Income Pursuant to Section 1 of the German Foreign Tax Act ("AStG") (**IV B 5 - S 1341/19/10017 :001) (hereinafter: "VWG 2021").[1] The VWG 2021 are to be applied by the tax authorities to all open cases with immediate effect and replace various MoF circulars relevant to transfer pricing to date (e.g. Administrative Principles 1983, Administrative Principles Procedure 2005 and Circular regarding the use of company names in company groups).

Overview

The new VWG 2021 with their 44 pages are based on the OECD Transfer Pricing Guidelines 2017 (hereinafter: "OECD TPG")[2], which are attached to the VWG 2021 as Annex 1 and through the application of which, according to the tax authorities, a uniform international implementation of the arm's length principle should be ensured and double taxation avoided. On the one hand, the VWG 2021 concretize the OECD TPG as a guideline for the German tax authorities, but on the other hand (despite the fundamental commitment to follow the OECD TPG) they deviate from them in part - and sometimes it seems without a German legal basis. Important points that have been taken from the OECD TPG into the VWG 2021 are, for example, the application of the DEMPE concept for transactions with intangible assets (licensing, transfer),[3] the risk control approach in the context of functional and risk analyses, as well as the simplification rules for so-called low value-adding services. In addition to the OECD TPG, the VWG 2021 also contain references to reports of the EU Joint Transfer Pricing Forum (hereinafter: "EU JTPF") and a reference to the (non-binding) UN Practical Manual on Transfer Pricing for Developing Countries (hereinafter: "UN TP Manual") with regard to emerging and developing countries.

Even though the VWG 2021 are not legally binding on courts and taxpayers, they nevertheless contain a lot of practice-relevant information for taxpayers, e.g. for current and future external tax audits, in which the topic of transfer pricing often plays a central role.

Key Takeaways

- The risk control approach of the OECD TPG including the DEMPE functions becomes a focal point of the arm's length analysis. This is likely to result in additional analysis and documentation efforts for taxpayers, since on the one hand the risk control aspect will assume considerable importance in the functional and risk analysis (especially in the differentiation and arm's length remuneration of routine entities compared to entrepreneurs/strategy bearers). On the other hand, especially in the case of business transactions involving intangible assets, the DEMPE functions exercised must be analyzed and documented, again also against the background of the extent to which the related

[1] Available at: https://www.bundesfinanzministerium.de/Content/DE/Downloads/BMF_Schreiben/Internationales_Steuerrecht/Allgemeine_Informationen/2021-07-14-verwaltungsgrundsaetze-verrechnungspreise.pdf?__blob=publicationFile&v=4, last accessed July 19, 2021.

[2] This version also includes Chapter X on Group Financing Transactions, published on February 11, 2020, as well as the updated recommendations on the application of the transaction-based profit split method.

[3] Even before the publication of the VWG 2021, the German tax authorities had assumed that the DEMPE concept (now also implemented in Sec. 1 (3c) AStG) was applicable from a German transfer pricing perspective and that this would only be clarified.

parties involved in the business transactions control the risks associated with the DEMPE functions.

- With regard to the arm's length principle, the VWG 2021 state that it is to be applied equally to both inbound and outbound cases. It remains to be seen to what extent this is relevant in practice. The German transfer pricing rules do contain provisions that act unilaterally in favor of the German tax authorities.
- Similarly, the VWG 2021 state that the arm's length principle should not be used to determine the profits that the taxpayer would have generated as an independent company. Rather, from an arm's length perspective, profits are to be achieved that the taxpayer would have achieved as part of a group of companies under similar conditions as those between unrelated third parties. In this context, it is clarified, among other things, that conditions resulting from the mere affiliation to a group of companies are not to be taken into account (e.g. group support (*Konzernrückhalt*)).
- The concept of a hybrid company, which is a company considered to be between a routine company and an entrepreneur bearer from the Administrative Principles Procedures 2005 is no longer pursued in the VWG 2021.
- The simplified approach to the remuneration of low value-adding services (i.e. application of the cost-plus method with a profit mark-up of 5%, which is to be regarded as arm's length, without the need for an in-depth analysis) is adopted from the OECD TPG. However, activities in the areas of research and development, manufacturing and production, sales, marketing and distribution are excluded.
- According to the VWG 2021, benefit off-setting (i.e. the offsetting of disadvantageous conditions of a business transaction by another advantageous business transaction) is generally permissible under certain conditions (internal connection of the business transactions; advantages and disadvantages can be quantified; benefit sharing is deliberately agreed or is part of the basis of the disadvantageous business transaction). However, it is stated in a restrictive manner that the disadvantageous conditions of the taxpayer (e.g. unusually lower profits or losses that would not be customary for third parties) can only be offset by another business transaction with the same contractual partner. This is expected to result in considerable administrative effort if, for example, the results have to be segmented at the transaction level for each contractual partner.
- For the determination of transfer prices in the transfer or transfer of use of intangible assets, the application of the hypothetical arm's length principle is the preferred method for the German tax authorities. At the same time, however, the VWG 2021 state that for the transfer or transfer of use, in particular, of company trademarks or brands the so-called license price analogy recognized by the Federal Court of Justice, which represents a variant of the comparable uncontrolled price method, can serve as a starting point for the individual case examination. Against this background, it remains unclear what role other transfer pricing methods such as the comparable uncontrolled price method should play, especially since, for example, external arm's length values (e.g. license rates) are usually used in the valuation of intangible assets and this view is also shared by the EU JTPF.
- With regard to the application of ranges in determining arm's length transfer prices or profit ratios, the VWG 2021 refer to the interquartile range standardized in Sec. 1 (3a) Sentence 3 AStG in the case of limited comparability. However, due to the repeal of the 2005 Administrative Principles Procedure, which had presented the exact determination of the interquartile range using a calculation example, it remains open how the interquartile range is to be determined in practice. This is likely to lead to possible discussions in external tax audits. Likewise, the statements made by the tax authorities that constant adjustments to the upper or lower value of the arm's length range resulting from the comparison of planned/actual figures would indicate conditions that are not at arm's length presumably hold considerable potential for discussion. This assumption is not covered by a German legal basis or the OECD TPG.

