ITPG

New Administrative Principles "VWG 2020" on Transfer Pricing in Germany 2020

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Need for Transfer Pricing Documentation

German companies or permanent establishments that are involved in intragroup cross-border services exceeding a value of EUR 600,000 p.a., or in intragroup cross-border supplies exceeding a value of EUR 6 million p.a., must present transfer pricing documentation to the German tax authorities that corresponds to strict and detailed German regulations. Companies that do not fulfil this obligation, or cannot prove that the transfer prices are correct, must expect severe penalties of up to EUR 1 million and may be faced with a high profit estimation from the tax office.

Legal Sources and the Administrative View

German law codifies the duty of the taxpayer to cooperate pursuant to Section 90 of the general tax code (AO) and those on estimation of profits in case of non-compliance in Section 162

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AO. Moreover, the GDPdU (principles of data access and verifiability of digital documents) must be taken into account. As the law leaves a lot of scope for speculation, the Federal Ministry of Finance issued administrative principles with their interpretation of the law in 2005. On 03 December 2020, they issued new administrative principles, hereinafter referred to as "VWG 2020". These are binding for the tax authorities but not for the taxpayer and the courts. However, they give an indication as to what the tax authorities expect and not all taxpayers are happy to fight for their own interpretation of the law before courts. This article gives a short overview on the impact of the changes in the VWG 2020.

Obligations of the Parties to Cooperate and Store Data Abroad

Section 90 para. 2 AO standardises duties to cooperate for foreign matters. The parties involved must clarify a tax-relevant fact that relates to transactions outside the scope of Germany by exhausting all existing legal and factual possibilities and procuring the necessary evidence. The taxpayer must also make some provision for evidence. According to the VWG 2020, the increased duties to cooperate also include ensuring that documents of a foreign related person that are relevant for the taxation of the German party involved are not destroyed before the domestic retention periods expire. Apparently, the tax authorities derive from the obligation to preserve evidence the obligation that the domestic taxpayer must ensure that corresponding documents are also destroyed at foreign companies only after the expiry of (possibly longer) domestic storage obligations rather than after the expiry of (possibly shorter) foreign storage obligations.

Improvements of the VWG 2020

Some of the statements of the VWG 2020 are to be welcomed, such as the clarification that the taxpayer does not have to carry out alternative calculations when determining transfer prices. However, the VWG states that the tax authorities should choose the right method themselves and this shall be the decisive one, with the taxpayer obliged

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to provide the necessary information for this method. In addition, the tax authority must also clarify the facts if the facts or evidence belong to the sphere of information or activity controlled by the taxpayer. With regard to the provision of evidence, it should be noted that a third party would only be granted access to the extent necessary for the implementation of the contractual agreements. The duty to preserve evidence can therefore only include the data that the taxpayer needs for "its" arm's-length price determination. Fortunately, this assessment is also shared by the VWG 2020.

Risks of the VWG 2020

The VWG 2020 seems to overinterpret the underlying legal regulations. In particular, the scope of evidence required to be submitted under the VWG 2020 appears to be too extensive, with regard both to the data for the verification and to expert opinions and statements, as well as electronic messages. Providing data on other transfer pricing methods than the one the taxpayer decided to use, or providing emails and texts used in messenger services, does not seem to be covered by the law.

With regard to the personal union in the management of two affiliated companies, the VWG 2020 misjudges the role of the managing director in the GmbH when they claim that this person has access to all information. A managing director in Germany is bound by the shareholders' instructions. Instead of the identity of the managing directors, it would be more appropriate to look at the identity of the shareholders.

Furthermore, the statement on the power of estimation, according to which an estimation is not excluded by the submission of usable records, must be rejected. Otherwise, the tax authorities could threaten with an estimation of the profits if they do not like the presented documentation. As long as the duties to cooperate are fulfilled, § 162 para. 2 AO does not permit an estimate. The opinion on income adjustment despite usable records also holds considerable potential for dispute. An income adjustment despite the submission of usable records can only be considered if the tax authorities prove the lack of arm's length.

Conclusion

The new VWG 2020 helps to understand the interpretation of the tax authorities of the law. However, it also gives room for good tax experts to oppose this interpretation where appropriate.

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