

Germany

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What is the current thinking with respect to Germany's laws, regulations or other pronouncements that have been issued or proposed for the relevant BEPS Actions (8–10, 13)?

Overall, German tax administration officials consider most of the German transfer pricing guidelines already to be aligned with the various BEPS Actions 8–10, so no fundamental new changes will likely be required in this field. However, the new BEPS publications will require the review and modification of certain parts of German transfer pricing legislation.

Germany's existing transfer pricing guidelines (Verwaltungsgrundsätze-Verfahren)¹ generally follow the OECD transfer pricing guidelines, but require modernization for dealing with a multitude of issues, where economic developments and the international consensus have evolved. Germany has a long history of transfer pricing regulation, with the arm's length principle as a fundamental segment of German transfer pricing legislation since 1972 (Art. 1 Foreign Tax Law),² but its application has changed considerably over time. The first comprehensive transfer pricing guidelines were issued in 1983³ and detailed laws and guidelines on documentation have existed since 2002.⁴ German field tax audits have audited transfer pricing since the early 1990s, and since 2000 there have been administrative provisions for audits.⁵ While Germany has a comprehensive set of transfer pricing regulations, it is also organized as a federal tax system with local authorities for audits and enforcements. Thus, the focus, quality, and aggressiveness of transfer pricing audits differ from state to state.

There have been recent changes to German transfer pricing regulations, which moved Germany closer in line with the BEPS Actions:

- In recent cases in 2014 and 2015,⁶ the highest German tax court (BFH) treated the arm's length principle of Art. 1, Foreign Tax Law as a treaty override. Therefore, the relation between Double Tax Treaties and the arm's-length principle must be adjusted.
- On January 27, 2016, Germany signed the Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of country-by-country reports.

- The German Ministry of Finance and the state ministries have been working on new transfer pricing guidelines for the last two years. The first draft is delayed and scheduled to be published in 2017, and it is anticipated to be finalized by 2018.

The federal German Finance Ministry requested that the states start acting on OECD BEPS Action 5 under existing tax laws as of April 2016. However, the states stated that they needed absolute clarity that the information exchange would not be in breach of tax secrecy rules. Therefore, on May 31, 2016, the Federal Ministry of Finance presented the comprehensive draft of new laws (German Fiscal Code, Foreign Tax, Income Tax, Corporate Tax, Trade Tax and codes) dealing primarily with Country by Country (CbC) reporting and information exchange.⁷ While this draft is being discussed, the existing tax laws are legally binding. From a German point of view, the changes in this draft are in line with Actions 13 and 5, 6 and 7 of the BEPS package. Most parts of the new legislation deriving from the draft will be applied for CbC reporting for years starting from or after January 1, 2016. Therefore, the legislation has to be approved by the German parliament (Bundestag) and the states (Bundesrat) before the end of 2016. It is likely that government, parliament, and federal states will find a compromise in December 2016. The law will be applied retroactively, when the legislation is approved.

Afterwards, the draft of a new guidance for action points 5 to 10 in the form of an ordinance (Durchführungsverordnung) will be prepared in 2017, as well as new transfer pricing guidelines (Richtlinien – Verwaltungsgrundsätze).

A. Actions 8–10

Actions 8–10 address transfer pricing issues relating to intangibles, risk allocation, capital allocation, and other transactions that would not or only very rarely occur between unrelated parties. The German existing guidelines are partly based on substance over form,⁸ but require substantial development to reconcile the German position with the new OECD guidance.

1. Intangibles

In the German transfer pricing regulations, the definition, identification, separation and valuation of intangibles is not regulated by specific legislation, but are

primarily addressed in the general transfer pricing package, and more explicitly in the context of “relocation of functions.”⁹ The relocation of functions covers packages of intangibles and non-routine functions that are transferred abroad. In cases where a relocation of non-routine functions is identified, tax inspectors calculate the value of the relocated intangibles from this function. The comprehensive guidelines on the relocation of functions have resulted in hundreds of field tax audits with tremendous tax adjustments. In practice, these principles are often applied to marketing intangibles (e.g., customer lists and local brands) and technical intangibles (e.g., R&D intangibles or best practices). The legislation for the relocation of functions defines a set of practical approaches regarding how to proceed in these cases, but does not provide clear guidance about how to define and value intangibles.

The existing German rules do not specifically focus on the “DEMPE” functions¹⁰ with regard to intangibles that the OECD’s Action 8–10 report highlights. The existing regulations require an economic analysis to identify and properly value the intangibles and transactions, but are not as detailed as the approach proposed by the OECD in the focus on DEMPE functions.

The future German domestic law guidelines regarding intangibles may have material effect on multinational groups, as far as they are using or expatriating certain intangibles from a German company. The definition of “Hard to Value Intangibles” under Action 8 may require adjustments of Article 1 of the Foreign Tax Law.

2. Risk

The existing German guidelines require the analysis of risk and risk taking.¹¹ Risk taking is a crucial requirement under current German transfer pricing regulations, expressed in terms of a requirement that all the parties will be compensated at arm’s length for the risks they assume which are related to the development and enhancement of intangibles. However, the guidelines are still lacking guidance on the remuneration of risk taking and risk management.

The tax authorities and many practitioners indicate that they see risk taking as the most important aspect. Control (decision whether to take on a risk) and management of the risk are seen more as prerequisites for the attraction of funds, which are necessary for the financial ability to bear the risk. The consequence of not sufficiently bearing and controlling risk is that an enterprise would not earn more than a risk-free return. The OECD’s view of “cash box” companies may be covered by the future German guidelines.