- The view of the tax authorities on financing relationships set out in the VWG 2021 (checking in a first step whether there is any debt capital at all, remuneration of financing companies and cash pool leaders based on the cost-plus method, emphasis on the group rating, collateralization of loans) is similar in structure and content to Section 1a AStG, which was considered as part of the draft bill for the ATAD Implementation Act (ATADUmsG) but was not adopted. In this respect, increased discussions in external audits are also to be expected in the area of financial transactions, in particular because the legal basis is doubtful.

Conclusion and outlook

The VWG 2021 is intended to achieve an internationally uniform application of the arm's length principle by orienting it to the OECD TPG. In principle, this approach of the tax authorities is to be welcomed, if it would help to avoid double taxation and lengthy mutual agreement procedures in transfer pricing cases. However, it should be emphasized that some of the assumptions of the tax authorities do not appear to be covered by a relevant German legal basis or the OECD TPG and in some cases also difficult to implement in practice (e.g. five year price adjustment period). Thus, discussions in tax audits are to be expected.

Detailed overview of the contents of the VWG 2021

Given that currently no official translation of the VWG 2021 is available, we provide an extensive summary of the VWG and comment on the most relevant sections.

Chapter I: Principles of income correction (para. 1.1 to para. 1.23)

Regulations on income correction and competitive relationship (para. 1.1 to 1.6)

Firstly, reference is made to the relevant legal bases for income adjustments in the case of business relationships between related companies (paragraph 1.1) or between the parent company and its permanent establishment (paragraph 1.2).

Subsequently, the competitive relationship between the correction norms is discussed. Accordingly, there should be no right of choice for the application of Sec. 1 AStG, but rather it should be applied in addition to, or instead of, the other correction rules, insofar as these do not ensure the recording of the correct domestic profit. It is the opinion of the tax authorities that if the recognition of the applicable domestic profit has already been ensured by the regulations on hidden profit distribution (*verdeckte Gewinnausschüttung*) or hidden contribution (*verdeckte Einlage*), the application of Sec. 1 AStG is unnecessary. The amount of the domestic profit is to be determined as a whole, taking into account corrections and counter-corrections. Insofar as these compensate each other in Germany (consumption of benefits), only Sec. 1 AStG should be applied and the application of the other correction norms - also at shareholder level - should be suspended (para. 1.3), cf. Federal Fiscal Court ("BFH") of November 27, 2019 (I R 40/19). A typical case of application is, for example, a loan granted free of charge or at a reduced rate by a German subsidiary to its foreign sister company, whereby the (common) parent company is also resident in Germany. In this constellation, the adjustment to the arm's length interest rate should only be made at the level of the German subsidiary via Sec. 1 AStG.

Furthermore, cases are shown in which the amount of the adjustment under Sec. 1 AStG exceeds the adjustments made under the other provisions. The adjustment to the median pursuant to Sec. 1 (3a) Sentence 4 AStG is mentioned by the tax authorities (in the case of a hidden profit distribution, the adjustment can only be made to the fair market value, and in the case of a hidden contribution, the

adjustment can only be made to the partial value). In addition, examples of competing applications are listed on the merits (para. 1.4).

Finally, it is stated that the arm's length principle is contained in every double taxation treaty concluded by Germany and that national tax law is to be used for the implementation of income adjustments, with Section 1 AStG implementing the international arm's length principle in the view of the tax authorities (para. 1.5). This can certainly be doubted in view of the provisions, some of which are very far-reaching and go beyond the OECD TPG (e.g. median adjustment for values outside the arm's length range, transfer package valuation for cross-border transfers of functions, etc.). Furthermore, it is clarified that the application of the arm's length principle can also refer to the reason and further conditions of a business relationship and not only to the adjustment of a (transfer) price.

Finally, paragraph 1.6 stipulates that the national income correction rules are also applicable in cases of interlinked interests not mentioned in the double taxation treaties.

Relation to CFC rules (*Para. 1.7 to 1. 8)*

Paragraphs 1.7 and 1.8 deal with the competing relationship between the income correction rules and the standards for the CFC taxation. However, any double taxation of the same income resulting from this must be appropriately dissolved in accordance with paragraph 1.8, which may require offsetting adjustments when determining the income of the intermediate company that is subject to additional income under CFC rules. This applies in particular to business transactions between the German parent company and its foreign intermediate company, insofar as these have led to a reduction in income in Germany due to transfer prices not in line with the arm's length principle. In order to avoid double taxation, the adjustment amount at the level of the parent company must be deducted accordingly when determining the (passive) income of the intermediate company in such constellations.

Related party (Sec. 1 (2) AStG) (paragraphs 1.9 to 1.15)

In para. 1.9, it is first clarified that related parties within the meaning of Sec. 1 (2) AStG can be natural persons and legal entities, but also partnerships and co-partnerships.

The interdependence through dominant influence can be based on legal or factual grounds or on the interaction of both, whereby the interdependence is already to be established by the mere possibility of exercising a dominant influence (para. 1.10).

