

New Circular on the Application of the Arm's Length Principle Issued by the Federal Ministry of Finance – Commitment to OECD Guidelines

Germany has published a new circular on transfer pricing that is binding for tax authorities and helps taxpayers with the interpretation of the arm's length principle. It deals with plenty of relevant topics for day-to-day work such as financial transactions, the DEMPE concept, services transactions and loss-making enterprises. Attached to the circular are the OECD Guidelines, which are becoming binding for tax authorities in Germany. The new circular is applicable to all open years including years that are currently under audit.

1. Introduction

On 14 July 2021, the Federal Ministry of Finance (BMF) published a long-awaited new circular on transfer pricing.¹ It regulates the application of the arm's length principle both for local legislation and for the interpretation of double taxation agreements.² It is not binding for taxpayers but it is for the tax authorities. The BMF circular is to be applied to all open cases, i.e. also in ongoing tax audits.³ It is closely based on the OECD Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines).⁴ The OECD Guidelines are attached to the circular as Annex 1.

Following the publication of the BMF circular "Verwaltungsgrundsätze 2020" (Administrative Principles 2020) of 3 December 2020,⁵ which addresses the procedural aspects of the transfer pricing audit including documentation, the latest circular deals with the question of how the arm's length principle should be applied. These two BMF circulars are the new cornerstones of tax audits on transfer pricing in Germany. They substitute the BMF circulars of 1983⁶ and 2005⁷ that dealt with the arm's length

principle and procedural questions. The new BMF circular repeals further circulars that dealt with specific topics such as trade names,⁸ write-off of loans,⁹ and the interpretation of an ECJ ruling.¹⁰ The BMF circulars on the relocation of functions¹¹ and on the deferral of profits from permanent establishments¹² remain valid.

The BMF circular provides guidance on many aspects of practical relevance, such as the correction to the median; intangibles including the development, enhancement, maintenance, protection and exploitation (DEMPE) concept; financial transactions; the aggregation of transactions; services transactions; loss-making enterprises; and the control-over-risk approach. The most important fundamental change is, however, the direct reference to the OECD Guidelines 2017, which are enclosed as an appendix to the BMF circular. As such, the OECD Guidelines have become a binding yardstick for tax inspectors during tax audits in Germany. So far, they have been taken as a source of reference during tax audits, considered within mutual agreement procedures, and are part of the syllabus of the internal training academy of the Federal Ministry of Finance for tax inspectors, but they did not have the status of an official document for tax auditors for tax audits in Germany. This article provides an overview of selected aspects of the BMF circular and summarizes its key aspects.¹³

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investigation and cooperation, corrections as well as mutual agreement and EU arbitration procedures (administrative principles procedure), BMF circular of 12 Apr. 2005, IV B 4 - S 1341 - 1/05, BStBl I, p. 570.

8. Use of name in the group, BMF circular of 7 Apr. 2017, IV B 5 - S 1341/16/10003, BStBl I, p. 701.
9. Application of Section 1 AStG to cases of partial value depreciation and other impairments on loans to affiliated foreign companies, BMF circular of 29 Mar. 2011, IV B 5 - S 1341/09/10004, BStBl I, p. 277.
10. Economic reasons justifying the conclusion of a transaction under conditions that are not "arm's length"; see DE: ECJ, 31 May 2018, Case C-382/16, *Hornbach-Baumarkt-AG v. Finanzamt Landau*, Case Law IBFD; and BMF circular of 6 Dec. 2018, IV B 5 - S 1341/11/10004-09, BStBl I, p. 1305.
11. Principles for the examination of the deferral of income between related parties in cases of cross-border relocation of functions (*Verwaltungsgrundsätze Funktionsverlagerung*), BMF circular of 13 Oct. 2020, IV B 5 - S 1341/08/10003.
12. Principles for the application of the arm's length principle to the apportionment of income between a domestic company and its foreign permanent establishment and to the determination of the income of the domestic permanent establishment of a foreign company in accordance with section 1(5) of the Foreign Tax Act and the Permanent Establishment Profit Apportionment Ordinance (*Verwaltungsgrundsätze Betriebsstättengewinnaufteilung*, VWG BsGa), BMF circular of 22 Dec. 2016, IV B 5 - S 1341/12/10001-03.
13. Further detailed analysis of the BMF circular is provided by O. Busch, Die neuen Verwaltungsgrundsätze Verrechnungspreise, 34, pp. 1908 ff, Der Betrieb, 2021 and S. Rasch, Die Verwaltungsgrundsätze Verrechnungspreise 2021, Die „83er Grundsätze“ sind Geschichte, IWB, 16,