3. Cost Contribution Arrangements

The OECD’s discussion of cost contribution arrangements can be seen in the context of two different existing German transfer pricing guidelines. Under the OECD’s Action 8, cost contribution arrangements may be usable for intangibles, tangible assets, or services equally. The German regulations on “cost-sharing arrangements” (Prüfungsgrundsätze Umlageverträge)¹² from 2000 deal specifically with the pooling of cost for developing intangible and other properties. The

German transfer pricing guidelines (Verwaltungsgrundsätze-Verfahren) from 2005 provide rules for services. Both guidelines are somewhat outdated.

Although the treatment of related party services for the development of intangibles by the OECD and the German rules are considerably different in form, in substance the two approaches are quite similar. In many cases, a price properly determined under one method would be acceptable under the other. However, there are differences: for example OECD allows location savings and assembled workforces, while the German rules do not.

4. Intra-group Services

OECD Action 10 and the German transfer pricing regulations normally intend intra-group services to be compensated at arm’s-length amounts, as indicated above. Both define administrative or supportive services and demand a cost plus remuneration for those activities. Consistent with its generally principles-based approach, the OECD report refers to these services as “low-value-adding” and suggests identifying them as not being a core activity, being supportive in character, and so on.

The German rules need to be amended. For instance, fixed mark-ups on costs for low value add services as suggested by the OECD¹³ are not part of the Germany regulations. Currently, these mark-ups need to be identified using economic analysis (e.g., comparable data or benefit tests).

B. Action 13

1. Country-by-Country Reporting

CbC reporting is the area which generated most controversy within the German tax community, owing not only to issues of how to assemble the information to be consistent with various requirements, but also due to fears of disclosing the information.

The proposed German legislation follows the rules of OECD’s Action 13 in most aspects.

2. The Master File/Local File

Current German rules do not require documentation in the form of a master file and a local file, as such. However, the requirements of German transfer pricing documentation have the same elements as the combined master file and local file contemplated by the OECD guidelines. German transfer pricing documentation consists of two parts: 1) A documentation of facts (Sachverhaltsdokumentation)¹⁴ and 2) an economic analysis to test intercompany transactions with respect to the arm’s-length principle (Angemessenheitsdokumentation).¹⁵

A German company has no obligation to prepare contemporaneous documentation for ordinary transactions.¹⁶ Only extraordinary transactions have to be documented contemporaneously.¹⁷ As a general matter, a taxpayer is obliged to prepare transfer pricing documentation that enables a knowledgeable examiner to determine within a reasonable period of time the intercompany transactions the taxpayer has

carried out and whether and the extent to which the taxpayer has observed the arm's-length principle.¹⁸

For non-German companies that want to document transactions with German affiliates, a properly prepared master file and local file should meet most of the German requirements for the documentation of the arm's-length nature. However, the documentation of facts usually requires additional documentation to be assembled for Germany (e.g., intercompany receipts, commercial register extracts, description of products, list of intangibles, description of business strategy, etc.).

German multinationals, on the other hand, are adjusting to the requirements that they have both a master file and various local files to comply with requirements in each of the countries where they do business. A principal concern in this regard is the possibility (now seeming to become a likelihood) that various countries will add requirements to one or the other of the files, eliminating the standard content format that would minimize reporting inefficiencies. Since countries are currently still finalizing their rules on this, there is a great deal of uncertainty and nervousness. Little can be done but to keep watching for the developments.

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¹ *Verwaltungsgrundsätze-Verfahren*, BMF-Schreiben 12.4.2005, IV B 4-S 1341-1/05 BStBl I 2005, 570.

² AStG (Auszensteuergesetz), Art.1, 8. September 1972, BGBl. I S. 1713.

³ Grundsätze für die Prüfung der Einkunftsabgrenzung bei international verbundenen Unternehmen (Verwaltungsgrundsätze) BMF v. 23.02.1983 - BStBl 1983 I S. 218.

⁴ Abgabenordnung (AO), § 90 Mitwirkungspflichten der Beteiligten, 1 Oktober 2002, BGBl. I S. 3866; 2003 I S. 61.

⁵ Allgemeine Verwaltungsvorschriften für die Betriebsprüfung – Betriebsprüfungsordnung – BpO 2000, Bundesanzeiger Nr. 58, S. 4898, BStBl. I, S. 358 ff.

⁶ BFH-decisions 17. December 2014, I R 23/13 and 24. Juni 2015 - I R 29/14.

⁷ BMF-Referententwurf, 31, Mai 2016, Entwurf eines Gesetzes zur Umsetzung der Änderungen der EU Amtshilferichtlinie und von weiteren Maßnahmen gegen Gewinnkürzungen und -verlagerungen.

⁸ C.f. the court ruling of the highest German court: BFH-Urteil vom 11. October 2012, I R 75/11.

⁹ Funktionsverlagerungsverordnung – FVerIV, 12. 8.2008, BGBl. I 2008, 1680.

¹⁰ “DEMPE” stands for Development, Enhancement, Maintenance, Protection & Exploitation.

¹¹ C.f. para. 3.4.10.2 c) of the Verwaltungsgrundsätze-Verfahren.

¹² Audit Principles for Cost Sharing Agreements (Prüfungsgrundsätze Umlageverträge) BMF- Decree 30. December 1999 - IV B 4 - S 1341 - 14/99.

¹³ C.f. OECD BEPS Action 10 D.2.2.

¹⁴ Documentation of facts (Sachverhaltensdocumentation) summarized in Verwaltungsgrundsätze- Verfahren para 3.4.11.

¹⁵ Documentation of appropriateness (Angemessenheitsdokumentation) summarized in Verwaltungsgrundsätze- Verfahren para 3.4.12.

¹⁶ § 90 para. 3 p. 9 AO.

¹⁷ § 3 para. 1 p. 2 GAufzV.

¹⁸ § 90 para. 3 AO.