

Tax  
Germany

March 2019

## Numerous changes of German transfer pricing rules - March 2019 Update

In January 2018 we provided an overview of the most important adopted and expected changes in German transfer pricing rules. We update this overview in this issue.

### I. Current and future changes

1. Possible changes in German CFC-Legislation in sec. 7 et seq. Foreign Tax Act to implement the EU Anti-Tax Avoidance Directive ("ATAD I Directive"): Probably effective for tax year 2019.
2. Draft governmental bill for the transition period after the exit of the United Kingdom of Great Britain and Northern Ireland from the European Union (Brexit Transition Law - Brexit-ÜG). EU membership of the UK is scheduled to end on March 29, 2019. According to the draft withdrawal agreement, European law shall be applicable in and for the United Kingdom during the transitional period until the end of 2020. The draft of the Brexit-ÜG stipulates that, during the transitional period, the United Kingdom is to be treated as an EU member state under federal law. This also applies to tax law. These provisions will only enter into force if a withdrawal agreement is reached. Realization is politically uncertain.
3. Law on Tax Arrangements to Accompany the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the EU (Brexit Tax Accompanying Act - Brexit-StBG). At the moment of withdrawal from the EU, the United Kingdom will become a non-member state.

This could lead to gain realization under a number of tax provisions. In particular

- a company could lose its tax residence in an EU or EEA country and be deemed liquidated, its goodwill taxed accordingly (sec. 12 para. 3 Corporate Tax Act),
- an asset transferred at book value to a permanent establishment (branch) in the United Kingdom could be deemed extracted and the (remaining) hidden reserves as of the time of transfer could be taxed (sec. 4g para. 2 Income Tax Act), and
- taxes on hidden reserves in shares deemed realized by shareholders moving to the United Kingdom, but not levied so far, could be levied immediately (sec. 6 para. 5 sentence 4 Foreign Tax Act).

The Brexit Tax Accompanying Act will provide for the avoidance of taxation of such profit realizations. In particular, compensatory tax book items recording the goodwill of an asset as at the time of its transfer to the United Kingdom can continue to be amortized over the remaining useful life of the

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asset, at the maximum over five years. The provisions are also to be implemented in case of a "hard brexit". Bill passed on March 15, entry into force on March 29, 2019.

4. Legislative regulation on details and application of the arm's length principle pursuant to sec. 1 para. 1 Foreign Tax Act: Supposedly in 2019.
5. Proposal for a Directive of the EU Commission on the introduction of a digital permanent establishment in the form of a 'significant digital presence'. The permanent establishment shall be assumed for corporation tax purposes and the profit allocation shall be based on AOA principles. A significant digital presence shall be assumed if within one member state and tax period at least one of the following criteria is met:
  - Revenues from providing digital services exceeds EUR 7 million. The share of revenue attributable to a certain member state is determined by the number of local digital interface access operations as a proportion of global access operations.
  - The number of users of digital services exceeds 100,000.
  - The number of contracts for the provision of digital services exceeds 3,000.The realization is politically uncertain.
6. Proposal for a Directive of the EU Commission introducing a tax on certain digital services. On a transitional basis, revenues from taxable services (net excl. VAT) shall be taxed at 3 %. Taxable shall be companies whose total worldwide revenues exceed EUR 750 million and whose revenues from taxable services within the EU (total gross revenues net of VAT and other similar taxes) are EUR 50 million or more. Taxable digital services are:
  - advertising,
  - social media and online marketplaces,
  - sale of data generated from user-provided information.Entry into force is proposed for January 1, 2020. The proposed directive is an alternative to the proposed directive on the introduction of a significant digital presence (see 5.). According to the proposed directive, Member States shall implement the Directive by December 31, 2019 with effect for tax years from January 1, 2020. Domestic implementation shall take place by December 31, 2019 with effect from January 1, 2020. On March 12, 2019, the European Council rejected the proposal in favor of a global approach.
7. Amendment to the EU Accounting Directive to introduce mandatory publication of income tax information for certain companies and branches ("Public Country-by-Country Reporting"): The EU Commission's draft is under discussion at European level.
8. Possible overall solution on hybrid financing, hybrid structures and implementation of the EU Directive on hybrid arrangements with third countries ("ATAD II Directive"): Expected for 2019.
9. Revision of the OECD report on the application of the profit split method following BEPS Action Point 10 (Revised Guidance on the Application of the Transactional Profit Split Method).