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1. Administrative Principles Transfer Pricing, Principles for the correction of income pursuant to section 1 AStG, BMF circular dated 14 July 2021, Z IV B 5 - S 1341/19/10017 [hereinafter BMF circular].
2. See BMF circular, cover sheet and para. 1.5.
3. Id., at para. 6.3
4. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration* (OECD 2017), Primary Sources IBFD.
5. Administrative Principles 2020, BMF circular of 3 Dec. 2020, IV B 5 - S 1341/19/10018:001 [hereinafter Administrative Principles 2020].
6. Principles for the examination of income differentiation in the case of internationally affiliated companies, BMF circular of 23 Feb. 1983, IV C 5 - S 1341 - 4/83, BStBl I, p. 218.
7. Principles for the examination of the accrual of income between related parties with cross-border business relations with regard to duties of

2. Mechanisms to Adjust Non-Arm's Length Transactions in Tax Audits: Withholding Tax and the Risk of a Correction to the Median

German law stipulates three mechanisms for corporates¹⁴ that require applying the arm's length principle: the hidden profit distribution¹⁵ and the hidden contribution that apply both in domestic and cross-border cases and the correction based on section 1 of the Foreign Tax Act (*Aussensteuergesetz*, AStG). In case a certain transaction is not at arm's length, the tax authorities adjust the taxable income based on one of the correction mechanisms as result of a tax audit. Before outlining differences in the consequences of their application, the three mechanisms are briefly explained.¹⁶ The hidden profit distribution mechanism applies if a German corporate pays an above arm's length price to its parent company or any other related party, for example, for the purchase of goods or services, or if it sells something below the arm's length price to a related party. Such a transaction would be deemed to be a dividend and, as such, is not allowed to lower the taxable income. It would be added to the taxable income of the entity outside of the balance sheet, i.e. only for tax calculation purposes. In addition, it would trigger 25% withholding tax plus solidarity surcharge unless a lower withholding tax on dividends is agreed upon in the double tax treaty or if it is reduced to zero within the European Union based on the Parent-Subsidiary Directive (2011/96). The reduction to a lower rate or zero is only granted if a tax exemption certificate is available for the respective year. A tax exemption certificate confirms that the conditions based on the treaty and/or the Parent-Subsidiary Directive are fulfilled. If this certificate is not available, 25% plus solidarity surcharge is withheld in first instance, but could be reclaimed from the Federal Tax Office in case the conditions are fulfilled. From a practical perspective, the refund is rather uncomfortable as it could last 9 to 12 months. A hidden contribution is assumed to exist if a parent company provides a benefit to its subsidiary below an arm's length compensation or pays an above arm's length price for goods or services received from related parties. The benefit needs to be depositable. Both the hidden profit distribution and the hidden contribution mechanism refer to the arm's length principle as a yardstick. However, no guidance is provided on how to determine the arm's length price. The correction based on section 1 of the AStG, which is solely applicable to cross-border transactions, provides more guidance as regards the method. A correction based on section 1 of the AStG results, same as the hidden profit distribu-

tion, in an adjustment of the taxable income outside of the balance sheet.

From a practical perspective it was unclear if the taxpayer could choose either an adjustment as hidden profit distribution or as a correction based on section 1 of the AStG. As outlined above, the difference is the withholding tax in case of a hidden profit distribution. The BMF circular states that the taxpayer cannot choose which mechanism to apply, but that the hidden profit distribution is the primary correction mechanism. This is not in line with the authors interpretation of a court case from the Federal Tax Court which states that the taxpayer has the chance to choose which adjustment mechanism to apply.¹⁷ In addition, in case of a withholding tax reduction to zero within the European Union and where a reduction to zero tax takes place because of a double tax treaty, it is questionable if it is appropriate to apply the 25% withholding tax in first instance, as it is not covered by the treaty, and not in section 43b of the Income Tax Code, that reflects the Parent-Subsidiary Directive either. As such, one may even argue that a hidden profit distribution might be applied but in that case it should not trigger withholding tax. Irrespective of the rather academic discussion which method to apply, the author proposes to discuss with tax inspectors if an adjustment based on section 1 of the AStG is possible to avoid liquidity effects and increasing the administrative burden for all involved parties

