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Additionally, Danny publishes on strategic transfer pricing concepts and techniques, leveraging his experience of financial services, investment management and private equity. Danny has been listed in Euromoney's (Legal Media Group) 'Guide to the World's Leading Transfer Pricing Advisers' and 'World's Leading Tax Controversy Advisers' as well as Chambers Tax. He has updated the Asia-Pacific Capital Markets Tax Committee and the British Bankers Association on transfer pricing issues. Danny has provided comments on discussion drafts in the context of the OECD's BEPS Project and participated in the associated public consultations.

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CHAPTER 2

OECD Transfer Pricing Guidelines

Andrew Cousins & Danny Beeton

§2.01 THE OECD TRANSFER PRICING GUIDELINES

[A] Purpose of the OECD Transfer Pricing Guidelines

The Organisation for Economic Cooperation and Development (OECD) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (hereinafter, 'OECD Guidelines') provide guidance on the application of the 'arm's length principle', the international consensus on transfer pricing set out in Article 9 of both the OECD and UN Model Tax Conventions. The OECD Guidelines were originally approved in 1995, were substantially revised in 2010 and have been subject to further extensive revision in 2015, subsequent to the Base Erosion and Profit Shifting ('BEPS') Project.

The OECD Guidelines represent the culmination of thought on the pricing issues posed by intra-group trade consequent upon globalization. The rise of multinational enterprises ('MNEs') and the growth of intra-group trade, with the resultant potential to misallocate profits, led to the unilateral introduction of domestic transfer pricing legislation, first in the United States and subsequently in other nations (now more than 100), to prevent the erosion of those countries' tax base.

The risk of double taxation on the MNE, with its potential to impede the development of cross-border trade and investment, led to the development of bilateral income tax treaties in the twentieth century. From the 1920s, the League of Nations took a lead in developing international cooperation on direct taxes, publishing a model tax convention in 1928, which aimed to eliminate double taxation, while also preventing escape from taxation.

In 1933, the League's Fiscal Committee prepared a draft multilateral convention on the allocation of profits, revised in 1935, which advocated treating a permanent

establishment as if it were a separate enterprise and determining its income based on what has subsequently come to be known as the arm's length principle.

Since the OECD was formed in 1961, its purpose has been to help countries develop policies together to promote economic growth and healthy labour markets, boost investment and trade, support sustainable development, raise living standards and improve the functioning of markets. The OECD consists of thirty-four member countries and is in accession talks with Colombia, Costa Rica, Latvia, Lithuania and the Russian Federation.[1]

The OECD became the successor to the League in leading development of a model tax convention and in 1963 the arm's length principle was expressed again through Article 9 (on Associated Enterprises) of *The OECD Model Tax Convention on Income and Capital* ('the OECD Model Tax Convention').

The OECD Model Tax Convention has been embraced by most developed countries with relatively minor adaptations and, with some more significant modifications, by much of the rest of the world. Accordingly, the arm's length principle today has universal application as it forms the basis of an extensive network of bilateral income tax treaties between OECD member countries and between OECD member countries and non-OECD economies and of transfer pricing rules in nearly every country's domestic legislation.

In 1979 the OECD issued a report on *Transfer Pricing and Multinational Enterprises*, providing practical guidance for the implementation of the arm's length principle under Article 9. This original document was amended from time to time, and in 1995 the OECD formally issued a more substantive document entitled *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. A revised version of the Guidelines was issued in July 2010.

The 2010 version introduced new guidance in Chapters I to III on the selection of the most appropriate transfer pricing method to the circumstances of the case, the practical application of transactional profit methods (the transactional net margin method and the profit split method), and the performance of comparability analyses. Moreover, the 2010 Guidelines introduced a new Chapter IX dedicated to transfer pricing aspects of business restructurings. The Guidelines continue to be subject to review and have been revised again in 2015 as a consequence of the work undertaken under the BEPS Project.

As the name suggests, the OECD Guidelines are designed to provide guidance to tax administrations and MNEs alike. Some tax authorities refer to the OECD Guidelines as the basis of their countries' own transfer pricing legislation, but the guidelines are accorded general authority and applicability in a wide range of OECD and non-OECD countries, representing as they do internationally agreed principles and guidelines for the application of the arm's length principle, of which Article 9 of the tax convention is the authoritative statement. On the same basis, MNEs refer to the OECD Guidelines, in order to limit the risks of economic double taxation associated with related-party cross-border transactions.

1. The accession process for the Russian Federation is currently suspended.

The OECD Guidelines state that:

> The Guidelines are intended to help tax administrations (of both OECD member countries and non-member countries) and MNEs by indicating ways to find mutually satisfactory solutions to transfer pricing cases, thereby minimising conflicts among tax administrations and between tax administrations and MNEs and avoiding costly litigation. The Guidelines analyse the methods for evaluating whether the conditions of commercial and financial relations within an MNE satisfy the arm's length principle and discuss the practical application of those methods. They also include a discussion of global formulary apportionment.
>
> OECD member countries are encouraged to follow these Guidelines in their domestic transfer pricing practices, and taxpayers are encouraged to follow these Guidelines in evaluating for tax purposes whether their transfer pricing complies with the arm's length principle. Tax administrations are encouraged to take into account the taxpayer's commercial judgment about the application of the arm's length principle in their examination practices and to undertake their analyses of transfer pricing from that perspective.[2]

[B] Contents of the OECD Transfer Pricing Guidelines

As already noted, the OECD Guidelines were substantially revised in 2015 as a result of the work conducted under the BEPS Action Plan. The following paragraphs describe the contents of the 2010 OECD Guidelines amended to take account of subsequent revisions, in particular those introduced in October 2015 as an outcome of the BEPS Project.

The OECD Guidelines contain nine chapters. These chapters are:

(I) 'The Arm's Length Principle': This chapter provides the background to the standard against which international related-party transactions are measured. It includes discussion of a suggested alternative to the arm's length approach, global formulary apportionment, only to reject it, and provides guidance on performing a transfer pricing analysis through application of the arm's length principle. Extensively reworked in 2015, the latest revisions emphasise the importance of accurately delineating the actual transaction and provide an analytical framework to determine which associated enterprise assumes risk for transfer pricing purposes.

(II) 'Transfer Pricing Methods': Chapter II describes the selection process for finding the most appropriate transfer pricing method for a particular case and goes on to describe the recognised transfer pricing methods for assessing intercompany transactions, these being of two kinds: 'traditional transaction methods' and 'transactional profit methods'. The former comprise the comparable uncontrolled price ('CUP') method, the resale price method and the cost plus method, while transactional profit methods are the transactional net margin method and the transactional profit split method.

2. OECD Guidelines, Preface paras 15 and 16.

(III) 'Comparability Analysis': This chapter provides practical recommendations for performing a comparability analysis, from the preliminary analysis of the conditions of the controlled transaction to the selection of the most appropriate transfer pricing method, through to the identification of potential comparables and ultimately a conclusion about whether the controlled transactions being examined are consistent with the arm's length principle.

(IV) 'Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes': Chapter IV proposes various approaches for minimising transfer pricing disputes and helping resolve disputes caused by transfer pricing adjustments, with a view to avoiding double taxation. It covers compliance practices by tax administrations and methods for facilitating resolution of transfer pricing issues between administrations, including the mutual agreement procedure, arbitration and simultaneous tax examinations, as well as devices for minimizing transfer pricing disputes between tax administrations and taxpayers, such as safe harbours and advance pricing agreements.

(V) 'Documentation': This chapter provides guidance for tax administrations to take into account in developing rules and/or procedures on documentation to be obtained from taxpayers in connection with a transfer pricing enquiry or risk assessment. It also provides guidance to assist taxpayers in identifying documentation that would be most helpful in showing that their transactions satisfy the arm's length principle and hence in resolving transfer pricing issues and facilitating tax examinations. Wholly revised in 2015, the chapter newly advocates a three-tiered system of transfer pricing documentation, comprising a Country-by-Country Report ('CbC Report'), a master file and local files.

(VI) 'Special Considerations for Intangible Property': This chapter deals specifically with the use and transfer of intangibles between entities of an MNE. The chapter has been wholly revised in 2015 and now provides extensive guidance on the determination of arm's length conditions for the use or transfer of intangibles, including identification of intangibles, as well as an examination of legal ownership and other contractual terms, together with guidance on the evaluation of the conduct of the parties based on functions, assets and risks. The new chapter outlines some typical scenarios involving intangibles and is supplemented by many new illustrative examples.

(VII) 'Special Considerations for Intra-Group Services': This chapter provides guidance for determining whether services have been provided by one member of an MNE to other entities of the group and for establishing arm's length prices for such services. Again, this chapter has been wholly revised in 2015. Some examples are provided of intra-group services and more focus is now given to low value-adding intra-group services, with respect to which a simplified approach for determining arm's length pricing is proposed, including a simplified benefits test.

(VIII) 'Cost Contribution Arrangements': This chapter discusses cost contribution arrangements ('CCAs') between two or more associated enterprises. Once again, this chapter has been wholly revised in 2015 as a result of the work done under the BEPS Project. It provides a general definition and overview of the concept of CCAs and guidance as to the application of the arm's length principle to CCAs, including guidance on how to measure contributions to a CCA and whether balancing payments are needed. It proposes suggestions for structuring and documenting CCAs.

