

# A Guide through Transfer Pricing Rules OECD + Germany

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# A Guide through Transfer Pricing Rules



## Transfer Pricing

- **Thoughts from a German Tax Perspective**
  - Definition Transfer Pricing
  - Cross-border transactions between related parties
  - Price setting between the involved related parties
- **Introduction into the basic knowledge on transfer pricing**
  - Taking into consideration the OECD Guidelines and the OECD Model Convention (“MC”)
- **Key terms**
  - Main principle in the field of transfer pricing: Dealing at Arm’s length
  - Adequate, appropriate, prevailing and acceptable for the involved tax authorities



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## Arm's length principle

- **Main legal rule:**
  - Art. 9 para. 1 and 2 OECD Model Convention
    - Generally also implemented into the respective domestic law
    - E.g. in Germany: Sec. 1 German Foreign Tax Act (CFC-Rules; “AStG”)
    - Consensus’ in more than 2,500 Double Tax Treaties (DTT) which follow the Model Convention (MC) consistently insofar
    - No serious alternatives (neither UN, nor EU nor US – nor BEPS)
- **Definition of the arm's length principle:**
  - The arm's length principle is commonly applied to commercial and financial transactions between related companies. It says that transactions should be valued as if they had been carried out between unrelated parties, each acting in his own best interest.

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## Arm's length principle

- **Weaknesses of the Dealing at Arm's Length Principle:**
  - Controversial 'fictional' consideration quite often to be dealt with
  - No 'accurate science'
  - Adequacy can normally not be proven in an academic way
  - Simulation of negotiations and their achievements
  - Synergy effects usually not comparable

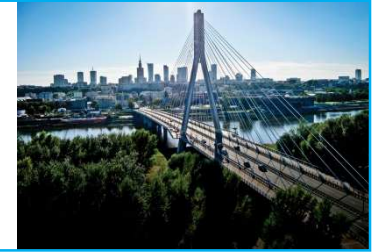
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## Key elements of dealing at Arm's length:

- **Prudent and conscientious business manager**
  - Basic principles:
    - Sec. 1 German Foreign Tax Act (CFC Rules) and constant jurisdiction of the German Federal Court of Finance (BFH)
    - Key rational also according to the OECD Guidelines on transfer pricing
    - OECD: “sound business principle”
  - “German” view?:
    - Sec. 1 German Foreign Tax Act (CFC Rules)
    - Criteria comparable to a hidden profit distribution or a hidden contribution
    - Prudent and conscientious business manager as benchmark is a kind of international consensus

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## Key elements of dealing at Arm's length:

- **Comparability**

- Key issue:
  - Searching for comparable prices, comparable values or mark-ups (depending on the chosen transfer pricing method to be explained in the following)
  - What are comparable transactions?
  - What are comparable enterprises?
- Criteria of comparability (5 criteria according to the OECD)
  - Character/quality of assets and services
  - Exercise functions (including considering the used assets and risks assumed)
  - Contractual conditions
  - Economic circumstances in the relevant market
  - Business strategy

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## Key elements of dealing at Arm's length:

- **Comparability**

- OECD-guidelines 2010 contain terms of comparability and define comparability as key criterion
  - OECD-guidelines shall be adopted in OECD-countries
  - In Germany contained in Sec. 1 para. 3 German Foreign Tax Act (CFC-Rules) and the “VerwGrsVerf” (guidelines of the tax administration)
    - “Unlimited” comparability
    - “Limited” comparability
    - “Incomparability”
  - Respectively different legal consequences (Sec. 1 par. 3 Foreign Tax Act (AStG))

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## Content of a transfer pricing documentation:

- **Information about the associated enterprises involved in the controlled transactions**
  - An outline of the business
  - The structure of the organization
  - Ownership linkages within the MNE group
  - The amount of sales and operating results from the last few years preceding the transaction
  - The level of the taxpayer's transactions with foreign associated enterprises (f.e. transfer of intangible property)
- **Information on pricing, including business strategies and special circumstances at issue**



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## Content of a transfer pricing documentation:

- **Special circumstances**
  - Details concerning any setoff transactions that have an effect on determining the arm's length price (introduce new products into a market)
- **Functional & Risk Analysis**
  - Information about functions performed by the associated enterprises
  - Information about the risks that are taken into account by the associated enterprises
  - Transfer of Intangible Property

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## Content of a transfer pricing documentation:

- **Transfer Pricing Analysis**
  - Choice of Transfer Pricing Method
    - Traditional transactional methods
      - The comparable uncontrolled-price method (CUP)
      - The cost-plus method (C+)
      - The resale-price method (RPM)
    - Transactional profit methods
      - The profit-split method
      - The transactional net-margin method (TNMM)
  - Evaluation of a Potential Transfer of Functions





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