In addition, paragraph 3a of section 1 of the AStG stipulates that if an actual result of a tested party is outside the range of a benchmark study, an adjustment to the median is due. This is not required for a hidden profit distribution. It is questionable whether such a median correction is possible if in a first step a hidden profit distribution is assumed. The BMF circular outlines that a hidden profit distribution can be assumed until the bandwidth is reached and a correction based on section 1 of the AStG from the upper or lower quartile to the median is made. This view is supported by an example in the BMF circular: a delivery of goods from a foreign parent company to its domestic parent company is assumed. The transfer price is EUR 10 million, the arm's length result of a benchmark study would be EUR 5 to 7 million with a median of EUR 6 million. The fair market value is EUR 7 million. Then, there is a hidden profit distribution of EUR 7 million, that is, in the amount of EUR 3 million and, in addition, a correction to the median via section 1 of the AStG in the amount of EUR 1 million. This should be considered by taxpayers, especially if a tax audit identifies that the actual result is only slightly outside the interquartile range. In such a case, the tax authorities may try to adjust to the lower or upper quartile, which only has a minor impact, but request in a second step for a severe adjustment to be made to the median. It is questionable whether this correction is in line with the European principles because it is only applied in cross-border cases.¹⁸

p. 654ff, 2021. Both appreciate the reference to the OECD whilst Rasch remarks that the OECD was rather intended as non-binding guidance. Furthermore, it is a compromise paper which results in less precise wording. I agree with the view of Rasch.

14. In the case of partnerships the correction is assumed by means of a contribution or withdrawal.
15. Often also referred to as deemed dividend.
16. Further details on legal base and criteria can be found e.g. in B. Heidecke/S. Lappe/N. Vertes, *Verrechnungspreise – Teil II: Korrekturmöglichkeiten und ihre Rechtsfolgen*, in: *Steuer und Studium*, 9, p. 578-582 (2017).

17. BFH vom 27. November 2019, I R 40/19 [ehem. I R 14/16], BFH/NV 2020, S. 1307.

18. See B. Heidecke & T. Müller, *EuGH-Urteil „Impresa Pizzarotti“ (C-558/19) – Abweichung vom Fremdvergleich?*, *UzG* (2021).

3. OECD Guidelines, EU Joint Transfer Pricing Forum and the UN Manual on Transfer Pricing

The BMF circular is based on the OECD Guidelines of 2017, which are included as Annex 1 to the BMF circular. Annex 1 is available on the website of the BMF. In the uploaded version, guidelines on financial transactions and the revised guidelines on the application of the transaction-based profit split method have been inserted in the relevant places because the OECD has not yet published a consolidated version of the guidelines with the two papers. It is unclear how the BMF will react to a possible adjustment of the OECD Guidelines. The next adjustment is expected for 2022.

The OECD Guidelines of 2017 reflect the results of the BEPS Project. Germany has supported the BEPS Project from the outset and promoted it at the highest political level, for example, as part of the German G20 Presidency in 2017 and the German EU Council Presidency in the second half of 2020.¹⁹ It therefore seems only consistent to now incorporate the OECD Guidelines into administrative practice via a BMF circular. This commitment to the OECD Guidelines as the basis for transfer pricing analysis can also be found in the explanatory memorandum to the government draft of a revised section 1 of the AStG.²⁰ Nevertheless, it must be critically questioned whether all aspects of the BMF circular are already covered by section 1 of the old version of the AStG, such as the DEMPE concept. If this were not the case, an administrative instruction that incorporates the DEMPE concept and requires it for all open years for old cases would be in contradiction to section 1 of the AStG (old version). This would place the tax administration in the position of carrying out an assessment that is not in accordance with the law.

Apart from the OECD, the BMF circular refers to publications of the EU Joint Transfer Pricing Forum (JTPF) that must also be applied especially for EU matters. Furthermore, the circular outlines that the UN Manual on transfer pricing may serve as guidance especially with regard to developing countries and emerging markets.²¹ This is very welcome, especially as the UN Manual on Transfer Pricing, drafted by the UN Subcommittee "Transfer Pricing", is providing helpful technical guidance on the application of the arm's length principle.

4. Overarching Issues in Transfer Pricing Analysis

The BMF circular addresses various topics that are to be considered overarching for different transactions. Selected topics are presented in section 4.1.-4.5.