According to paragraph 1.11, direct and indirect shareholdings of a taxpayer are to be added together for the purpose of assessing whether a related party relationship within the meaning of Sec. 1 (2) AStG exists. The participation quotas of the indirect participations are to be calculated proportionately by multiplying the respective quotas with each other (example: A has a direct participation of 20% in T2, which in turn holds 10% in T1. In this case, A's indirect shareholding in T1 is 20% x 10% = 2%).

Paragraph 1.12 clarifies that the existence of an influence outside the business relationship does not require a controlling influence, but that there must be a possibility that, due to the influence, there is no conflict of interests sufficient for the arm's length negotiation of the terms and conditions of the respective business relationship.

Finally, paragraphs 1.13 to 1.15 deal with cases of relatedness due to one's own interest in generating the income of another (Sec. 1 (2) No. 4 Alt. 2 AStG). This could be the case, for example, with all participants in networks and their organizational units as well as with pyramid-like organizational structures.

Business relationship (Sec. 1 (4) AStG) (paragraphs 1.16 to 1.23)

According to paragraph 1.16, business relations within the meaning of Sec. 1 (4) AStG are understood to be individual or several interrelated economic transactions (business transactions) between a taxpayer and a related party.

Following the now repealed paragraph 1.4.3 of the 2004 AStG decree, the tax administration is of the opinion that business relations with foreign countries between related parties can also exist by means of domestic or foreign permanent establishments (para. 1.17). For example, business transactions between two domestic companies may fall within the scope of Sec. 1 AStG if the transaction is attributable to a foreign permanent establishment at the level of one of the two companies. The same should apply to transactions between two foreign companies if the transaction at the level of one of the two companies is attributable to a domestic permanent establishment. Consequently, such transactions would also have to be considered and, if necessary, included in the transfer pricing documentation. Critically, this interpretation contradicts the BFH ruling of April 28, 2004 (I R 5-6/02), against which the MoF issued a non-application decree on July 22, 2005 (IV B 4 - S-1341 - 4/05).

A similar line of thought is followed in paragraph 1.18, according to which, business relations with foreign countries may also exist if a business transaction between foreign related parties takes place which affects the amount of domestic income of one of the persons (for example, in the case of renting out domestic real estate).

Paragraphs 1.19 to 1.21 deal with the distinction between agreements under the law of obligations and agreements under company law, as the latter do not fall within the scope of application of Sec. 1 AStG. Accordingly, an agreement under company law is to be understood as an agreement which directly leads to a legal change in the shareholder's position (e.g. the amount of the participation or the participation rights), i.e. which is associated with a change in the material shareholder's position. However, the transfer of voting rights may constitute a business relationship if it is accompanied by an economic advantage which would be remunerated between unrelated third parties.

Paragraph 1.22 reiterates (see also para. 1.5) that Sec. 1 AstG not only permits a correction of prices that are not in line with the arm's length principle, but also a correction of income reductions caused by conditions that are not in line with the arm's length principle. With regard to the question of the recognition of business relationships as such, an assessment of all the circumstances of the individual case (and not isolated individual conditions) must always be carried out. However, circumstances which cannot be agreed upon by related parties (e.g. legal framework conditions or the conditions of the respective market) are not to be considered as conditions, although these are to be taken into account as comparative factors within the framework of the arm’s length analysis (para. 1.23).

Chapter II: Relevance of the OECD Transfer Pricing Guidelines for the Audit of Cross-Border Business Relationships (pararaphs. 2.1 to 2.6)

In order to ensure an international orientation and alignment with the OECD TPG, reference is made in paragraph 2.1 to the OECD TPG attached as Annex 1. According to the tax authorities, their application is intended to ensure a uniform international implementation of the arm's length principle and to avoid double taxation.

In para. 2.3, it is then stated that, in the view of the tax authorities, a static or dynamic interpretation of Article 9 (1) OECD Model Tax Convention or UN Model Tax Convention Articles in the respective Double Tax Agreement is not relevant for the decision, since the application of the arm's length principle is

primarily based on the application of time- and context-dependent economic principles. The view taken by the tax authorities here is likely to be at odds with the long-standing case law of the BFH, which has repeatedly advocated for a static interpretation (in para. 2.3 itself, reference is made to corresponding BFH rulings in this context).

In addition to the OECD TPG, paragraphs 2.5 and 2.6 also contain references to reports of the EU JTPF, in particular for situations involving an EU member state, and to the UN TP Manual, in particular for situations involving developing countries.

Chapter III: Guidelines (paragraphs 3.1 to 3.102)

Arm's length principle (paragraphs 3.1 to 3.8)

Paragraphs 3.1 to 3.8 summarize the key points of the arm's length principle as understood by the tax authorities. These include the application of the concept of the dual ordinary manager (paragraph 3.1), the focus on actual circumstances (paragraph 3.2), its uniform application in inbound and outbound cases (paragraph 3.3), the risk control approach (paragraphs. 3.5 to 3.7) and the analysis of realistically available options (*Handlungsoptionen*) (paragraph 3.8). In principle, para. 3.4 emphasizes that the profit to be determined in the context of the arm's length principle is not that which independent transaction partners would have achieved on the market. Rather, the profit that profit-maximizing transaction partners have achieved within a group is to be determined.

Relevant for practice is the renewed emphasis on the risk control approach, which will thus play a more central role in the transfer pricing documentation than before. The analysis of realistically available options and the two-sided analysis from the perspective of both transaction partners will probably continue to be of more importance in the context of corporate restructurings. It remains to be seen to what extent the requirement for the uniform application of arm's length pricing in inbound and outbound cases will be relevant in practice. For example, the German transfer pricing rules do contain provisions that act unilaterally in favor of the German tax authorities.