(IX) 'Transfer Pricing Aspects of Business Restructurings': This chapter discusses how the arm's length principle should apply to business restructurings and in particular to subsequent reallocation of profits among the members of the restructuring MNE. Chapter IX was not subject to revision as part of the BEPS Project and consequently there are some discrepancies between the text and that of the revised chapters, notably the examination of risk in Chapter I and Chapter VI. The OECD is working in 2016 to address these discrepancies and has made clear that where a conflict exists between Chapter IX and the revised chapters, the revisions take precedence.

[1] The Arm's Length Principle

[a] Statement of the Arm's Length Principle

The arm's length principle is the standard on which the OECD Guidelines are based. According to the definition in the OECD Guidelines, the arm's length principle is:

> The international standard that OECD Member countries have agreed should be used for determining transfer prices for tax purposes. It is set forth in Article 9 of the OECD Model Tax Convention as follows: where conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.[3]

In other words, the arm's length principle requires that the amount charged by one related party to another for a given product, asset or service must be the same as if the parties were not related. An arm's length price for a transaction is therefore what the price of that transaction would be on the open market. The arm's length principle follows the 'separate entity approach' of treating members of an MNE group as separate entities rather than as inseparable parts of a single unified business. The OECD Guidelines note some of the flaws of the arm's length principle, such as the fact that it may not always account for the economies of scale and interrelation of diverse activities created by integrated businesses. Nonetheless, the arm's length principle is

3. OECD Guidelines, Glossary, 'Arm's length principle'.

deemed to be theoretically sound, on the grounds that it is considered to provide the best basis on which to approximate the workings of the open market for goods transferred and services rendered between associated parties. It is also held to provide broad parity of tax treatment for members of MNE groups and independent enterprises, avoiding the creation of tax advantages or disadvantages that would distort relative competitiveness and so promoting the growth of international trade and investment. The view among OECD member countries is therefore that the arm's length principle should continue to govern the evaluation of transfer prices among associated enterprises.

[b] A Non-arm's-Length Approach: Global Formulary Apportionment

Were it to be applied, global formulary apportionment would allocate the global profits earned by an MNE group on a consolidated basis among the associated enterprises in different countries on the basis of a predetermined and mechanistic formula. The OECD Guidelines note that generally speaking there would be three essential components to applying global formulary apportionment: (i) determining which entities within the MNE comprise the global consolidated entity on which to apply the apportionment, (ii) accurately determining what the global profits are, and (iii) establishing a viable formula for allocating the profits, based, for example, on some combination of costs, assets, payroll and sales. The formula for allocation of profits would be predetermined for all taxpayers rather than determined on a case-by-case basis.

The OECD Guidelines include the reasons that proponents of global formulary apportionment advance for adoption of this method, including greater administrative convenience and certainty for taxpayers, a reduction of compliance costs for taxpayers and a closer alignment with economic reality, based on the argument that it is difficult to assess the separate operating entities of an MNE and to determine accurately each of these entities' contribution to the overall MNE's profit, particularly in highly integrated groups.

OECD member countries, as stated in the Guidelines, do not accept the propositions for formulary apportionment.[4] The primary reason provided is that this method cannot adequately protect against double taxation, there being no international consensus on the predetermined formulae to be used. It is argued that each jurisdiction would seek to devise its formulary apportionment on the basis of self-interest, and as such, different results would be yielded by different jurisdictions. The risk of tax avoidance through the artificial manipulation of the components of the formulae by taxpayers would be high. Furthermore, an extraordinary degree of international cooperation would be necessary for the universal adoption of a new system, the failure of which would inevitably lead to double taxation, as some countries still applied the arm's length standard. The arbitrariness of predetermined formulae and their disregard for market conditions and the circumstances of individual enterprises are also held to be significant concerns. A number of other problems are identified, including the

4. OECD Guidelines, Ch. I, para. 1.21.

distorting effect of exchange rate movements and difficulties in determining the sales of each member and in the valuation of assets, especially in the valuation of intangible property. Global formulary apportionment abandons the separate entity approach, taxing the MNE group on a consolidated basis, therefore failing to recognize important geographical differences, separate company efficiencies and other company-specific factors. In conclusion, the OECD Guidelines reject the global formulary approach and argue that it does not provide a reasonable means of assessing an arm's length price between two related parties.

[c] Guidance for Applying the Arm's Length Principle

A 'comparability analysis' is held to be at the heart of the arm's length principle, based on a comparison of the conditions in a controlled transaction with the conditions that would have been made had the parties been independent and undertaking a comparable transaction under comparable circumstances.

The first aspect of such an analysis is the accurate delineation of the controlled transaction. Section D of Chapter I has been wholly rewritten in 2015 as a result of the BEPS Project and places a new emphasis on this delineation of the actual transaction for the comparability analysis. Contractual arrangements still form the starting point of the analysis, but clarity is provided on the relationship between contractual arrangements and conduct. Knowledge of the conduct of the parties to the transaction is considered relevant to assess whether there are contradictions between contractual arrangements and conduct, to fill in gaps in the contractual arrangements and to interpret the contracts for transfer pricing purposes.

It is necessary to identify the economically relevant characteristics of the commercial or financial relations between the associated enterprises, through an understanding of the industry sector in which the MNE group operates and identification of how the entities within the group operate before analyzing the economically relevant characteristics of the transaction.

The economically relevant characteristics or comparability factors that need to be identified in the commercial or financial relations between the associated enterprises for the accurate delineation of the actual transaction comprise:

- the contractual terms of the transaction;
- the functions performed by the parties to the transaction, taking into account assets used and risks assumed;
- the characteristics of the property transferred or services provided;
- the economic circumstances of the parties and of the market; and
- the business strategies pursued by the parties.

The contractual terms of the transaction, where they exist, being the first factor of comparability, serve as the starting point for delineating the transaction and how the responsibilities, risks and anticipated outcomes arising from their interaction were intended to be divided at the time of entering into the contract. However, actual business transactions undertaken by associated enterprises must be accurately delineated and, where the economic reality of the transaction is inconsistent with the

written contract, the transfer pricing analysis should be based on the characteristics of the transaction reflected in the conduct of the parties.

The second factor of comparability is the functional analysis. In delineating the controlled transaction and determining comparability between controlled and uncontrolled transactions or entities, a functional analysis is necessary, which seeks to identify the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions.

In the 2015 revision, substantially more guidance on risk has been provided as part of the guidance on the functional analysis. The chapter now includes a framework for performing the risk analysis.[5] A materiality threshold is included within the framework, whereby economically significant risks need to be identified with specificity.

The chapter recognizes 'risk-return trade-offs', supporting the notion that it is economically rational to take on (or lay off) risk in return for higher (or lower) anticipated nominal income. Control over risk has been clarified and the financial capacity to assume a risk is included as a criterion on equal footing with control in the analysis on assumption of risk. Contractual allocations of risk are respected only when they are supported by actual decision-making.

The guidance helps to determine accurately the actual contributions made by an associated enterprise that solely provides capital. Where the capital provider does not exercise control over the investment risks that may give rise to premium returns, that associated enterprise should expect no more than a risk-free return.

The third comparability factor is the characteristics of the property or services being transferred, differences in which often account for differences in value in the open market. Important considerations may include the physical features of the property, its quality and reliability, the availability and volume of supply. The OECD Guidelines state that the weight attributed to this factor of comparability will depend on the transfer pricing method selected. The requirement for comparability of goods and services transferred is strictest for the comparable uncontrolled price method (see below).

The fourth economically relevant characteristic or comparability factor is the economic circumstances of the parties to the transactions being compared and of the markets. The Guidelines provide examples of circumstances that may be relevant to determining market comparability, including the geographic location, the size of the markets, the extent of competition in the markets, the availability of substitute goods or services, consumer purchasing power, the regulation of the market, and the cost of production.

Finally, the fifth economically relevant characteristic or comparability factor to be examined is the business strategy of the parties involved in the transactions being compared. Such strategies take into account such factors with a bearing on the conduct of the business as innovation and new product development, degree of diversification, risk aversion and so on. They may also include market penetration schemes that temporarily charge a lower price for comparable products in the same market.

5. OECD Guidelines, Ch. I, para. 1.60.

Substantially new guidance is now provided on recognition of the accurately delineated transaction. Where the characteristics of the accurately delineated transaction are found to be inconsistent with the written contract, the OECD encourage pricing consistent with the accurate delineation. Non-recognition is not encouraged except under exceptional circumstances. The circumstances where non-recognition may apply is linked to the notion of commercial rationality and whether unrelated parties would agree the arrangements under comparable economic circumstances.

The new Chapter I also provides additional guidance on:

- locational savings and other local market features;
- assembled workforce; and
- MNE group synergies.

In the context of Chapter I, there is a follow-up project being undertaken by the OECD in 2016/2017 on financial transactions, owing to the important interaction with the work on interest deductibility and on risks.

[2] *Transfer Pricing Methods*

Chapter II describes the 'traditional transaction methods' and the 'transactional profit methods' that can be used to establish whether the transfer prices set between associated enterprises are consistent with the arm's length principle. Traditional transaction methods are the comparable uncontrolled price method or CUP method, the resale price method, and the cost plus method. Transactional profit methods are the transactional net margin method and the transactional profit split method.