4.1. An economic perspective: Actual circumstances, substance, risk-control approach

The BMF circular highlights the relevance of substance and the actual economic circumstances of a transaction to assess its arm's length nature.²² The agreement under civil law thus recedes into the background and is only the starting point of the analysis. The circumstances are the contractual terms, the functions performed by each of the parties to the transaction, taking into account the assets used and risks assumed,²³ customary practices in the industry, the characteristics of the asset transferred or the services provided, the economic circumstances of the parties and the market in which they operate, and the business strategies. The core of the analysis of the actual circumstances is nevertheless the functional and risk analysis.²⁴ With regard to risk analysis, the BMF introduces the risk-control approach closely based on that of the OECD, according to which an allocation of risks to the group units is made on the basis of the distribution of (personnel) functions to control risks and the financial resources to assume risks. Control is defined here as the ability to decide on taking risks and managing risks, and to exercise these decision-making functions. Therefore, the personnel of the companies involved must be examined and the financial ability to bear the risks must be taken into account.²⁵ Furthermore, in order to bear the risks, the decision maker must have the necessary skills and experience and be sufficiently informed. The taxpayer is recommended to document the actual behaviour, together with the substance, that is practised by the decision maker.²⁶

Even if the actual behaviour has a stronger impact, it is recommended to conclude contracts within the group. In this way, one retains the sovereignty of interpretation in disputed cases. It is recommended to thoroughly document both the actual circumstances and their reflection in the comparability analysis.

The focus on the actual circumstances, the associated stronger economic view, a more in-depth analysis of the risk including consideration of the location of key personnel for the arm's length comparison, all underpin that a more economic approach must also be taken within the framework of the comparability analysis. A stronger consideration of the economic perspective is at first sight to be welcomed, because it brings one closer to the actual third-party behaviour. Nevertheless, the question remains how this can be implemented in a legally secure manner and how the relationship between contract and economic behaviour needs to be seen. A sole economic view is opposed by a still prevalent interpretation that places civil law agreements at the centre of the analysis.²⁷ A com-

19. See Federal Ministry of Finance, *Questions and Answers on the BEPS Project* (2021), available at <https://www.bundesfinanzministerium.de/Content/DE/FAQ/2017-06-02-faq-beps.html> (accessed 4 Oct. 2021).
20. See the Federal Government's draft bill, Draft Act to Modernise Relief from Withholding Taxes and the Certification of Capital Gains Tax (Withholding Tax Relief Modernisation Act - AbzStEntModG), art. 4 (Amendment of the Foreign Tax Act) (17 Mar. 2021).
21. See Heidecke, Al-Anaswah, Christen, Ebeling (forthcoming), ISR.

22. See BMF circular, at para. 3.2.
23. Id., at para. 3.5.
24. Id.
25. Id., at para. 3.6.
26. Id., at para. 3.19.
27. See M. Kircher, A. Leclair, C. Marburg, L.S. Worbs, *Intra-group contracts as a framework of options for action*, in *Verrechnungspreise im Lichte der Corona-Pandemie*, Institut Finanzen und Steuern (ifst) No. 535 (B. Heidecke & J. Wilmanns eds., 2020).

plete reclassification of contractual relationships must still remain the exception as outlined during court cases. The relationship between civil law agreements and economic thinking in the transfer pricing analysis could have been more clearly regulated in the BMF circular.²⁸

4.2. Grouping of transactions

Even though the comparability analysis should initially consider each individual business transaction²⁹ it has long been the practice to combine business transactions. This is emphasized by the BMF. This is common practice for long-term contracts for the supply of goods and services, but also for products that are closely linked and offered together ("pallet approach"). The BMF also recognizes a portfolio approach if a taxable person sells products with a low margin together with high-margin products. In this case, the total margin must be taken into account.

4.3. Loss-making enterprises

The BMF circular states that independent companies would discontinue loss-making business activities if no total profit is expected within a foreseeable period of time.³⁰ For entrepreneurial entities, the period of loss absorption is not defined. For routine companies, a total profit should be achieved in 5 years.³¹ The root cause for losses should be determined, such as market conditions or local mismanagement. Only if a company is able to make the decisions that led to the losses and has the financial ability to bear those losses, it should suffer losses.³² In the event of losses, it is advisable to document the causes thoroughly, including the responsibilities. In this regard, financial sustainability should also be considered. It is unclear how financial sustainability can be determined. The equity capital is likely to be too low on a regular basis. An alternative might be to use a percentage of the average turnover or to consider the financial ability determined due to the EBIT. The BMF circular's stating that injections of capital or capital-replacing measures, such as guarantees, can be seen as indications³³ that the company is only being maintained in the interests of the group cannot be accepted as a general rule. Rather, the reasons for capital injections or capital-replacing measures must be examined.