Transfer pricing methods and valuation techniques (paras. 3.9 to 3.17)

Paragraphs 3.9 to 3.11 deal with the transfer pricing methods listed in the OECD TPG and their application. Paragraphs 3.12 to 3.17 essentially deal with the application of the hypothetical arm's length comparison, e.g. with regard to permissible valuation methods, the plausibility and consistency of the valuation assumptions and the handling of the situation in cases where an agreement/settlement is not reached.

The clear commitment of the tax authorities to the hypothetical arm's length comparison in the determination of transfer prices in the context of transfer of functions and for the isolated valuation of intangible assets is relevant for practice (para. 3.12). This shows a clear reservation of the tax authorities against license database studies.

Comparability analysis (paras. 3.18 to 3.44)

Basic principles. The principles of the comparability analysis (paras. 3.18 to 3.22) essentially correspond to the OECD TPG. Reference is also made to the "Report on the use of comparables in the EU" of the EU JTPF (para. 3.18). In the comparability analysis, all factors relevant to the comparability test should be taken into account and documented (paras. 3.19 and 3.20). Moreover, multi-year values were generally permissible (para. 3.21). Comparability is not given if the business relationships used for comparison differed significantly from the audited intragroup business transaction or if, among other things, specific

intangible assets were part of the business transactions (para. 3.22). The latter point coincides with the apparent preference expressed in the 2021 VWG for the application of the hypothetical arm's length comparison in the context of intangible assets.

Grouping of business transactions. Paragraphs 3.23 to 3.24 clarify that the aggregation of transactions (i.e. grouping) is generally permissible. According to paragraph 3.23, this applies in particular to closely related or closely successive business transactions for which an assessment of the individual business transaction is not possible. From the point of view of the taxpayer, it should be welcomed that the VWG 2021 recognize that a grouping of business transactions may be in line with the taxpayer's business strategy. It is also worth emphasizing that, according to paragraph 3.24, the determination of individual prices can be dispensed with if an overall package of transactions is provided (package approach) and reliable arm's length values can be presented for this.

Benefit sharing *(Vorteilsausgleich)*. Paragraphs 3.25 to 3.28 refer to the sharing of benefits in the case of intra-group transactions, i.e. where related parties agree to offset disadvantageous transactions with advantageous transactions (paragraph 3.25). Paragraph 3.26 clarifies that 1) the business transactions must be internally related, 2) advantages and disadvantages must be quantifiable, and 3) the compensation of advantages must have been expressly agreed upon or be part of the business basis of the disadvantageous business transaction. If a loss or an inappropriately low profit for a business transaction already results from the price determination, this would have to be compensated by the same contracting party (paragraph 3.27) and this would have to be done within a "reasonable period of time" (unless this has already happened in the current business year) (paragraph 3.28).

Loss-making enterprises. The topic of loss-making enterprises is addressed in paragraphs 3.31 to 3.37. Paragraph 3.31 indicates that independent companies would discontinue a permanently loss-making operation, while cases may exist where it may also be advantageous from a group perspective to continue the uneconomic business operations of a group company. In this case, the loss-making company would have to be compensated by the profit-making group companies. In this context, it is a welcome reference that the operational processes are subject to the entrepreneurial freedom of disposition according to paragraph 3.32. However, against the background of the risk control approach, it is stated that it is not considered in line with the arm’s length principle for a company to be assigned risks over which it neither has the relevant decision-making authority (i.e. to assume or reduce the risks) nor the financial capacity to assume such risks (risk control aspect).

According to the VWG 2021, this applies in particular to routine companies (paragraph 3.33), which should only generate losses for a short period of time and show an appropriate total profit within five years, although this period may be deviated from upwards (e.g. in the case of high initial investments or due to market conditions that cannot be influenced) or downwards (e.g. in the case of products with a short life cycle) in individual cases (paragraph 3.34). Finally, it is stated that the loss situation should be analyzed against the background of the functions performed and risks borne (para. 3.35), that an adjustment of the transfer prices applied should also be made if a distribution company is supplied at the same prices as third parties in the event of differing business conditions (para. 3.36), and that capital injections or capital-replacing measures are an indication of a group interest in continuing the unprofitable business activity (para. 3.37). In order to be prepared for possible discussions in tax audits, taxpayers should document the reasons why group companies with a limited functional and risk profile have not generated an appropriate total profit in the five-year period under review (or a shorter or longer period in individual cases) and why this is not justified by the group interest.

Time of the arm's length comparison. In the next step, paragraphs 3.38 to 3.44 focus on the point in time of the arm's length comparison. According to paragraph 3.38, the conclusion of the contract and not

the time of performance is decisive. According to paragraph 3.39, the thinking of a prudent and conscientious business manager (i.e. a third party) would check, in particular in the case of negotiations on long-term agreements, whether changes to the agreements would be legally possible and economically advantageous and whether there would be other realistically available alternative options. Accordingly, the point in time at which a third party would have negotiated new contractual conditions or entered into a new, more advantageous business relationship must also be taken into account. From the explanations, a form of the ex ante approach in the arm's length analysis thus arises in principle, which is, however, put into perspective by paragraph 3.39. According to this, taxpayers should document the terms and conditions applied at the time of the conclusion of the contract, but at the same time also regularly analyze and document arm's length adjustments to the contractual terms and conditions that a third party would make (especially in the case of long-term contracts).

According to paragraph 3.40, budgeted calculations for the determination of transfer prices are permissible, in particular for the application of certain return ratios, whereby existing empirical values and cautious, economically justified expectations should be used and a target/actual comparison should be carried out at least at the end of the financial year (paragraph 3.41). In the event of deviations of actual results from the range of results customary for third parties, appropriate adjustments should be made in accordance with paragraph 3.42. In addition, according to paragraph 3.43, the selected transfer prices and the forecast planning data should be used to achieve an average value within the range for the respective return ratio in the case of a "cautious profit forecast". A legal basis for the "mean value" (which may be interpreted as a median) is not stated and does not exist in this form, which is why paragraph note 3.43 should be viewed critically in principle.

