Crowe Transfer Pricing Wednesday

Germany

New transfer pricing circular (“VWG-VP”) issued on July 14, 2021

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Overview of the new transfer pricing circular (“VWG-VP”)

On July 14, 2021, the German Federal Ministry of Finance released a new transfer pricing circular (“VWG-VP”) which focuses on the material aspects in a transfer pricing analysis. The circular intends to give clear guidance with respect to the adjustment of income between related parties with cross-border activities according to Sec. 1 of the German Foreign Tax Code (Sec. 1 FTC) under consideration of the arm’s length principle. Together with the new transfer pricing circular published on December 3, 2020 (“VWG 2020”) with focus on procedural law aspects in a transfer pricing analysis, and further changes in tax law due to the implementation of the AbzStEntMod on June 2, 2021 and the ATADUmsG on June 25, 2021, the current circular “VWG VP” marks an important revision in Sec. 1 FTC since the introduction of the German Foreign Transaction Tax Act in 1972.

The circular “VWG-VP” aims to align with the 2017 OECD Transfer Pricing Guidelines, which reflect the outcome of the OECD BEPS-project. In particular, the objective of the new circular “VWG-VP” in alignment with the 2017 OECD Transfer Pricing Guidelines is to obtain a worldwide consistent cross-border implementation of the arm’s length principle, which is generally seen as an instrument to avoid double taxation as well as double-non taxation. In this context, Germany’s Federal Ministry of Finance stresses that it will base its assumptions on the 2017 OECD Transfer Pricing Guidelines in all cases. Hence, it will not differentiate between OECD-member and non-OECD-member countries. Further, it will not be of relevance whether there is a double-taxation treaty applicable between countries or not. The new circular “VWG-VP” states that its guidelines on the arm’s length principle will be applicable to local German tax rules and will also have to be followed for the interpretation of the respective double taxation treaties. Nonetheless, it has to be mentioned that the new circular “VWG-VP”, as all circulars issued by the German Federal Ministry of Finance, is not binding for the taxpayer, but only within the fiscal authority.

Structure and content of the “VWG-VP”

The new circular contains six chapters. Chapter I describes general principles that have to be applied in order to determine if taxable income was appropriately appointed under the arm’s length principle. In this context the new circular “VWG-VP” clarifies that Sec. 1 FTC is invariably applicable next to the other regulations in the German Fiscal Code (i.e. § 4 Abs. 1 Satz 8 ITA (Income Tax Act) resp. § 4 Abs. 1 Satz 2 ff. ITA for sole proprietors and partnerships; § 8 Abs. 3 Satz 2 CTA (Corporate Tax Act) resp. § 8 Abs. 3 Satz 3 ff. CTA for corporations). Furthermore, in chapter I the term “related party” is defined as well as the term “business relation”.

Chapter II emphasizes the importance of the 2017 OECD Transfer Pricing Guidelines for examining intercompany cross-border relations. By referring to the German translation of the 2017 OECD Transfer Pricing Guidelines which is provided in the circular’s annex (annex 1), it becomes obvious that the German Federal Ministry of Finance internalizes the 2017 OECD Transfer Pricing Guidelines basic statements to a wide extent. The new circular “VWG-VP” further refers to OECD’s Transfer Pricing Guidance on Financial Transactions as well as to the revised OECD guidance on the application of the transactional profit split method in the annex (Annex 1) as the OECD hasn’t provided a consolidated version of all documents as of yet.

Chapter III includes detailed guidance in respect to the arm’s length principle and therefore addresses material issues in order to determine how the arm’s length principle is to be applied. It addresses transfer pricing methods and valuation techniques, gives further guidance with regard to the comparability analysis and with regard to procedural aspects in order to avoid and settle transfer pricing conflicts as well as regarding the documentation of the transfer pricing analysis. It further addresses aspects in respect to intangible assets as well as the DEMPE-functions and the delivery of goods, services and financial transactions.

Chapter IV contains further general guidance in respect to the treatment of compensation payments as well as to corresponding adjustments.

Chapter V refers to the glossary for specific transfer pricing related tax terms in the annex (annex 2).

Chapter VI refers to a list of transfer pricing circulars which were repealed with the release of the new circular; amongst others circular “Verwaltungsgrundsätze” of February 23, 1983 as well as circular “Verwaltungsgrundsätze-Verfahren” of April 12, 2005.

In chapter VI it is also stated that the new transfer pricing circular VWG-VP is applicable to all open cases, i.e. in the case of on-going tax audits.

Summary of the new “VWG-VP”

- The circular “VWG-VP” aims at specifying certain topics based on the BEPS recommendations. This way, it becomes clear that the German tax authority adheres to the internationally agreed guidelines (OECD Transfer Pricing Guidelines, EUJTPF, UN Manual).

- The definition of intangible assets corresponds to Sec. 1 Abs. 3c FTC with the new price adjustment clause in Sec. 1a FTC. In this context, the attribution of revenue from intangible assets strictly follows the DEMPE-approach. In addition, it is clarified that the remuneration of royalties shall regularly be computed based on the concept of the hypothetical arm’s length test. Furthermore, the new circular “VWG-VP” concerns the particularities with regard to the remuneration of trademarks and group names. The circular issued on April 7, 2017 regarding trademarks was therefore repealed.

- The new circular „VWG-VP“ adheres to financial transactions by referring to the newly adopted chapter X of the OECD transfer pricing guidelines. A regulation on financial transactions had been considered earlier in the context of the legislative procedure on Sec. 1 FTC, but finally was not adopted.

- In addition, with regard to the functional and risk analysis, the circular takes into account the OECD’s control over risk concept for the allocation of risks to the group entities.

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