4.4. Plan vs actual deviations and year-end adjustments

Transfer prices are often set on the basis of future expectations. If, for example, a target margin such as a return on sales, a cost premium or a return on capital³⁴ is determined with a benchmark study, the transfer prices are to be set so that the actual result meets the target margin. For routine companies, it is assumed that a value in the

middle of the range is targeted in order to also allow the company to still have opportunities and risks within the range.³⁵ The BMF acknowledges that prices must be determined based on planning data. The planning data must be justified on the basis of the experience of periods that have already elapsed and of commercially sound, cautious forecasts.³⁶ If a plan-based approach is used, a gap analysis explaining the gap between the planning data and the actual must be carried out during the year or at least at the end of the year. If the actual values are outside the range, an adjustment of the yield ratio into the range should be made. These recordings should make year-end adjustments much more defensible in the future.³⁷ Nevertheless, it remains unclear how the adjustment is to be carried out, for example, via a one-off payment or a subsequent adjustment of the prices. Both should then be an option for the taxpayer. The BMF takes a critical view of year-end adjustments that are always made in one direction, for example, that always bring the taxpayer to a figure above the upper quartile. This should therefore be avoided in practice.³⁸

5. Selected Transactions

After selected overarching topics have been presented and acknowledged, which must be observed irrespective of the transaction, the requirements for selected transactions are presented.

5.1. Intangible assets: Trademarks, economic benefit, DEMPE and valuation

The provided definition of intangible assets in the BMF circular corresponds to the wording of the new section 1(3c) of the AStG and that of the OECD. The OECD's distinction between intangible assets that are hard to value and other intangible assets is not necessary because the OECD introduced this for the purposes of the price adjustment clause.³⁹ However, the German legislator has provided a specific price adjustment clause with factual features via section 1a of the AStG. The adjustment clause assumes that third parties would agree upon a price adjustment in case of income-based valuations. If no price adjustment clause is agreed upon, section 1a of the AStG assumes an adjustment is possible within 7 years if the actual figures deviate by more than 20% from the planning data. The allocation of income from intangible assets⁴⁰ is based on the OECD's DEMPE concept, which was most recently included in the amended section 1 of the AStG. However, the decree specifies that the essential personnel functions combined with control with regard to development, enhancement, maintenance, protection and exploitation are decisive for the entitlement to income.

The Trademark Decree of 7 April 2017,⁴¹ which regulated special features of the trademark settlement and remuneration

28. See Bundesfinanzhof (BFH) of 29 Oct. 1997, BFH of 27 Feb. 2019.

29. See BMF circular, at para. 3.23.

30. Id., at para. 3.31.

31. Id., at para. 3.35.

32. Id., at para. 3.32.

33. Id., at para. 3.37.

34. Id., at para. 3.40.

35. Id., at para. 3.44.

36. Id., at para. 3.41.

37. Id., at para. 3.42.

38. Id., at para. 3.43.

39. Id., at para. 3.52.

40. Id., at para. 3.53.

41. See B. Heidecke, O. Busch & H. Schenkelberg, *Transfer Pricing of the Use of Trademarks and Company Names: Ministry of Finance Publishes*

neration of group names, has been repealed. However, the principles of the Trademark Decree can be found again in paragraph 3.55 et seq. Thus, the use of a trademark right within a multinational group of companies is to be remunerated if economic benefits result from the use of the trademark right and third parties could be excluded from this use under a legal system applicable to a geographical area in which the use takes place. Thus, actual exclusion is no longer relevant. A legal analysis in the respective country of trademark protection is therefore appropriate. The decisive factor in trademark accounting is the economic benefit and this should be documented. Especially in the case of B2B trademarks, offsetting is already frequently applied. Aspects such as quality and reliability, which are also associated with brand values, should be established.