To be seen equally as critically is the assumption stated in paragraph 3.44 that constant adjustments (after the target/actual comparison) of the results of "preferred" or "disadvantaged" group companies to the upper or lower value of the arm's length range would indicate a lack of arm's length (contractual) conditions (because: by definition, arm's length results within the arm's length benchmarking range cannot indicate behavior that is not in line with the arm's length principle). This and also paragraph 3.43 are fundamentally not in line with the arm's length approach according to the OECD TPG. According to the OECD TPG, in the case of limited comparability (i.e. application of the interquartile range explicitly mentioned in the VWG 2021), each value within the interquartile range is to be regarded as equally likely and at arm's length. The assumption is also not covered by the relevant legal basis in Sec. 1 (3a) AStG, according to which a median correction can only be applied if results lie outside the range and the taxpayer does not credibly demonstrate that other values within the range comply with the arm's length principle. This can result in considerable potential for discussion for taxpayers in external tax audits.

Administrative approaches to avoid and resolve transfer pricing conflicts (para. 3.45)

In paragraph 3.45, reference is made to the *Fact Sheet on International Mutual Agreement and Arbitration Proceedings in the Field of Taxes on Income and on Capital of October 9, 2018 (BStBl. I p. 1122)*, the *Fact Sheet on Bilateral or Multilateral Advance Pricing Agreements on the Basis of Double Taxation Treaties for the Issuance of Binding Advance Pricing Agreements between Internationally Associated Enterprises ("Advance Pricing Agreements" - APAs) of October 5, 2006 (BStBl. I p. 594) and the Fact Sheet on Coordinated Tax Audits with Tax Administrations of Other States and Territories of October 5, 2006 (BStBl. I p. 594). "Advance Pricing Agreements" - APAs) of October 5, 2006 (BStBl. I p. 594)* and the Fact Sheet *on Coordinated External Tax Audits with Tax Administrations of Other States and Territories of January 9, 2017 (BStBl. I p. 89).*

Documentation (paragraph 3.46)

In paragraph 3.46, reference is made only to the *Administrative Principles 2020 of December 3, 2020 and* the *Application Decree to the German Fiscal Code on Sections 90, 138a and 162 AO.*

Intangible assets (paragraphs 3.47 to 3.61)

Paragraphs 3.47 to 3.61 deal with fundamental questions regarding intangible assets (paragraphs 3.47 to 3.52). The same paragraphs also emphasize the application of the DEMPE concept of the OECD TPG (paragraphs 3.53 and 3.54) and deal intensively with the use of corporate names/ identifiers and trademarks (paragraphs 3.55 to 3.61).

With regard to fundamental considerations on intangible assets, it is above all relevant that, according to paragraph 3.51, it is only appropriate to charge a license if the licensee generates a reasonable profit from the use. The conclusion of profit-related licenses by taxpayers should therefore be increasingly recognized by the tax authorities. It is also noteworthy that the VWG 2021 explicitly rejects the price adjustment rules of the OECD TPG and refers to the adjustment rules under Section 1a AStG. This view is likely to increase the risk of conflicts with foreign tax administrations in practice.

What is noteworthy about the comments on the use of corporate identifiers and trademarks is the detailed treatment of the legal protection of trademarks as a necessary condition for a party to charge a fee for the use of the trademark (para. 3.56 to para. 3.57). In practice, this means that the taxpayer should carry out a detailed analysis of its trademark portfolio not only to defend itself against trademark infringements by third parties, but also from a tax perspective. If a trademark is not protected because, for example, it is not registered in a certain territory or is only registered for a certain use, the charging of a license would not apply on the merits.

Supplies of goods and services (paragraphs 3.62 to 3.80)

Supply of goods. paragraphs 3.62 and 3.63 comment on the supply of goods. In particular, they state that potential financing services (e.g. payment terms), provisions or ancillary services for supply transactions should be taken into account in the transfer price. In addition, there should be no chargeable or chargeable use of intangible assets due to the acquisition and subsequent use of such goods, provided they were manufactured using such assets. Accordingly, the corresponding conditions of the existing supply transactions should already be taken into account in the transfer price planning of e.g. goods prices.

Services. Paragraphs 3.64 to 3.73 address the principles for the treatment of services between related parties. At the outset, reference is made to the application of the principles of Chapter VII of the OECD TPG. In particular, the opinion on the remuneration of services and the transfer pricing method to be applied is presented and the link between services in connection with the supply of goods is established, i.e. that such services cannot be charged separately if they are usually included in the price of the goods between unrelated third parties (para. 3.73).

Separate charging of services is, however, given if the chargeability (para. 3.65) of these can be concretely justified by the fact that an independent third party would be prepared to provide these services against payment or to obtain these services against payment or to provide such services as an own service.

Services must actually be provided; a mere offer of such services is not sufficient for charging a service fee (paragraph 3.67). However, services on call may also be eligible for payment if certain criteria are met (paragraph 3.68). Here again, the arm's length principle is applied, namely that an independent third party

would also have been prepared to pay a fee for such availability on demand. The tax authorities specify that an independent third party would not pay a fee if the probability of the service being required is low, the benefit is insignificant, or the service can be procured promptly elsewhere at a lower cost.

It is also clarified that the procurement of a service constitutes an independent service (para. 3.66), which must also be remunerated at arm's length taking into account the costs incurred for this (the costs of the brokered services are not to be included here).