The OECD has, in its 2010 update, abolished its reliance on a hierarchical preference for transfer pricing methods; all the methods it recognizes may now be equally analysed in order to assess whether they are appropriate to a specific case. The OECD Guidelines now state that selection of a transfer pricing method aims at finding the most appropriate method for a particular case. Thus, the selection process should take account of:

> the respective strengths and weaknesses of the OECD recognized methods; the appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis; the availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and/or other methods; and the degree of comparability between controlled and uncontrolled transactions.[6]

However, traditional transaction methods are regarded as the most direct means to establish whether the conditions of the commercial and financial relations between associated enterprises are at arm's length. Consequently, if all methods are applicable in an equally reliable manner, the CUP method is to be preferred to any other method and the traditional transaction method is preferable to the transactional profit method.[7]

6. OECD Guidelines, Ch. II, para. 2.2.
7. OECD Guidelines, Ch. II, para. 2.3.

Chapter 5

Belgium

Natalie Reypens

§5.01 IMPORTANCE OF TP FOR MULTINATIONAL COMPANIES OPERATING WITHIN BELGIUM

Recently, Belgian tax authorities have become increasingly aware of TP issues. On 28 June 1999, the Belgian tax authorities issued their first TP Circular Letter, in which they accepted the principles of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines).[1] The Circular Letter was issued to increase the awareness of the tax authorities. When the Belgian government adopted the EU Arbitration Convention of 23 July 1990 in 2000, a Circular Letter was issued by the Belgian tax authorities on the application of the Arbitration Convention. This is one of the components of the defensive aspects of TP.[2] Another Circular Letter followed in 2006 containing guidelines for TP audits and transfer pricing documentation (TPD).[3]

The Law of 24 December 2002, effective 1 January 2003, introduced advanced decisions (Rulings) that allow taxpayers to seek confirmation in advance on the tax consequences of their transactions, including their TP policy. Further changes to this ruling system have followed with the Law of 21 June 2004, and the new ruling Commission became active 1 January 2005. The intention of these developments in legislation was to give foreign investors in Belgium certainty regarding the tax consequences of their transactions. The advanced decision legislation forced the Belgian tax authorities to become more and more skilled in TP.

1. Circular No. AFZ/98-0003 dated 28 Jun. 1999.
2. Circular No. AFZ/INTERN. IB/98-0170 dated 7 Jul. 2000.
3. Circular No. Ci.RH.421/580.456 (AOIF 40/2006) dated 14 Nov. 2006.

In June, 2004, Article 185 section 2 in the Belgian Income Tax Code (ITC) implemented the arm's-length principle in Belgium. Before that time, TP provisions in Belgian tax law were based on 'abnormal or benevolent advantages'.

With the introduction of the internationally accepted arm's-length standard and the new ruling system, Belgium offers important tax incentives for multinational enterprises doing business in Belgium. 'Excess profit rulings' provide an important TP opportunity; they allow downward profit adjustments while a corresponding upward adjustment is not a necessity.[4]

A TP Unit (*'Cel Verrekenprijzen/Cellule Prix de Transfert'*) was officially established on 1 July 2006. This Unit acts as a knowledge-centre. It gives technical and operational assistance related to TP audits and it also performs TP audits.

Apart from the developments in TP, Belgium has introduced other tax incentives to attract foreign investors, such as the notional interest deduction (NID) regime and the patent income deduction regime.[5] The implementation of these tax incentives in Belgian tax practice has also increased the awareness and skills of the Belgian tax authorities, and in particular, the Ruling Commission in TP matters. Hence, as Belgium has become a favourable location for finance and treasury companies, IP companies, central entrepreneurs etc., the importance of TP for multinational companies operating in Belgium has grown substantially.

§5.02 REGULATORY FRAMEWORK

[A] Legal Authority

Until mid 2004, the arm's-length principle in the strict sense of the concept was not available in Belgian domestic tax law. The Belgian tax authorities did however have other resources to challenge the transfer prices of Belgian taxpayers and subsequently adjust their taxable basis. Under Article 26 ITC the Belgian tax authorities can adjust transfer prices to the detriment of a Belgian company or establishment. The arm's-length principle was implemented by the Law of 21 June 2004 with effect as of 19 July 2004.[6] For reasons of clarity and transparency and to avoid interpretation differences the Belgian legislator chose to align Belgian tax law as much as possible with the international rules.[7] Article 185 section 2 ITC was introduced to guarantee that the taxable basis of a Belgian taxpayer can be adjusted to take into account the arm's-length principle. The Belgian legislator deemed it necessary to complete the introduction of the arm's-length principle with an amendment to the regulations on the ruling system. In this respect, the introduction and explicit recognition of the international arm's-length principle will increase the legal security of the taxpayer which will lead to a better investment climate and economy in Belgium.[8]

4. Reference is also made to s. 8.1.
5. Reference is also made to ss 8.2. and 8.3.
6. The Law of 21 Jun. 2004, *Belgian Official Gazette*, 9 Jul. 2004.
7. *Parl. Doc.* Chamber, 2003/2004, No. 1079/001, 2003/2004, 9.
8. *Parl. Doc.* Chamber, 2003/2004, No. 1079/001, 2003/2004, 6.

[1] *Article 185 Section 2 ITC*

Article 185 section 2 ITC reads as follows:

> for two enterprises which form part of a multinational group of associated enterprises and with respect to their cross-border mutual relations:
>
> (a) where between the two enterprises in their commercial or financial relations, conditions are made or imposed that differ from those that would be made between independent enterprises, then, any profits that one of the enterprises would have realized without those conditions, but has not by reason of those conditions, may be included in the profits of that enterprise;
>
> (b) where profit is included in the profit of an enterprise which is also included in the profit of another enterprise, and the so included profit consists of profit that this other enterprise would have realized if between the two enterprises such conditions would be made that would have been made between independent enterprises, then, the profit of the first – mentioned enterprise will be adjusted in an appropriate way.

The first section applies by advanced decision notwithstanding the application of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436) of 23 July 1990 and the international conventions for the avoidance of double taxation.

[a] *Scope of Application*

Article 185 section 2 is exclusively applicable to cross-border commercial and financial relations:

- between a Belgian company and a non-Belgian company which are members of the same multinational group of associated enterprises;
- between a Belgian establishment and a non-Belgian establishment of another enterprise of the same multinational group of associated enterprises;
- between a Belgian company and a non-Belgian establishment of another Belgian company which are members of the same multinational group of associated enterprises;
- between a Belgian establishment and its non-Belgian head office;
- between a Belgian establishment and a non-Belgian establishment of the same company, which are located in a country other than the country of the head office.[9]

The application of this Article is not restricted to non-Belgian enterprises or establishments located in EU countries or countries which have concluded a convention for the avoidance of double taxation with Belgium.

With respect to the term 'multinational group of associated enterprises', the Circular of 1999 refers to the wording of Article 11,1° of the Belgian Company Code, which defines 'associated enterprises to a certain enterprise' as enterprises which

9. Circular Ci. RH.421/569.019 (AOIF 25/2006) dated 4 Jul. 2006, No. 3.

exercise control over that enterprise or over which that enterprise exercises control, enterprises which are members to a consortium to which the enterprise is a member, and any other enterprises which are, by means of its management board, under the control of the aforementioned enterprises.

Article 185 §2 does not apply to domestic controlled transactions, cross-border transactions between a company and an individual or between two individuals and to uncontrolled transactions. On this point, Article 185 §2 differs from Article 9 of the OECD Model Convention which can be applied to enterprises carried on by individuals.[10] The Belgian legislator has not deemed it necessary to apply Article 185 §2 to those situations as there is not the same level of complexity of the relationships where an individual is involved.[11] Transactions among individuals are covered by Article 26 ITC.

[b] *Adjustments*

On the basis of Article 185 §2 a), the profit that a Belgian company or a Belgian establishment of a non-Belgian company that is a member of a multinational group should have realized in arm's-length conditions on the occasion of a cross-border commercial or financial controlled transaction may be included in its taxable profit. The profit will be added to the Belgian company or establishment's taxable basis by reporting it as a disallowed expense on the tax return.

On the basis of Article 185 §2 b) ITC, a Belgian company or a Belgian establishment is, under certain conditions, allowed to make a downward profit adjustment for corporate income tax purposes. If it can be justified that the accounting result exceeds the arm's-length result, this difference can be exempt from tax.

According to the parliamentary works, the corresponding downward adjustment should be determined in accordance with the arm's-length principle. An adjustment should only be made to the extent that the Belgian tax authorities are of the opinion that the profit adjustment was justified. Therefore, the corresponding adjustment should not be made if the profit in the other country has been increased to exceed the arm's-length standard.[12] Contrary to Article 9 §2 of the OECD Model Convention Article 185 §2 b) ITC offers the legal basis to reduce the taxable basis without actual or likely double taxation.

The downward adjustment of the profit of a Belgian taxpayer is reported in the annual corporate income tax return through an increase in the taxable reserves at the beginning of the year.[13]

While the upward adjustment was already included in Belgian tax law before 2004 under Article 26 ITC, the downward adjustment was not yet provided for in Belgian tax law. The absence of the legal basis for a downward adjustment in Belgian domestic tax law created problems where such adjustment was required as a result of the mutual agreement procedure (MAP) under the treaties or EU arbitration procedure.

10. For instance, commercial or financial relations between an enterprise carried on by an individual in Belgium and a controlled non-Belgian entity fall within the scope of application of Art. 9 OECD Model Convention but not within the scope of 185§2 ITC.
11. *Parl. Doc.* Chamber, 2003/2004, No. 1079/001, 2003/2004, 10.
12. *Parl. Doc.* Chamber, 2003/2004, No. 1079/001, 2003/2004, 11.
13. Circular Ci. RH.421/569.019 (AOIF 25/2006) dated 4 Jul. 2006, No. 8.