Irrespective of the intangible value (e.g. trademark, patent and technology), the amount of the remuneration requires that the user expects an economic benefit, irrespective of whether this actually occurs (ex ante consideration). If the benefit does not materialize, third parties would review the agreement.⁴² The BMF is thus extending the explanations, which were previously already set out in the BMF circular on the use of names in the group, to all intangible assets and not just to trademarks and company logos.

As a rule, the amount of remuneration for licence fees is to be determined according to the hypothetical arm's length principle rather than by benchmarking studies. This is shown by the repeated statements on trademarks,⁴³ but also by the indication that a third party would only pay a licence fee as long as it receives a reasonable operating profit.⁴⁴ How the operating profit is to be defined remains unclear. In practice, it is likely to be based on a routine profit determined via a benchmark study. The hypothetical arm's length approach should also be applied to the valuation of intangible assets for transfer, unless other methods are relevant. The hypothetical arm's length comparison is based on economically recognized valuation methods such as discounted cash flow (DCF) methods.⁴⁵ Income-based methods are now not only permissible but the preferred methods.⁴⁶ Consistency of methods and assumptions between valuations for tax and non-tax purposes must be ensured or possible differences must be explained upon request by the tax auditor.⁴⁷ This is likely to be particularly relevant in practice for purchase price allocations but also for comparison with impairment tests. A value derived from the share value according to sections 9 and 11 of the BewG can only serve as a point of reference.⁴⁸ A simplified capitalized earnings value in accordance with section 199 ff of the BewG should at best be considered as a rough estimate.

In practice, it often happens that the maximum willingness to pay for an intangible asset is lower than the seller's minimum requirement. In these cases, the BMF assumes that the midpoint between the two values nevertheless has to be selected, provided that there are no other causes for the deviations, such as other, non-quantifiable effects. The proposed procedure is economically not easy to follow. It would mean, for example, that a party asks for at least 100 as they would see higher outside options. The buyer is willing to pay a maximum of 80 because he expects to get that return after taxes. In that case, the seller would always be worse off selling for less than 100 as the higher outside options are more lucrative. The same applies to the buyer. Particularly against the background of the economic view in the BMF circular and the realistic alternatives, this is simply not logical.

If the use of an intangible asset is already compensated by the transfer price for a delivery or service, for example, in transactions with a distribution company, no separate licence has to be recognized. A separate offset should nevertheless be recognized to the extent that this leads to a compensation of the advantages or disadvantages. It is advisable to document this compensation consideration.⁴⁹ As the BMF circular repeats its request to assess the arm's length nature of licence payments by the hypothetical arm's length test rather than by benchmarking studies, but as benchmarking studies are often needed abroad, it is advisable to prepare both a benchmarking study and to run a hypothetical arm's length test to choose a figure that is covered by both methods. Only so it is possible to meet both the German and the foreign requirements. It is critical that the hypothetical arm's length test is also requested for open years, as this was not clearly required by the underlying law.

5.2. Services

Chapter VII of the OECD Guidelines provides extensive guidance on group services that are mainly reflected in the BMF circular. Crucial aspects are highlighted. A service recipient is only willing to pay a service fee because they would otherwise have to buy it in or the service arises as an internal service.⁵⁰ It is not sufficient if the service is only offered but not requested. However, it would be permissible if the service provision fluctuates over time.⁵¹ It is conceivable, for example, that HR services are only demanded in those months when hiring is particularly busy. The procurement of a service is itself a service that is to be remunerated on a cost basis, without the volume procured having to be taken into account.⁵² A shareholder expense is not remunerable. The BMF circular provides an overview of typical shareholder activities. The inclusion of corporate group management activities is noteworthy.⁵³ For practical purposes, it is necessary to establish and document what is part of strategic group management and

Trade Name Decree, 24 Intl. Transfer Pricing J. 4 (2017), Journal Articles & Opinion Pieces IBFD.

42. See BMF circular, at para. 3.49.

43. Id., at para. 3.59.

44. Id., at para. 3.51.

45. Id., at para. 3.13.

46. See BMF circular on relocation of functions, at para. 88.

47. See BMF circular, at para. 3.14.

48. Id., at para. 3.15.

49. Id., at para. 3.50.

50. Id., at para. 3.65.

51. Id., at para. 3.67.

52. Id., at para. 3.66.

53. Id., at para. 3.70e.

not a shareholder activity and as such qualifies as entrepreneurial function, and what is a shareholder function. Particularly in the case of decentralized structures with a central shareholder and decentralized entrepreneurial entities, the question is which activities the shareholder can perform without also being assigned an entrepreneurial position. Nevertheless, the circular does not provide further explanation as to how the strategic tasks of group management can be distinguished by the shareholder from the strategic tasks of entrepreneurs.