In particular, shareholder expenses are not eligible for compensation (paragraph 3.69). This includes, in particular, expenses incurred as a result of the obligations of a shareholder under company law. A list of non-exhaustive examples is provided. However, services provided by a company in the interest of a shareholder must generally be remunerated at arm's length (paragraph 3.70). Furthermore, benefits (paragraph 3.71) resulting from pure group affiliation are not remunerable (group retention).

For the charging of services (and financing, insurance, and reinsurance services), the application of the cost-plus method (based on all direct and indirect costs) is considered to be generally appropriate - provided that the comparable uncontrolled price method is ruled out (para. 3.73).

Overall, the VWG 2021 bring few innovations with regard to the provision of goods and services. Overall, all material circumstances in the planning of the prices of goods are to be taken into account in the transfer price (delivery transactions). With regard to services, their ability to be paid and remunerated is to be taken into account. In this context, the arm's length principle is applied, in particular against the background of an actual provision of the services, whether the services are advantageous and not provided from a purely shareholder-driven point of view. There is also a preference for using the cost-plus method in addition to the comparable uncontrolled price method, although the latter is often ruled out in practice due to a lack of comparability.

The tax authorities' view on the potential acceptance of commitment fees and the extension of the cost-plus method to financing, insurance and reinsurance services, which in the past were typically remunerated and sampled on the basis of the comparable uncontrolled price method, appear to be new. However, the second part in particular reflects the observations made in the course of recent tax audits and also the elaborations - ultimately not passed into law - on the subject of group financing. In the future, both topics will require a stronger focus in the context of transfer price planning and documentation in order to avoid potential disputes with or in the tax audit.

Low value-adding routine services. Another focus is on low value-adding routine services (paras. 3.74 to 3.77). Overall, it is specified here that prices for such services should also be determined on the basis of the cost-plus method and that a potential profit mark-up of 5% - provided that this is implemented uniformly within the group - is acceptable in accordance with section 7.61 of the OECD TPG (para. 3.74). However, at the same time, a definition of low value-adding routine services is introduced (para. 3.75), which - analogous to the explanations in para. 7.45 of the OECD TPG - requires a supporting activity that is not a principal activity, is performed without the use of significant intangible assets and in connection with which no significant risks are assumed and controlled. To illustrate this, examples such as accounting, preparation of tax returns, recruitment of personnel (in para. 3.76) are given and, in addition, certain services are specifically excluded from the definition of low value-adding services, such as services relating to research and development, manufacturing and production and sales, marketing and distribution (para. 3.77).

In principle, it is to be welcomed that explanations on routine services have been included in the VWG 2021 for the purpose of simplifying transfer pricing planning and documentation. These reflect that the tax

authorities also generally follow the view of the OECD with regard to simplification in the context of routine low value-adding services. On the other hand, certain types of services are categorically excluded from being characterized as routine services, which, at least according to the EU Joint Transfer Pricing Forum (EUJTPF), may very well constitute routine services in individual cases. In the future, this issue will probably be increasingly addressed by the tax authorities in tax audits if there is no reliable documentation, in particular evidencing the appropriateness of transfer pricing planning and testing (e.g. through suitable benchmarking studies).

Group service allocations (*Konzernumlagen*). Reference is made to the topic of group allocations in paragraphs 3.78 and 3.79. Here, reference is made to the principles set out in the context of services. It is further specified here that costs that cannot be allocated directly can be allocated to the companies receiving the services on the basis of an appropriate allocation key if direct allocation is only possible by incurring disproportionately high expenses. Depending on the type of costs to be allocated, sales or the number of employees, for example, are named as possible allocation keys. In this regard, it is specified that the taxpayer, within the scope of its duty to cooperate, must demonstrate that the scope of the services actually rendered is in the interest of the respective recipient and the transfer prices charged are appropriate. It is also specified that a calculation must be made on the basis of actual costs and, if budgeted costs are used, an allocation must be made at the latest at the end of the year on the basis of a budgeted/actual cost comparison (paragraph 3.79).

The view of the tax authorities expressed in the VWG 2021 has already become apparent in recent tax audit practice. Although the topic of allocation keys is not new, the VWG 2021 requires increased planning and documentation efforts. The focus here is on demonstrating the appropriateness of transfer prices in line with the arm's length principle in the interest of the receiving company. In this context, it appears that in the future, in addition to the qualitative "benefit test" on the part of the recipient company, a quantitative analysis of the extent of the interest - taking into account the allocation keys applied - will also be required as part of the preparation of the transfer pricing documentation. In addition, continuous monitoring of the allocation of costs within the scope of the service provision becomes indispensable. A purely budgeted cost approach will presumably lead to increased potential for detection in tax audits. Accordingly, in case of doubt, adjustments to a company's internal technical implementation and controlling processes are required along with increased documentation compliance and administration efforts, since it is expected that it must also be demonstrated to the tax authorities that such a reconciliation has actually been carried out.

Secondments. In paragraph 3.80 on the subject of secondments, reference is made to the implementation within the MoF circular "Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen international verbundenen Unternehmen in Fällen der Arbeitnehmerentsendungen" [Principles for the examination of the allocation of income between internationally affiliated companies in cases of employee secondments] of November 9, 2001 (BStBl. I p. 796).

Cost Contribution Arrangements (Kostenumlagen) (paragraphs 3.81 to 3.86)

First, in paragraph 3.81, reference is made to Chapter VIII of the OECD TPG for the examination of income deferral through Cost Contribution Arrangements (CCA) between related parties.