By introducing Article 185 §2 b) ITC, downward adjustments are also possible in situations outside the application of tax treaties and the Arbitration Convention.

Article 185 §2 b) ITC offers an interesting planning opportunity, that is, 'excess profit' rulings. This is further discussed in section §5.08[A] below.

On the basis of the law, upward and downward adjustments can only be applied by Advanced Decision, notwithstanding the application of the Arbitration Convention or the international conventions on the avoidance of double taxation.

This means that the tax authorities cannot apply Article 185 §2 a) to proceed with an upward adjustment of a Belgian taxpayer's taxable basis in situations where the application of the above conventions is not requested. However, in those situations, the Belgian tax authorities could still invoke Article 26 ITC to make an upward adjustment.

According to legal scholars, the legislator has 'made a mistake': the Belgian tax authorities should be able to apply Article 185 §2 a) to adjust the profit of a Belgian taxpayer without an Advanced Decision.[14] It remains to be seen how tax authorities will deal with this in the future, and whether the law will be changed. In any event, the Ruling Commission requests in practice to include the confirmation of non-application of Article 185 §2 a) ITC in the demands for an Advanced Decision in TP matters. This might be an indication that the tax authorities are of the opinion that Article 185 §2 a) ITC could be applied without an Advanced Decision.

It seems logical that a downward adjustment on the basis of Article 185 §2 b) ITC can only be requested through an Advanced Decision with the Ruling Commission. Apparently, the legislator is of the opinion that only the Ruling Commission is sufficiently skilled to decide in this delicate matter of downward profit adjustments.[15]

[2] *Abnormal or Benevolent Advantage Granted: Article 26 ITC*

Article 26 allows the Belgian tax authorities to include in a Belgian taxpayer's taxable basis the abnormal or benevolent advantages granted by the taxpayer to a non-Belgian company or establishment, except if these advantages are taken into account to determine the taxable basis of the non-Belgian beneficiary. This exception is referred to as the 'escape clause'. However, the second paragraph of Article 26 lists three situations where the advantages can be included in the taxable basis of the Belgian taxpayer even if they have been taken into account to determine the recipient's taxable basis ('exceptions to the escape clause').

Article 26 ITC reads as follows:

> when an enterprise established in Belgium grants abnormal or benevolent advantages, these advantages are to be added to the enterprise's profits unless the advantages are relevant for ascertaining the taxable income of the beneficiaries thereof.

14. S. Van Crombrugge & S. Huysman, *T.R.V.* 2006, 06/7, 561&dev;575.
15. S. Van Crombrugge & S. Huysman, *T.R.V.* 2006, 06/7, 561&dev;575.

Notwithstanding the limitation contained in paragraph one, the abnormal or benevolent advantages are to be added to the enterprise's profits when granted to:

(1) a taxpayer mentioned in Article 227 (i.e., non-residents) with which the enterprise established in Belgium has any direct or indirect relationship of interdependence whatsoever;
(2) a taxpayer mentioned in Article 227 or to a foreign establishment which, pursuant to the legislative provisions of the country of which they are established, are not subject to income tax or are governed by a tax regime considerably more favourable than that which governs the enterprise resident in Belgium;
(3) a taxpayer mentioned in Article 227 who is sharing common interests with the taxpayer or the establishment mentioned in 1 or 2 (above).

Belgian tax law does not define 'abnormal or benevolent advantage'. However, the Administrative Guidelines of the Belgian tax authorities state that an abnormal or benevolent advantage is basically any enrichment of the recipient of the advantage without accurate and actual consideration.[16]

Pursuant to the Guidelines, an advantage is an enrichment of the recipient without, from the perspective of the grantor of the advantage, real compensation that is equivalent to the advantage granted.[17] Abnormal is that which is contrary to the customary way of things, the rules and the established practice or, also, what is contrary to that what is usual in similar situations.[18] A benevolent advantage is an advantage that is granted without a contractual obligation or that is granted without any consideration.[19] An intentional element is not required.[20] The identity of the beneficiary is irrelevant.[21]

Whether an abnormal or benevolent advantage is granted is a factual matter. The economic circumstances of the moment, the situation in which parties involved are and the factual circumstances of the case should be taken into consideration.[22]

To determine the value of shares, it is generally accepted that one should also take into account the future return, to the extent that the parties are aware of such

16. Administrative Guidelines to ITC, No. 26/17.
17. Administrative Guidelines to ITC, No. 26/16.
18. Administrative Guidelines to ITC, No. 26/16 and, for example, Cass. 22 Sep. 2011, <www.cass.be>; Liège 24 Mar. 2006, *F.J.F.* 2008, No. 2, 146 and Court of First Instance Liège 6 Sep. 2010, *Fisc.Koer.* 11/247.
19. Administrative Guidelines to ITC, No. 26/16; Cass. 22 Sep. 2011, <www.cass.be>.
20. Court of First Instance Mons 18 Jan. 2006, *Fiscoloog* No. 1019, 10: a Belgian company has received an invoice from an Irish company to be paid in German currency. By mistake, the company paid the amount in USD which was higher than the amount due in German currency. The Court held that the excess part constitutes an abnormal or benevolent advantage.
21. Contra: Court of First Instance Namur 25 Sep. 2002, *F.J.F.* 2003, No. 1, 50.
22. Antwerp 28 Jun. 2011, *Fiscoloog* 2011, No. 1265, 11; Brussels 29 Jun. 2007, *T.F.R.* 2008, No. 338, 329; Antwerp 4 Apr. 2006, *F.J.F.* 2007, No. 2, 143; Court of First Instance Antwerp, 4 Jun. 2003, *F.J.F.* 2004, No. 5, 421; Liège 20 Mar. 2002, *F.J.F.* 2006, No. 3, 277; Court of First Instance Antwerp. 25 Oct. 2002, *Fisc.Koer.* 2003, No. 4, 250 and *F.J.F.* 2004, No. 2, 122. Reference is also made to ss 2.4. and 7.2.

future perspectives at the moment of the sale.[23] Although the law does not impose a particular valuation method, one should use the valuation method which, taking into account the legal and factual circumstances of the transaction, could be considered to best reflect the economic value of the shares.[24]

The abnormal or benevolent advantage could consist of an exorbitant income or a saved expense. The value of the abnormal or benevolent advantage must be determined from the perspective of the recipient.[25]

The amount of the abnormal or benevolent advantage granted is added to the taxpayer's taxable basis as a disallowed expense.

[a] *Escape Clause*

No profit adjustment on the basis of Article 26 can be made if the advantages are relevant for ascertaining the taxable income of the beneficiaries of the abnormal or benevolent advantages. It is not required that the advantage is subject to actual taxation in the hands of the beneficiary.[26] For instance, the beneficiary might be able to offset the advantage received with its carried forward losses.

According to the Belgian Minister of Finance, an abnormal or benevolent advantage will be deemed to be taken into account for determination of the taxable basis of the beneficiary if the beneficiary is a Belgian company. As a result, Article 26 has no effect if the beneficiary of the abnormal or benevolent advantage is a Belgian enterprise subject to the Belgian corporate income tax.[27] According to the Minister of Finance, in limited circumstances this tolerance does not apply if it would result in an illegitimate exemption or deduction in the hands of the company that grants the abnormal or benevolent advantage, without being effectively taxed in the hands of the beneficiary of the advantage.[28] While the profit of the Belgian taxpayer granting the advantage will not be adjusted based on Article 26 ITC, the Belgian beneficiary of the advantage might face adverse Belgian tax consequences on the basis of Articles 79 and 207 ITC (see below).

23. Liège 13 Dec. 2002, *F.J.F.* 2003, 278.
24. Court of First Instance Louvain, 26 Jan. 2007, *T.F.R.* 2007, No. 322, 428 &dev; see also s. 6 below.
25. Administrative Guidelines to ITC, No. 26/22.
26. Court of First Instance Liège, 1 Apr. 2003, *F.J.F.* 2005, No. 10, 1026; Brussels 19 May 2005, *F.J.F.* 2007, No. 7, 609; Court of First Instance Antwerp, 3 Oct. 2007, *Fisc.Koer.* 2008, No. 4, 353; Court of First Instance Ghent, 14 Feb. 2011, *Fiscoloog* 2011, No. 1249, 12; Antwerp 15 Jun. 1999, *Act.Fisc.* 1999, No. 26, 4 and *Fisc.Koer.*1999, 598.
27. Parl. Q. No. 174 of Mr Cooreman dated 26 Apr. 1990, *Q. and A.*, Senate, 12 Jun. 1990, 1640; Parl. Q. No. 302 of Mr Cooreman dated 9 Mar. 1993, *Q. and A.*, Senate, 13 Apr. 1993, 2457; Parl. Q. No. 866 of Mrs Pieters dated 29 Jun. 2005, *Q. and A.*, Chamber, 27 Mar. 2006, 21901; Parl. Q. No. 916 of Mr de Seny of 9 Dec. 1994, *Q. and A.*, Senate, 14 Feb. 1995, 7692.
28. Parl. Q. No. 3 of Mrs Nelis-Van Liedekerke dated 14 Jul. 1995, *Q. and A.*, Senate, 12 Mar. 1993, 559, *Fisc.Koer.* 96/255. A company acquired shares at an overestimated price. As capital gains are tax exempt, the advantage resulting from the overprice was never taxable in the hands of the beneficiary. Losses on shares not being tax deductible, one could say that the transaction is tax neutral. However, in case of liquidation of the company of which the shares have been sold, part of the loss on the shares is tax deductible (up to the amount of paid up capital).