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Traditionally, the OECD deemed the profit split method (potentially) applicable in situations involving

- unique and (particularly) valuable value adding contributions of the transaction parties, and
- highly integrated business operations.

The OECD now recommends examining the application of the profit split method in two further situations, namely

- where economically significant risks are jointly assumed by various parties, and
- where different parties separately bear closely related risk.

In addition, the OECD now explicitly distinguishes situations in which it is appropriate to share actual profits from those in which it is appropriate to share planned or expected profits.

The revision has been incorporated into the OECD Transfer Pricing Guidelines 2017 as Chapter II, "Transactional Profit Split Method": Published on June 21, 2018.

10. Publication of a draft OECD discussion paper on transfer pricing for financial transactions. As a follow-up to the OECD BEPS report on action points 8 - 10, the draft discusses transfer pricing for treasury functions, intra-group loans, guarantee fees, cash pools, hedging and captive insurance companies: Published on July 3, 2018.

The draft does not yet represent consensus views of the OECD Committee on Fiscal Affairs. Nevertheless, it contains a number of clear statements. In particular, the treasury function is characterized as a pure service for other value-adding functions. If profits are generated through the aggregation and balancing of risk positions in the group, these are seen as group synergies to be divided between companies.

11. Publication by the OECD of Additional Guidance on the Attribution of Profits to a Permanent Establishment under BEPS Action 7. The OECD attempts to clarify a number of detailed conceptual and practical questions about profit determination under the AOA. Simultaneously, the OECD has stated that the highly discussed issue of whether to first apply Article 7 or Article 9 cannot impact the permanent establishment profit. The report contains explanatory examples on profit allocation: Published on March 22, 2018.

12. OECD publication on Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles. The OECD provides detailed guidance on how tax authorities shall apply the principles set out in BEPS Action Point 8 when dealing with hard-to-value intangibles (HTVI). *Inter alia*, the HTVI report suggests an expansion of the tax administrations' authority to adjust transfer prices for intangibles *ex post* in view of actual profits accrued since the initial transaction. Published on June 21, 2018.

13. Entry into force of selective amendments to double taxation conventions by implementation of the OECD-BEPS recommendations as notified to the OECD on the basis of the Multilateral Instrument. The Federal Ministry of Finance is aiming for bilateral agreements with treaty states: Expectedly with legal effect from 2020.

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Particularly noteworthy are the following points:

- Germany has confirmed its longstanding position on specific activity exemptions from permanent establishments: Accordingly, the preparatory and auxiliary activities listed in a double taxation agreement only avoid a permanent establishment if they actually prepare or support the company's main activity in individual cases. The preparatory and auxiliary activities listed do not constitute "automatic" or *per se* exceptions to the permanent establishment concept.
- Germany has opted out of generally deeming commissionaires permanent establishments of the principal. Germany may, however, include such deeming clauses in bilateral double tax treaties (as agreed in the double tax treaty concluded with Australia in 2015 with effect as from October 11, 2016) and
- Germany indicated its commitment to introduce MAP procedures with guaranteed settlements via arbitration.

14. ECJ ruling (May 31, 2018 - C-382/16, Hornbach) on the compatibility of sec. 1 Foreign Tax Act with European law. Although sec. 1 AStG restricts the freedom of establishment, it is not contrary to European law if the taxpayer is given the opportunity to present "economic reasons" justifying transfer prices deviating from the arm's length principle.
15. New administrative regulations dated December 6, 2018 (IV B 5 - S 1341/11/10004-09) on the application of the ECJ judgment in the Hornbach case. The Federal Ministry of Finance restricts the criterion of "economic reasons" to actions related to near insolvency situations. The taxpayer must in particular prove the related party's or the group's need and capability for recovery: Applied since December 6, 2018 to all open cases.
16. New administrative regulations on the automatic exchange of information on financial accounts in tax matters in accordance with the Financial Account Information Exchange Act (FKAustG); Contains the publication of a final list of cooperating states within the meaning of sec. 1 (1) FKAustG: Applies since September 30, 2018.
17. New administrative regulations on cost allocation agreements between affiliated companies; the BMF circular of the same name of December 30, 1999 is repealed. Instead, the principles of Chapter VIII of the 2017 OECD Transfer Pricing Guidelines shall apply for fiscal years beginning after December 31, 2018. For a transitional period until December 31, 2019, existing cost allocation agreements will be assessed according to the circular dated December 30, 1999.
18. Revision of the BMF fact sheet on international mutual agreement and arbitration procedures. The fact sheet now contains an updated list of countries for which the EU Arbitration Convention applies. In addition, the Federal Ministry of Finance included information on bilaterally agreed application deadlines for the initiation of arbitration proceedings, deviating from the OECD Model Convention, as well as an updated paragraph 5 on the waiver of a mutual agreement procedure, which was revised in 2017: Applies since October 9, 2018.
19. Circular of the supreme tax authorities of the federal states concerning gifts with the participation of corporations or cooperatives. The supreme tax authorities of the Federal States follow the Federal Fiscal Court's jurisprudence ac-

