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By PwC Deutschland | 02 January 2013

No transfer pricing adjustment for breaches of formality

The Supreme Tax Court has rejected a tax office assessment attempt on the basis of a hidden distribution of profits because of a delay in agreeing management charges in writing, saying that the double tax treaty related party provision bases the arm’s length standard on amount, rather than on the reason for, or documentation, of a transaction.

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A GmbH agreed at year end to accept management charges from its Dutch parent for services performed during the year. This agreement was in writing, but applied in retrospect to the beginning of the year. Management maintained that an oral agreement had been reached prior to the first service delivery, but was unable to produce any evidence of this. The tax office followed the rules set forth in the “Administrative Principles” on transfer pricing requiring that services between related parties be documented by a prior written agreement and disallowed the expense as a hidden distribution of profits. The GmbH objected as it felt the charges to have been reasonable.

The Supreme Tax Court has now agreed with the taxpayer. The related party clause in the double tax treaty with Holland provided for pricing adjustments as necessary to meet arm’s length standards. However, arm’s length was a measure of amount and – sham transactions apart – not a principle governing the reasons for a transaction or its documentation. The treaty provision thus excluded pricing adjustments on grounds other than questions of amount and the tax office was therefore unable to apply provisions of domestic law setting formal requirements going beyond the standards laid down in the treaty. Since there was nothing to suggest that the charge might have been excessive, there was no ground for disallowing it as a business expense.

Supreme Tax Court judgment I R 75/11 of October 11, 2012, published on January 2, 2013

Keywords

management charges, related party, transfer pricing