The Belgian Minister of Finance has confirmed that if the abnormal or benevolent advantage is granted to a non-Belgian taxpayer which is not associated with the Belgian taxpayer who has granted the advantage and the advantage is taken into account to ascertain the taxable basis of this non-Belgian taxpayer on the basis of the tax regime as applicable in its country of residence, the escape clause should apply unless one of the three exceptions are applicable. The impact of this position is very limited as in most cases, an abnormal or benevolent advantage is granted to an associated taxpayer.[29]

[b] *Exceptions to the Escape Clause*

The profit adjustment will be made irrespective of whether the abnormal or benevolent advantage has been taken into account to determine the beneficiary's taxable basis, if the beneficiary is:

(1) a non-resident company with which the enterprise established in Belgium has any direct or indirect relationship of interdependence whatsoever. The relationship of interdependency is present when:
   - a non-resident enterprise (individual or company) directly controls one or several Belgian resident enterprises (individuals or companies);
   - a Belgian resident enterprise (individual or company) directly controls one or several non-resident enterprises (individuals or companies);
   - one or several Belgian resident enterprises (individuals or company) and one or several non-resident enterprises (individuals or companies) are controlled by a third person or an enterprise, or are part of the same group and, thus, have an indirect relationship of interdependency (it does not matter whether the person or the third enterprise that creates the interdependency is a resident of a Member State of the European Union or of a third State).[30] The relationship of interdependency could also be based on the fact that the boards of directors of both companies are composed in the same way to a great extent, that one entity *is to a great extent* dependent on another entity for the purchase of its raw materials or know how or that one entity is the only customer of another entity. The relationship of interdependency is a factual matter. As mentioned above, Article 26 ITC does not apply if the beneficiary is a related Belgian company. According to an answer of the Minister of Finance to a Parliamentary Question of 1998, Article 26 ITC would apply if the beneficiary is a Belgian establishment of a non-Belgian company.[31] This viewpoint could trigger double taxation and is therefore questionable.

29. Parl. Q. No. 472 of Mr Eerdekens dated 6 Oct. 2000, *Q. and A.*, Chamber, 5 Feb. 2001, 6988; see also *'Les Prix de Transfert'*, T. Vanwelkenhuyzen, 46.
30. Circular No. AFZ/INTERN. IB/98-0170 dated 7 Jul. 2000.
31. Parl. Q. No. 1255 of Mrs Pieters dated 23 Feb. 1998, *Q. and A.*, Chamber, 20 Apr. 1998, 17314. The Minister confirmed that Art. 26 applies in a situation where a Belgian company sells its

(2) a non-Belgian company or a non-Belgian establishment which, pursuant to the legislative provisions of the country of which they are established, are not subject to income tax or are governed by a tax regime considerably more favourable than that which governs the enterprise resident in Belgium. The law does not define 'considerably more advantageous'. The phrases 'not subject to income tax' and 'governed by a tax regime considerably more advantageous' are also referred to in the Belgian tax provisions dealing with the participation exemption regime. In this context, a tax regime is considered 'considerably more advantageous' if the applicable tax rate is below 15% or if the effective tax rate (as applied to a tax base calculated in accordance to the Belgian rules) is below 15%. The tax regimes of the EU Member States are not considerably more advantageous.[32] According to the tax authorities, the countries appearing on the list for the participation exemption are the ones meant in this Article;[33]

(3) a non-Belgian company that shares common interests with the taxpayer or the establishment mentioned in (1) or (2).On the basis of this exception to the escape clause, an abnormal or benevolent benefit can be added to a Belgian company's taxable basis where granted to a non-Belgian taxpayer (subject to a normal tax regime) which has common interests with a non-Belgian company that is related to the Belgian company or common interests with a non-Belgian company or non-Belgian establishment which is subject to a considerably more advantageous tax regime. This exception has been implemented to avoid the strategy of 'stepping stone', that is, interposing a non-Belgian company to avoid application of (1) and (2) where the *ultimate beneficiary* of the advantage is a company mentioned under (1) and (2). It is required that the abnormal or benevolent advantage is actually transferred to the company mentioned under (1) and (2).

The definition of 'common interests' is not clear, but it is broader than the 'relationship of interdependence' definition. Common interest could, for instance, be deemed present where two independent enterprises are part of a joint venture.

The tax authorities need to prove that an advantage is granted and that the advantage is abnormal or benevolent.[34] It is then the taxpayer who needs to prove that the escape clause applies, that is, that the abnormal or benevolent advantage is taken into account for ascertaining the taxable basis of the beneficiary. Then, the burden shifts back to the tax authorities to prove that one of the exceptions to the escape clause applies.[35]

business against book value to a German related company as a result of which the German company would avail of a taxable Belgian establishment.
32. Article 203 ITC.
33. Cauwenbergh P. in Vennootschap & Belastingen, Deel XIII, 4-850.
34. Administrative Guidelines to ITC, No. 26/48.
35. For example, Court of First Instance Mons 18 Jan. 2006, *Fisc. Koerier* 2006, No. 7, 498.

CHAPTER 10

Germany

Angelika Thies

§10.01 IMPORTANCE OF TRANSFER PRICING FOR MULTINATIONAL COMPANIES OPERATING WITHIN GERMANY

Transfer pricing rules have assumed major importance in the German tax practice due to developments in business, such as the increase in international transactions and the building of a globalized economy. A global strategy is necessary for many companies who wish to remain competitive. Therefore, internal structures and functions are often reorganized based on a global approach. Furthermore, due to uncertain business cycles, as well as financial and economic crises, business approaches may need to be changed.

Consequently, many local governments and tax authorities have adjusted tax and transfer pricing rules to meet new needs. In Germany, it has been observed that many of the new tax rules tend to secure or increase the German tax basis, while the corporation tax rate has been decreased as of fiscal years 2008 for the last time.

New legislation has resulted in stricter transfer pricing rules and documentation requirements, and transfer pricing rules are still being developed. Furthermore, new decisions of the German fiscal courts, the European Court of Justice and the work of the OECD, in particular concerning the BEPS program, are influencing transfer pricing rules. This means that multinational companies have to review the latest status of legislation and the view taken by the German tax authorities on a frequent basis. They may also need to adjust their transfer pricing documentation and tax filings to new requirements in order to avoid adjustments and penalties.

§10.02 REGULATORY FRAMEWORK

[A] Legal Authority

German transfer pricing regulation is based on statutory rules and administrative decrees. However, administrative decrees are mandatory guidelines for the tax authorities, for example, for the tax auditor, but do not have a binding effect on the taxpayer, who may take a different view in appeals proceedings or before a tax court. Tax assessments may not be adjusted after the statutory period of limitation has been reached.

[1] *Statutory Rules*

The statutory rules on transfer pricing in Germany are found in several provisions in different acts. For example, the provisions include a definition of related parties and provide that where the assets or income of the German taxpayer are reduced by means of non-arm's-length transactions with related parties, the income of the German taxpayer shall be adjusted accordingly. The statutory references are as follows:

(1) Section 1 paragraphs 1-4 German Foreign Tax Act (*Außensteuergesetz*): The general arm's-length principle, transfer pricing methods to be applied
(2) Section 1 paragraph 3 sentences 9-12 German Foreign Tax Act (*Außensteuergesetz*): Taxation of a transfer of functions (and business risks)
(3) Regulations regarding the application of the taxation principles on a transfer of business functions according to section 1 paragraph 1 German Foreign Tax Act (*Außensteuergesetz*) of 12 August 2008 (BGBl I, 2008, p. 1680)
(4) Section 1 paragraph 5 German Foreign Tax Act (*Außensteuergesetz*): Determination of taxable profit in case of a permanent establishment (Authorized OECD Approach; AOA)
(5) Section 4 paragraph 1 sentence 1 German Income Tax Act (*Einkommensteuergesetz*): Principles of income determination
(6) Section 8 paragraph 3 German Corporation Tax Act (*Koerperschaftsteuergesetz*): Hidden profit distributions/constructive dividends
(7) Section 40 German Corporation Tax Regulations (*Koerperschaftsteuerrichtlinien*): Hidden capital contributions/constructive injections/contributions
(8) Section 90 German General Tax Code (*Abgabenordnung*): Obligation for providing information and documentation
(9) Regulations regarding the documentation requirements of section 90 paragraph 3 German General Tax Code (*Abgabenordnung*) of 13 November 2003 (BGBl I, 2003, p. 2296)
(10) Section 162 German General Tax Code (*Abgabenordnung*): Right for an income increase and charge of penalties by the German tax authorities

Regarding (1): section 1 paragraph 1-4 German Foreign Tax Act (*Außensteuergesetz*) grants the tax authorities the right to adjust a German taxpayer's taxable income from cross-border transactions with related parties if the transactions were not at arm's-length. Consequently, any cross-border business transaction with related parties, which includes corporations as well as partnerships, has to be carried out at its fair market value (*gemeiner Wert*). In this context, the term 'related party' may be based on a direct or indirect shareholding of at least 25%, a dominating influence, any other possible influence, or it may be based on identical interests or an acting in concert.