The services should be remunerated on a cost basis if no price comparison is available. This also applies to financing services and insurance and reinsurance services.⁵⁴ Routine services with low added value can be remunerated with a cost markup of 5%.⁵⁵ Low value-added routine services include accounting, tax preparation and recruitment. R&D, manufacturing and production, and marketing and distribution are explicitly not low value-added routine services.⁵⁶

Analogous to the user charges for intangible assets, no services should be charged if they are compensated via the price of the goods.⁵⁷

5.3. Financial transactions

In the introduction to the financial transactions, reference is made to chapter X of the OECD Guidelines. In the further course of the circular, particular positions of the BMF are specified.⁵⁸ In the case of financing services, a two-stage procedure is to be followed: First, it must be examined whether it is debt capital for tax purposes. In doing so, it must also be analysed whether a third party would have required the money.⁵⁹ An arm's length test of the interest rate must be carried out only if a loan is considered to be debt capital. Unless the lender has the substance in terms of people to bear and control the risk arising from the financing, it should at most be awarded a risk-free return. The taxpayer should therefore document the substance of a financing company in the context of the function and risk analysis. The BMF circular briefly discusses group retention.⁶⁰ Group retention and the interaction with creditworthiness should be examined. A clear position in stand-alone as compared to group rating is missing. However, the pure stand-alone view clearly takes a back seat. The UN Manual⁶¹ is much more explicit in this respect than the OECD and because the former is accepted as an aid in the BMF circular, it is advisable to take it into account in the creditworthiness analysis. For cash pools, the BMF assumes a cost-based remuneration for the cash pool leader as the rule.⁶² The distribution and calculation of synergy effects between the cash pool companies remains open.

54. Id., at para. 3.72.

55. Id., at para. 3.74.

56. Id., at para. 3.76f.

57. Id., at para. 3.72.

58. Id., at para. 3.88.

59. Id., at para. 3.90f.

60. Id., at para. 3.94.

61. See UN Manual 2021, at para. 9.8.11.

62. See BMF circular, at para. 3.98 et seq.

6. Conclusion

The BMF circular published on 14 July 2021 is likely to shape the transfer pricing analysis for both companies and the tax administration for the years to come, together with the circular of 3 December 2020. Even if it is not binding for the taxpayer, it gives indications of the assessment by the tax administration. It thus helps the taxpayer in planning and defending transfer pricing systems. Clear deviations from the BMF circular should be disclosed. The strong orientation of the circular towards the OECD Guidelines is striking. Significant changes to the existing BMF circular are the inclusion of financing transactions; the inclusion of the DEMPE concept; the consideration of the risk-control approach; the references to the OECD, the EU Joint Transfer Pricing Forum and the UN Manual; and an acceptance of a 5% cost markup for routine services with low added value and guidance on year-end-adjustments. As the BMF circular is applicable to all open cases, i.e. also years which are still under audit, it is expected that this causes conflicts with tax authorities. Same as Busch,⁶³ the author sees conflict potential especially around financial transactions and intangibles.

The circular is clearly more economically oriented due to the reference to the OECD, the economic consideration in the arm's length analysis, the emphasis on actual conduct, the departure from written agreements and the emphasis on the hypothetical arm's length comparison. It is expected that the stronger economic view will lead to more subjectivity in the analysis. It is therefore advisable to properly document the reasoning in the arm's length analysis. Moreover, the taxpayer will have to choose between an analysis of the actual third-party behaviour that is determined as much as possible, for example, by taking into account country and market peculiarities, and following a standardized procedure, for example, by means of a relatively fuzzy benchmark study, which nevertheless still has a high level of acceptance as an industry convention both domestically and abroad.

As an economist, the author would much prefer to see such an economic view became more prevalent in transfer pricing analysis globally, not only because of the author's profession and academic background, but also because the question as to what constitutes arm's length is a very economic one. That means that tax authorities need to build up the capacity to conduct analysis based on economic thinking and taxpayers have to explain and document why they believe a certain transaction is at arm's length based on economic thinking. If both parties are committed to follow this implicit guidance of the OECD, the rather fuzzy benchmark studies will likely become obsolete.

63. Busch, *supra* n. 13.