In the following paragraphs, the view of the tax authorities on an appropriate remuneration for so-called development CCAs and so-called service CCAs is set out, whereby reference is regularly made to the explanations from Chapter VIII of the OECD TPG. Thus, it is clarified in paragraph 3.82 that, for the purpose of implementing the arm's length principle, the statements of Chapter VIII of the OECD TPG must be applied in the case of CCA. According to this, the contribution for each participating company must be

determined in such a way that its contribution corresponds to the expected benefits. The tax authorities expressly reject a cost-based assessment in this context. However, the tax authorities also follow the exceptions described in the OECD TPG and cite examples where a purely cost-based valuation appears acceptable, such as case constellations with a small cost-value difference, where considerable administrative effort is required to determine the arm's length values or where the contributions of the pool participants correspond to the amounts.

In paragraphs 3.84 and 3.85, the tax authorities go into more detail on development CCAs and only consider the participation of companies which, on the one hand, legitimately expect benefits and, on the other hand, can control potential risks. In the case of termination of a development CCA (this also applies to withdrawal from a development CCA), as well as joining a development CCA, the tax authorities explicitly require corresponding compensation.

In paragraph 3.86, the tax authorities require a regular review of cost contribution agreements with regard to the apportionment keys.

Transfer of functions (paragraph 3.87)

Paragraph 3.87 merely refers to the *Administrative Principles on the Relocation of Functions of October 13, 2010*.

Financing relationships (paragraphs 3.88 to 3.102)

The comments on financing relationships are divided into three subsections: General (paragraphs. 3.88 to 3.95), compensation for enhanced creditworthiness (paragraphs 3.96 to 3.97), cash pool as a financing relationship within a multinational group (paragraphs 3.98 to 3.100), and other financing instruments and self-insurers (paragraphs 3.101 to 3.102).

First of all, in paragraph 3.88, reference is made to Chapter X of the OECD TPG for the examination of the deferral of income in the case of financing relationships between related parties. In this context, the need to conduct a functional and risk analysis, also with regard to financing relationships, is mentioned in paragraph 3.89. Following these general principles, the following paragraphs set out the view of the tax authorities on the raising of finance. This is similar in structure and content to Section 1a AStG (financing relationships), which was considered as part of the draft bill for the ATAD Implementation Act (ATADUmsG) but which was not adopted. In this respect, certain legal bases underlying the view taken by the tax authorities appear questionable.

Loans. For example, paragraph 3.90 clarifies that the first step is to examine whether the loan is considered as borrowed capital for tax purposes. According to paragraph 3.91, the financing must be economically necessary (positive expected return) and used for the business purposes of the company in order for a loan relationship to be deemed to be at arm's length per reason and per amount. In the view of the tax authorities, an investment in a call money /savings account or a deposit in the group's internal cash pool is not part of the purpose of the company.

Financing companies. Intra-group financing companies are to be remunerated for the provision of capital to domestic taxpayers only up to the amount of a risk-free return on the basis of the cost-plus method if they do not have the risk-control or risk-bearing capacity (paragraph 3.92). When applying the cost-plus method, directly attributable operating costs are to be used; refinancing costs are generally not to be included.

Write-offs to the lower going-concern value (Teilwertabschreibungen). According to paragraph 3.93, a write-off of an interest-free or low-interest loan to the lower going-concern value is not possible for tax purposes if the interest-free or low-interest loan was granted for reasons other than the loan relationship rather than an equity injection.

Group support (*Konzernrückhalt*). Paragraph 3.94 contains the view of the tax authorities on group support. Although corporate backing does not constitute a legally enforceable security, it does have a de facto effect on the creditworthiness of the intra-group borrower. In the view of the tax authorities, the concept of "implicit support" referred to here probably means that a purely isolated view of the borrower ("stand-alone rating") takes a back seat.

Collateral/Security. Paragraph 3.95 clarifies the view of the tax authorities that the security of a loan is generally at arm's length, while non-securitization may be at arm's length, but this must be examined separately in each individual case. A non-exhaustive list of aspects is cited for the examination of the arm's length nature of a non-securitization. For this examination, the behavior of the group of companies vis-à-vis third parties is to be taken into account, the economic advantage of securitization or the alternatives realistically available to the borrower are to be assessed, and the amount of the loan is to be taken into account.

Guarantees. If the creditworthiness of a company increases as a result of the granting of a guarantee, hard letter of comfort or other collateral, remuneration for the obligor/obligated party is to be recognized according to paragraph 3.96, provided that the obligor assumes an actual risk position. In determining the amount of the remuneration, the benefits of the increased creditworthiness resulting from the provision of collateral are to be taken into account, which are limited to the difference between the group rating and the stand-alone rating of the company assuming the obligation. If it is only the provision of collateral by the group of companies or by a related party to a third party that enables a company to raise capital, the assumption of the obligation in EU/EEA cases constitutes a (non-compensable) shareholder contribution in the view of the tax authorities in paragraph 3.97 if there is an economic reason within the meaning of the Hornbach ruling of the ECJ.

Cash pool. With regard to the cash pool, the tax authorities take the position in paragraph 3.98 that the cash pool leader only provides a routine service, although this principle is qualified by the fact that the function and risk profile is decisive in each individual case. The assumed routine functionality of the cash pool leader is to be remunerated on the basis of a cost-plus based method. According to the tax authorities a profit mark-up of between 5% and 10% on the directly attributable costs is not objectionable, whereby the financing costs are not to be included in the cost basis. With regard to the synergy effects arising within the framework of cash pooling structures, paragraph 3.99 states that their allocation to the cash pool participants is not possible on a causation basis, so that synergy effects have to be assessed specifically for each individual case. If cash deposits or borrowings by cash pool participants are not merely of a short-term nature, they should be regarded as individual long-term loan relationships according to paragraph 3.100 and treated accordingly.