Regarding (2) and (3): sentences 9-12 of section 1 paragraph 3 German Foreign Tax Act (*Außensteuergesetz*) focuses on the determination and adjustment of transfer prices in case of a business restructuring and the cross-border transfer of business functions. Additionally, on 12 August 2008, regulations (FVerlV) regarding the provisions on a transfer of business functions were issued.[1]

Regarding (4): section 1 paragraph 5 German Foreign Tax Act (*Außensteuergesetz*) provides for detailed rules on the determination of taxable profit of a permanent establishment. Such rules basically refer to the Authorized OECD Approach (AOA) and are applicable as of fiscal years ending in 2013, provided that a double tax treaty does not include contrary rules, and the German taxpayer can prove that the other state has actually taxed the income and a double taxation would result if the AOA is used. Thus, the profit determination of a permanent establishment (e.g., branch or dependent agent) has generally to be based on the arm's-length principle, assuming that the permanent establishment is a separate entity.

Regarding (5): section 4 paragraph 1 sentence 1 German Income Tax Act (*Einkommensteuergesetz*) is the basic rule on how to determine the taxable income of an enterprise. Basically, the equity at the end of the fiscal year has to be compared with the equity at the beginning of such fiscal year. Any difference has to be increased by all withdrawals of the current fiscal year, and has to be reduced by all contributions of the shareholder during such fiscal year. The remaining result is the profit, which becomes subject to tax, but may be adjusted based on specific tax rules (e.g., regarding non-deductible expenses, limitation of interest deduction, tax-free income, etc.).

In particular, a withdrawal (e.g., for private purposes) or a contribution (e.g., private property) not connected to the business must not affect the amount of taxable income. For example, if an asset is taken out of the business by a shareholder, such withdrawal has to be carried out at the so-called partial value (*Teilwert*). Partial value is defined as the value an asset purchaser would pay for the single asset if he/she were buying the entire business.

If the shareholder contributes an asset to the business without any remuneration, the asset may be capitalized (in most cases) at partial value (*Teilwert*), which is then the basis for any depreciation. The partial value (*Teilwert*) is often equal to the

1. See Verordnung zur Anwendung des Fremdvergleichsgrundsatzes nach §1 Abs. 1 Außensteuergesetz in Faellen grenzueberschreitender Funktionsverlagerung (Funktionsverlagerungsverordnung – FVerlV) of 12 Aug. 2008, BGBl I, 2008, 1680, update of 26 June 2013, BGBl 1 I, 2013, 1809.

arm's-length value of the assets, but there are some major exceptions. For instance, the partial value of a current asset is based on its full cost but excludes a profit markup. Thus, if a German parent delivers its products to its German subsidiary for cost (without any markup), the parent's income cannot be increased because the products were delivered at partial value (*Teilwert*). Moreover, it should be noted that only tangible or intangible property could be subject to a contribution, whereas the use of property or the rendering of services to the subsidiary free of charge or below an arm's-length price is not within the scope of the rules governing the shareholder's capital contribution. However, concerning cross-border transactions, section 1 German Foreign Tax Act (*Außensteuergesetz*) would apply, resulting in an adjustment based on the arm's-length principle. Therefore, such transactions – independently whether they are carried out between corporations or partnerships – result in profit recognition for German tax purposes.

Concerning a permanent establishment outside Germany, the transfer of an asset cross-border into a permanent establishment of the same taxpayer results in a capital gains tax if Germany loses its taxation right through such transfer. This is generally the case if a double tax treaty is in place (Germany has concluded more than ninety double tax treaties), as in nearly all double tax treaties the exemption method (rather than the credit method) has been agreed with respect to business income and permanent establishments. An exemption only applies with regard to shares in a SE (Societas Europaea), if the SE transfers its place of management into another EU Member State. A deferral of resulting taxes over a time period of five years may be applied if the transfer is carried out within the European Union.[2]

Regarding (6): For corporations, section 8 paragraph 3 German Corporation Tax Act (*Koerperschaftsteuergesetz*) states that a hidden distribution of profits cannot reduce the taxable income. The term 'hidden profit distribution' is defined by extensive case law and the administrative regulations on the German Corporation Tax Act (*Koerperschaftsteuerrichtlinien*). Under these regulations, a hidden profit distribution is a decrease of assets or a prevented increase of assets of a corporation which is caused by the relation of the company to its shareholder and the decrease or prevented increase affects the corporation's income. A decrease or prevented increase of profits is based on the relationship of the shareholder to the corporation if a prudent and diligent managing director, under the same facts and circumstances, would not have accepted the decrease or the prevented increase of assets vis-à-vis a person who is not a shareholder. Thus, section 8 paragraph 3 German Corporation Tax Act (*Koerperschaftsteuergesetz*) relates to domestic and cross-border transactions, whereas section 1 German Foreign Tax Act (*Außensteuergesetz*) relates to cross-border transactions only. Generally, section 8 paragraph 3 German Corporation Tax Act (*Koerperschaftsteuergesetz*) has to be tested prior to section 1 German Foreign Tax Act (*Außensteuergesetz*).

It should be noted that a hidden profit distribution which is based on section 8 paragraph 3 German Corporation Tax Act (*Koerperschaftsteuergesetz*) triggers

2. See s. 4g German Income Tax Act (*Einkommensteuergesetz*).

withholding tax on dividends, similar to an ordinary profit distribution. Generally, a local withholding tax (the current local rate of 25% plus a 5.5% solidarity surcharge thereon, that is, a combined 26.375%) applies, unless a certificate is available, stating a lower rate based on a double tax treaty, or the 0% EU withholding tax rate on dividends. If no double tax treaty applies or the EU parent-subsidiary directive is not applicable, the withholding tax may be reduced by 2/5, that is, down to 15% plus a 5.5% solidarity surcharge thereon (combined 15.825%), for foreign parent companies.[3] To apply for any such certificate or reduction, the taxpayer has to demonstrate sufficient substance within the meaning of section 50d paragraph 3 German Income Tax Act (*Einkommensteuergesetz*), if the shareholder was not directly entitled to such relief and has to fulfil several other (formal) requirements, similar to an application for a withholding tax reduction under a double tax treaty or the European parent-subsidiary directive.

The substance rules of section 50d paragraph 3 German Income Tax Act (*Einkommensteuergesetz*) apply to any non-German parent company of a German corporation if dividends are paid, including hidden profit distributions. Under such rules, a non-German corporation (intermediate) will not be entitled to a reduced withholding tax rate in terms of any applicable double tax treaty or the benefits of the European parent-subsidiary directive or a withholding tax reduction based on section 44a paragraph 9 German Income Tax Act (*Einkommensteuergesetz*), if the requirements are not met. In particular, a reduced withholding tax rate is denied:

(1) to the extent that the shareholders of the intermediate corporation would not be entitled to the reduction if they would have invested directly; and
(2) as far as the functional requirements of Article 50d paragraph 3 German Income Tax Act (*Einkommensteuergesetz*) are not fulfilled, that is, the company derives harmful revenue.

Such functional requirements are met:

(1) as far as the intermediate corporation generates its gross income from its own active business activities; or
(2) in regard to the intermediate corporation's gross income that is not generated from its own business activities if:
    (a) there are economic or other important reasons for the use of the intermediate company in view of the respective income; and
    (b) the foreign company is adequately equipped for carrying out its own business activities (i.e., economic assets such as personnel and office space, etc.; outsourcing is not sufficient) and for participating in the general commerce.

Section 50d paragraph 3 German Income Tax Act (*Einkommensteuergesetz*) was amended as of 1 January 2012, in response to the infringement procedure initiated by

3. See s. 44a para. 9 German Income Tax Act (*Einkommensteuergesetz*).

the European Commission against Germany in 2010. Under the old rules, the withholding tax reduction was denied to an intermediate corporation, *inter alia*, if the corporation did not generate more than 10% of its gross income from its own active business activities. The European Commission considered this all-or-nothing approach as disproportionate and going beyond what is necessary to attain the objective of preventing tax evasion. The amended rules provide now for a pro-rata relief, to the extent the functional requirements are met. The burden of proof is on the non-German intermediate corporation.

On 24 January 2012, the German tax authorities issued a decree[4] with their interpretation of the substance rules of section 50d paragraph 3 German Income Tax Act (*Einkommensteuergesetz*). For example, the decree defines 'own business activities' as activities that exceed the mere management of assets and require a participation in general commerce. Furthermore, the interposition of an EU corporation can only qualify if the interposed corporation participates in general commerce within the Member State of its jurisdiction in an active, permanent and persistent fashion. Services for group companies qualify as business activities if invoiced at arm's-length. However, the understanding of the German tax authorities to apply a reduced withholding tax rate on a pro-rata approach over all income types if the interposed entity has 'active' and 'non-active' business is controversially discussed in German literature, in particular concerning the question whether such an approach is in line with EU law. For example, this would result in a withholding tax on generally withholding tax-exempt dividends or license fees within the European Union, only because the interposed entity also carries out not-accepted activities (e.g., dividend from a non-active participation outside the EU).

Regarding (7): For corporations, section 40 German Corporation Tax Regulations (*Koerperschaftsteuerrichtlinien*) rules that a contribution of assets by the shareholder (or another related party) does not increase the taxable income if the contribution qualifies as a hidden capital contribution (*verdeckte Einlage*). This rule has its legal basis in section 4 paragraph 1 sentence 1 German Income Tax Act (*Einkommensteuergesetz*) in conjunction with section 8 paragraph 1 German Corporation Tax Act (*Koerperschaftsteuergesetz*).

A hidden capital contribution (*verdeckte Einlage*) can be assumed if a shareholder or a related party of the shareholder makes a contribution to the corporation without proper consideration and the reason for this contribution can only be found in the shareholder relationship. This is the case if a third party (a non-shareholder) – by applying the prudent business manager standard – would not have agreed to the conditions of the transaction. Similar to the principles of a hidden profit distribution, the rules governing hidden capital contributions have been developed by jurisprudence.

As a result of a hidden capital contribution, the taxable income of the parties to the transaction must be adjusted accordingly. The taxable income of the recipient may not be affected by the contribution, for example, a contributed asset has to be

4. See Schreiben betr. Entlastungsberechtigung auslaendischer Gesellschafter (§50d Abs. 3 EStG) as of 24 Jan. 2012, No. IV B 3 – S 2411/07/10016).

capitalized against capital reserve in the tax balance sheet. Furthermore, the taxable income of the German parent company must generally be increased in the amount of the contribution, and the parent's book value of the shares in the subsidiary has to be increased accordingly for tax purposes.

Generally, the rule is comparable to section 4 paragraph 1 sentence 1 German Income Tax Act (*Einkommensteuergesetz*) which applies to non-corporate taxpayers. The use of property or the rendering of services to a company free of charge or below an arm's-length price is not within the scope of the contribution rules. However, the use of property or the rendering of services below an arm's-length price to a foreign subsidiary by a German corporation would become subject to an income adjustment under section 1 German Foreign Tax Act (*Außensteuergesetz*).

Regarding (8) and (9): In response to the 2001 landmark decision of the German Federal Tax Court (*Bundesfinanzhof – BFH*)[5] that put the burden of proof for a taxpayer's failure to adhere to the arm's-length principle on the tax authority, the legislation was amended accordingly, and extensive documentation requirements were introduced in the German General Tax Code (*Abgabenordnung*). According to section 90 paragraph 3 German General Tax Code (*Abgabenordnung*), the taxpayer is obliged to prepare and, upon request, to present appropriate documentation with respect to the transactions between related parties. In October 2003, the German Ministry of Finance enacted regulations (GAufzV) with respect to the details of the documentation obligations.[6]

Regarding (10): If the documentation requirements regarding transfer pricing are not fulfilled, the German tax authorities are allowed to increase the taxable income (upper range) and to charge additional (non-deductible) penalties based on section 162 German General Tax Code (*Abgabenordnung*).

[2] Administrative Decrees

The German tax authorities have issued decrees on the interpretation of the provisions of the statutory rules and on their understanding of the transfer pricing and documentation rules which are applicable in Germany:

(1) Administrative decree of 23 February 1983 (BStBl I, 1983, p. 218), including main transfer pricing rules ('1983 Administrative Guidelines').[7]
(2) Administrative decree of 30 December 1999 (BStBl I, 1999, p. 1122) on cost allocation and cost sharing agreements ('Cost Sharing Decree').[8]

5. See BFH, Decision I R 103/00 of 17 Oct. 2001, BStBl II, 2004, 171.
6. See Verordnung zu Art, Inhalt und Umfang von Aufzeichnungen im Sinne des §90 Abs. 3 Abgabenordnung (Gewinnabgrenzungsaufzeichnungsverordnung – GAufzV) as of 13 Nov. 2003, BStBl I, 2003, 2296, including last update of 26 Jun. 2013, BStBl I, 2013, 1809.
7. See Schreiben betr. Grundsaetze fuer die Pruefung der Einkunftsabgrenzung bei international verbundenen Unternehmen (Verwaltungsgrundsaetze) as of 23 Feb. 1983, BStBl I, 1983, 218, including updates of 1999 and 2005.
8. See Schreiben betr. Grundsaetze fuer die Pruefung der Einkunftsabgrenzung durch Umlagevertraege zwischen international verbundenen Unternehmen as of 30 Dec. 1999, BStBl I, 1999, 1122.

(3) Administrative decree of 12 April 2005 (BStBl I, 2005, p. 570), including main transfer pricing rules and documentation requirements ('2005 Administrative Guidelines').[9]

In 1983, the German Ministry of Finance published its first administrative guidelines. The 1983 Administrative Guidelines include instructions for the application of section 1 German Foreign Tax Act (*Außensteuergesetz*), along with a detailed description of the applicable transfer pricing methods. Although most of these guidelines are still in force, in 1999, the part dealing with cost-sharing agreements was replaced with a new letter from the German Ministry of Finance.

In 2005, in response to the revised OECD transfer pricing guidelines and the new transfer pricing documentation obligations, the German Ministry of Finance issued new administrative guidelines. The 2005 Administrative Guidelines partly replace the 1983 Administrative Guidelines.

Furthermore, the tax authorities have started to update and to add regulations on specific subjects, in particular:

- Administrative decree of 31 July 1995 (Internationales Steuerrecht 1995, p. 539) on formal requirements of a profit allocation between related parties and a profit determination of permanent establishments ('Decree on formal issues').[10]
- Administrative decree of 24 December 1999 (BStBl I, 1999, p. 1076) on permanent establishment regulations and its adjustment in 2000, 2004, 2009, 2010, 2013 and 2014 ('PE Decree').[11]
- Administrative decree of 9 November 2001 (BStBl I, 2001, p. 796) on the secondment of personnel ('Secondment Decree').[12]
- Administrative decree of 13 October 2010 (BStBl I, 2010, p. 774) on tax rules regarding the transfer of business functions.[13]

9. See Grundsaetze fuer die Pruefung der Einkunftsabgrenzung zwischen nahestehenden Personen mit grenzueberschreitenden Geschaeftsbeziehungen in Bezug auf Ermittlungs- und Mitwirkungspflichten, Berichtigungen sowie auf Verstaendigungs- und EU-Schiedsverfahren (Verwaltungsgrundsaetze-Verfahren) as of 12 Apr. 2005, BStBl I, 2005, 570.
10. See Erlass betr. Einkunftsabgrenzung bei international verbundenen Unternehmen und im Rahmen der Betriebsstaettengewinnermittlung; Pruefhinweise fuer die Pruefung der 'Verrechnungspreise' inlaendischer Unternehmen/Betriebsstaetten mit verbundenen Unternehmen/Stammhaus im Ausland as of 31 Jul. 1995, Internationales Steuerrecht 1995, 539.
11. See Grundsaetze der Verwaltung fuer die Pruefung der Aufteilung der Einkuenfte bei Betriebsstaetten international taetiger Unternehmen (Betriebsstaetten-Verwaltungsgrundsaetze) as of 24 Dec. 1999, BStBl I, 1999, 1076; amended on 20 Nov. 2000, BStBl I, 2000, 1509, on 29 Sep. 2004, BStBl I, 2004, 917, on 25 Aug. 2009, BStBl I, 2009, 888, and on 16 Apr. 2010, BStBl I, 2010, 354, on 20 June 2013, BStBl I, 2013, 980 and on 26 Sep. 2014, BStBl I, 2014, 1258.
12. See Schreiben betr. Grundsaetze fuer die Pruefung der Einkunftsabgrenzung zwischen international verbundenen Unternehmen in Faellen der Arbeitnehmerentsendung (Verwaltungsgrundsaetze – Arbeitnehmerentsendung) as of 9 Nov. 2001, BStBl I, 2001, 796.
13. See Grundsaetze fuer die Pruefung der Einkunftsabgrenzung zwischen nahe stehenden Personen in Faellen von grenzueberschreitenden Funktionsverlagerungen (Verwaltungsgrundsaetze Funktionsverlagerung) as of 13 Oct. 2010, BStBl I, 2010, 774.

The administrative decrees indicate to the taxpayer how the tax authorities will treat specific transactions (e.g., flow of goods, rendering of services, transfer of assets). They provide a directive for the tax auditor concerning the tax audit treatment of transfer pricing cases, and they ensure the uniform application of rules and methods within the fiscal services. Although the German tax authorities are bound to such decrees, the taxpayer may take a different view in appeals procedures against tax assessment notices and before the tax courts.

[3] Statutory Period of Limitation

For German tax purposes, the standard statutory period of limitation for consumption taxes and customs duty is one year, generally starting after the calendar year of the relevant transaction resulting in the consumption tax or customs duty. In all other cases, it is usually four years. However, the limitation period may run for a longer period of time, depending on when tax returns were filed and whether a tax audit has been announced and started. A longer statute of limitation applies in Germany for tax evasion and tax fraud: In cases of illegal tax avoidance/tax evasion the statute of limitation is five years; in cases of tax fraud it is ten years.

[B] Relationship to OECD Guidelines

Germany is a member of the OECD and has approved the OECD Guidelines on transfer pricing, despite having previously expressed reservations about certain sections of the Guidelines, such as those dealing with profit-based pricing methods. However, representatives of the German tax authorities state that the OECD Guidelines cannot result in a direct obligation of a Member State, and courts or companies cannot claim any right based on the OECD Guidelines.

As the OECD Guidelines have to be regarded as a compromise of the various Member States, it can be argued that room is left for further national interpretation. From a German tax perspective, it may be highlighted that in particular the following principles in the 2010 OECD Guidelines are generally followed or considered:

- No. 2.11: The arm's-length principle does not require the application of more than one transfer pricing method; the best-method-approach could create a significant burden for taxpayers.
- No. 4.16: Taxpayers and tax administrations shall take special care and use restraint in relying on the burden of proof in the course of the examination of a transfer pricing case.
- No. 3.36: The application of any arm's-length method can only be based on information which is available to the taxpayer.
- No. 1.35: When a specific transfer pricing method is applied, adjustments must be made to account for differences between the controlled and uncontrolled situations that would significantly affect the price charged or return required by

independent enterprises. In no event can unadjusted industry average returns themselves establish arm's-length conditions.