Financial instruments and self-insurers. The section on financing relationships concludes with the treatment of financial instruments as defined in Section 1 (11) of the German Banking Act (paragraph 3.101) and of self-insurers (paragraph 3.102).

Chapter IV: Other general principles (para. 4.1 to para. 4.8)

Initial correction (paragraph 4.1 to 4.2)

Paragraph 4.1 refers to the *Administrative Principles 2020 of December 3, 2020*. There is only a clarification (para 4.2) to the effect that corrections in the case of income reductions are to be made for the respective assessment period and corrections are to be attributed to the type of income of the corrected income.

Treatment of compensation payments (paras. 4.3 to 4.5)

In paragraph 4.3, the tax authorities set out basic rules for the treatment of compensation payments. Thus, in the case of corrections due to the assumption of a hidden profit distribution by a domestic corporation, a compensation payment is to be treated as a contribution, and in the case of a hidden contribution to a foreign corporation, it is to be treated as a benefit leading to capital income for the shareholder. In the case of adjustments due to an assumed withdrawal, this should be treated as a contribution or due to a contribution as a withdrawal. In the case of transactions that have led to an adjustment based on Section 1 AStG, the compensation made for the adjustment is to be offset off the balance sheet against the surcharge made for the purposes of the adjustment for reasons of equity, provided that compensation payments have actually been made within one year of notification of the corrected tax assessment.

Paragraph 4.4 contains information on circumstances in which transactions of earlier assessment periods have led to an adjustment in accordance with Sec. 1 AStG. If, however, these have not yet been offset and the shareholding in the foreign company is now sold or this company is liquidated, a different assessment of taxes is to be permitted for reasons of equity (Sec. 163 AO). However, in the case of a reduced capital gain or liquidation profit subject to the provision of Sec. 8b Corporate Income Tax (KStG), the flat-rate non-deductible operating expenses (Sec. 8b (3) Sentence 1 and (5) Sentence 1 KStG) shall only be determined from the reduced profit. A higher capital gain or liquidation gain, on the other hand, is to be added off the balance sheet in accordance with Sec. 8b (3) Sentence 3 KStG. When applying the partial income procedure, only 60% of the adjustment amount is to be taken into account (this is also to apply to shareholders if the adjustment was made at the subsidiary and Sec. 1 AStG takes precedence over Sec. 8 (3) Sentence 2 KStG).

According to paragraph 4.5, in the case of liquidations, the reductions should generally be made in the assessment period in which any liquidation proceeds are to be recognized in profit or loss in accordance with generally accepted accounting principles.

Counter-adjustment (paragraph 4.6)

The tax authorities clarify that adjustments to transfer prices due to double taxation in the case of income corrections by foreign tax authorities are subject to the documentation obligations pursuant to Section 90 (3) of AO and that subsequent counter-adjustments must be permissible under substantive and procedural law. In this context, national deduction restrictions and the principle of sectional taxation are to be taken into account.

In Article 9 of the OECD Model Tax Convention, the tax authorities see a general entitlement to counter corrections and explicitly name as unilateral remedies (mutual agreement or arbitration proceedings are therefore not required) the correction provisions of the domestic delimitation rules, the review of tax assessments (Section 164 (2) AO) and the cancellation or amendment of tax assessments due to new facts or evidence coming to light (Section 173 (1) No. 2 AO). Section 175a AO is cited for the implementation of a mutual agreement or an arbitration award.

Customs (paragraph 4.7 to 4.8)

In paragraph 4.7, the tax authorities state that a customs valuation can be used as a supplementary aid for determining the arm's length price. This applies irrespective of the fact that these values may deviate from the relevant arm's length price.

According to paragraph 4.8, it is mandatory to notify the competent main customs office of transfer price adjustments in the form of subsequent charges (§ 153 AO) and, in the case of credit notes, there is sometimes a claim for reimbursement. In this context, the tax authorities consider it mandatory to request to see the contractually agreed-upon terms underlying adjustment.

Chapter V: Glossary (para. no. 5.1)

In paragraph 5.1, reference is made to the OECD's extensive Glossary of Tax Terms, which is also expanded in Annex 2 of the VWG 2021 by additional definitions of terms "*which are not contained therein.*" In contrast, the so-called "Transfer Pricing Glossary" (MoF circular of 19.5.2014) will be repealed or replaced.

The glossary includes the following definitions of terms: *Cash Pool, Cash Pool Head, EBT, Proprietary Insurer, Arm's Length Price, Function, Inbound Subject Matter, Multinational Group of Companies, Net Margin, Outbound Subject Matter, Risk, Routine Company, Corporate Backing in Multinational Group of Companies (Group Support/Corporate Backing), Entrepreneur, Comparables, Ratios, Assets, Benefits, Value Added.*

Chapter VI: Repeal of MoF circular and application regulation (paragraph 6.1 - 6.3)

In paragraph 6.1, it is clarified that the VWG 2021 are to be applied by the tax authorities to all open cases with immediate effect and that, in addition, various MoF circulars relevant to transfer pricing to date will be repealed.

This includes, among others, the Administrative Principles 1983 (MoF circular of 23.2.1983), the Administrative Principles Procedures (MoF circular of 12.4.2005), the MoF circular of 29.3.2011 (Teilwertabschreibungen), the MoF circular of 19.5.2014 (Glossary of transfer prices), the MoF circular dated 7.4.2017 (Use of names in the group), the MoF circular dated 5.7.2018 (Administrative principles Examination of income deferral apportionment agreements) and the MoF circular dated 6.12.2018 (MoF on ECJ Hornbach ruling). In addition, text item 1 of the principles for the application of the Foreign Tax Act (MoF circular dated May 14, 2004) is repealed.