- No. 2.6: The profit split method and other profit-based pricing methods (in particular the US comparable profits method) can only be accepted if they are in line with recognized OECD methods, for example, considering a transactional approach.
- No. 4.28: Rules on penalties shall consider that an imposition of a sizable 'no-fault' penalty based on the mere existence of an understatement of a certain amount would be unduly harsh when it is attributable to good faith error rather than negligence or an actual intent to avoid tax.

[C] Transfer Pricing Penalty Framework

If the taxpayer does not produce transfer pricing documentation, or the transfer pricing documentation is materially unusable, or if it is recognized that the transfer pricing documentation has not been created in due time as required by law (see below), it will be assumed that the income of the taxpayer is higher than reported. However, the taxpayer is permitted to rebut this legal presumption. If the taxpayer cannot provide proof to the contrary, the tax authorities are allowed to estimate or to increase the tax basis (e.g., up to the upper range to the burden of the taxpayer) in line with section 162 paragraph 3 sentence 2 German General Tax Code (*Abgabenordnung*). Furthermore, they are allowed to assess penalties according to section 162 paragraph 4 German General Tax Code (*Abgabenordnung*). Such penalties are treated as non-deductible expenses for tax purposes.

Based on section 90 paragraph 3 German General Tax Code (*Abgabenordnung*), firms have to submit appropriate documentation (which is in essence not unusable) within sixty days upon the tax authorities' request during a tax audit. However, this time frame is generally too short to create transfer pricing documentation. Furthermore, the time frame of sixty days is reduced to thirty days for extraordinary business transactions (e.g., restructuring or change of sales systems) or similar matters of major importance; an extension may only be granted upon application and the presentation of good reasons.

The tax authorities are allowed to charge penalties if the documentation requirements are not fulfilled. The taxpayer has to pay a penalty of EUR 5,000 if the documentation has not been produced or if the documentation is materially unusable. However, the penalty has to be 5% to 10% of the additional income that is assessed as a result of the non-production of the records, if this amount exceeds EUR 5,000. If the documentation is produced after the sixty-day period or the thirty-day period, a minimum penalty of EUR 100 per day will be due, up to EUR 1 million. Such penalties do not qualify as taxes and are not tax deductible. The following table provides an overview of the penalties that can be assessed:

Issue	*Penalty*
No or unusable documents were provided	5%–10% of the income increase, at least EUR 5,000
Late filing of useful documents	at least EUR 100 per day of delay, max. EUR 1,000,000

[D] Arm's-Length Standard

German tax legislation uses the arm's-length approach as the basic principle in determining appropriate transfer prices. Therefore, based on section 1 German Foreign Tax Act (*Außensteuergesetz*), the 1983 Administrative Guidelines establish the arm's-length principle as the standard to be applied in determining whether an entity's intercompany transfer pricing is correct.[14]

According to the tax authorities, under the arm's-length standard of section 1 German Foreign Tax Act (*Außensteuergesetz*), a controlled transaction has to be carried out under the same conditions as an uncontrolled transaction that was carried out on a free market. The comparison has to be based on the ordinary diligence of a prudent and diligent managing director vis-à-vis a third party.

Generally, it has to be assumed that prices between third parties are agreed on a transactional basis, that is, separately for each delivery or service. However, if a total price for various deliveries or services is common in the market, such a total price may be used and broken down into the relevant transactions.[15]

Pursuant to the 1983 Administrative Guidelines, Data for establishing transfer prices between related parties has to be taken from prices negotiated and agreed between third parties on a free market. This procedure may be supported by considering:

- stock market prices, typical prices of a specific industry market and other market information;
- prices actually agreed by the taxpayer, a related party or a third party on the relevant market;
- profit margins, calculation schemes or any other economical basis which have an influence on the price setting on a free market.

However, such data has to be appropriately adjusted in order to determine the relevant transfer price. The adjustments must cover any difference between the controlled and uncontrolled transaction that would affect the price. Furthermore, common discounts have to be considered. A resulting pricing range (if any) may be

14. See Schreiben betr. Grundsaetze fuer die Pruefung der Einkunftsabgrenzung bei international verbundenen Unternehmen (Verwaltungsgrundsaetze) as of 23 Feb. 1983, BStBl I, 1983, 218 (including updates of 1999 and 2005), No. 1.1.1 and 2.1.
15. See Schreiben betr. Grundsaetze fuer die Pruefung der Einkunftsabgrenzung bei international verbundenen Unternehmen (Verwaltungsgrundsaetze) as of 23 Feb. 1983, BStBl I, 1983, 218 (including updates of 1999 and 2005), No. 2.1.4.

used in a controlled transaction in the same manner as would be done in an uncontrolled transaction, considering the common negotiation practice of the taxpayer, the relevant market sector and the general market.

§10.03 DETERMINING THE APPROPRIATE INTERCOMPANY PRICE

[A] Method Selection

Based on the arm's-length approach, the German tax authorities historically applied three standard (traditional transactional) transfer pricing methods, briefly described in the 1983 Administrative Guidelines, that conform to the OECD Guidelines in this respect. The German corporation tax reform 2008 first codified which transfer pricing methods have to be applied and the manner in which this must be done. Section 1 paragraph 3 German Foreign Tax Act (*Außensteuergesetz*) stipulates that transfer pricing should be based on one of the following methods:

- Comparable uncontrolled price (CUP) method: Method of pricing based on the price charged between unrelated entities in respect of a comparable transaction in comparable circumstances.
- Resale price method: Method of pricing based on the price at which a product is resold less a percentage of the resale price.
- Cost-plus method: Method of pricing based on the costs incurred plus a percentage of those costs. In case of administrative services, the German tax authorities generally accept a markup of 5%–10%.

The 2005 Administrative Guidelines, released in response to the revision of the 1995 OECD Guidelines, permit use of the transactional net margin method (TNMM) and the profit split method in specific situations in addition to the three standard pricing methods. However, German tax authorities generally only accept the TNMM if routine transactions are concerned, no or only very limited risk is taken (e.g., in the case of an agent or commissionaire) and sufficient (and comparable) data is available in a database (e.g., Amadeus, published by Bureau van Dijk). The TNMM may also be used to verify (plausibility check) the results of one of the three standard methods.

The Profit Split Method is regarded as a last resort, to be used when the other three methods may not give reliable results. It has to be assumed that the profit split method would only be accepted in rare cases. The German tax authorities refer to 'global trading' as an example, that is, if various group entities are involved in a joint cross-border project (targeting and fulfilment) and no allocation of single amounts is possible.

In contrast to this, the comparable profit method is still not accepted by the German tax authorities.

Generally, it is left to the taxpayer to determine which transfer pricing method is most appropriate in a particular case. Therefore, it is only necessary to provide sufficient documentation regarding one method to the German tax authorities. However, the transfer pricing method chosen has to be in line with the analysis of chances

and risks to be taken by the different related parties involved (functional analysis), for example, the remuneration has to appropriately consider who is making decisions, who owns (intangible) assets and who carries out a function or takes a risk.

German tax authorities follow a strict transaction-based approach. A grouping of products is allowed only if the criteria have been set clearly in advance, and the transactions are comparable and of approximately the same value (or if the grouping is typically done by third parties). In other words, a separation by products, product lines or product groups would be decisive. The same applies to different German entities. A transfer pricing analysis and documentation generally has to be applied to each German group entity. An analysis covering all German entities as a whole is not sufficient. Additionally, each German entity has to be in the position to demonstrate that the intercompany agreements were concluded in advance were carried out as agreed, and that products or services have actually been received.

The above-mentioned standard methods take precedence over any other transfer pricing method if arm's-length prices can clearly be determined based on reliable data. If such a price determination is less clear, adjustments have to be made considering the specific facts and circumstances of the underlying case. This may include the use of other comparables, such as gross-margins, cost-plus rates and provision rates.

However, if even limited comparable arm's-length prices cannot be determined, a hypothetical arm's-length comparison has to be carried out. This 'price category' was introduced with effect as of 1 January 2008. A hypothetical arm's-length comparison is based on a simulation of a price determination process (fictitious price negotiations between independent third parties), and assumes that full information is available. In particular, the assumption of full information has led to extensive criticism in literature, as this is not in line with a real scenario. Furthermore, the German tax authorities would like to use the hypothetical arm's-length comparison on a general basis, whereas many authors in literature want to limit the application to cases referring to the transfer of a business function. The result of the described working step is a range of prices which generally all qualify as being in line with the arm's-length test, assuming that the lower limit of the seller's price is below the upper limit of an acceptable price of the buyer. These upper and lower prices need to be calculated by using function- and risk-adjusted interest rates, and they constitute the 'settlement margin'. The final transfer price shall be the price which corresponds most likely to the arm's-length principle. Unless no such specific price can be demonstrated as being appropriate, the median value is to be used as final transfer price.

Since 1 January 2008, the median value also applies if the transfer prices used are not within the arm's-length range. In such a case, the tax authorities may adjust the transfer price to the median value and may re-calculate the taxable income accordingly. However, if there is one price which most likely applies, this needs to be used (similar to OECD Guidelines). It should be noted that the tax authorities are allowed to adjust transfer prices even to the taxpayer's most disadvantageous end of the range if no transfer pricing documentation is available.

Additionally, the taxpayer has to narrow the range of derived (limited comparable) arm's-length prices, for example, by using the interquartile method, due to the change of section 1 paragraph 3 sentence 3 German Foreign Tax Act