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cording to which legal (business) relations there are only open and hidden profit distributions as well as capital repayments from corporations to their shareholders. There are no generous gifts according to sec. 7 para. 1 no. 1 Inheritance Tax Act. In the reverse relationship of shareholders to corporations, however, gift tax regulations could be applicable. In force since April 20, 2018.

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The following table provides an overview of the changes, their content and time of application:

	Law or Rule affected	Content	Date of Application
1.	Sec. 7 et seq. Foreign Tax Act	Possible changes in the German in sec. 7 et seq. Foreign Tax Act in implementation of the EU Anti-Tax Avoidance Directive ("ATAD I Directive").	Probably 2019.
2.	Brexit Tax Accompanying Act Draft / Brexit Transitional Law	Government draft of a Brexit Transitional Law. If a withdrawal agreement is reached, Great Britain will continue to be treated as an EU member state for the transitional period (until the end of 2020). Realization politically uncertain.	March 29, 2019 until the end of 2020, if a withdrawal agreement is reached.
3.	Brexit-StBG	From the time of withdrawal, Great Britain becomes a third country for tax purposes. Regulations also apply in case of a "hard Brexit".	Passed on March 15, 2019; enters in force on March 29, 2019.
4.	Arm's length regulation	Ordinance on the application of the arm's length principle pursuant to sec. 1 para. 1 Foreign Tax Act.	Supposedly 2019.
5.	EU Directive Proposal for the Introduction of a Significant Digital Presence (Digital PE), COM(2018) 147 final	Proposal on the EU-wide extension of the concept of a permanent establishment to a significant digital presence.	Implementation into national law by December 31, 2019. Entry into force planned for January 1, 2020. Rejected on March 12, 2019.
6.	EU Directive Proposal for a Tax on Digital Services (Digital Service Tax), COM(2018) 148 final	Proposal for an EU-wide "transitional tax" of 3% on certain revenues from digital services.	On March 12, 2019, the European Council rejected the proposal in favor of a global approach.
7.	Draft EU Accounting Directive	Publication requirements for income tax information for certain companies and branches ("Public Country-by-Country Reporting").	Open.
8.	BEPS Implementation Act II	Further BEPS Implementation Acts,	Expected 2019.

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	<b>Law or Rule affected</b>	<b>Content</b>	<b>Date of Application</b>
		e.g. on hybrid financing structures.	
9.	OECD - Revised Guidance on the Application of the Transactional Profit Split Method	Revised OECD report on the application of the profit split method following BEPS Action Point 10.	Published on June 21, 2018.
10.	OECD - discussion draft on the treatment of financial transactions	Transfer pricing treatment of financial transactions.	Published on July 3, 2018.
11.	OECD - Additional Guidance on the Attribution of Profits to Permanent Establishments	Further information on profit allocation to permanent establishments with regard to the changes in Art. 5 OECD-MC.	Published on March 22, 2018.
12.	OECD - Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles	OECD Guidance on the application of the approach to deal with hard-to-value intangibles under BEPS Action Point 8.	Published on June 21, 2018.
13.	Multilateral Instrument	Implementation of notified amendments to DTTs as a result of the OECD-BEPS recommendations through bilateral agreements.	In force since July 1, 2018; ratification by Germany pending.
14.	ECJ on May 31, 2018 -C- 382/16 (Hornbach)	Sec. 1 Foreign Tax Act is not contrary to European law if the taxpayer is given the opportunity to present economic reasons justifying a deviation of transfer prices from the arm's length principle.	Applicable to all versions of sec. 1 Foreign Tax Act.
15.	BMF Circular - IV B 5 - S 1341/11/10004-09	On the ECJ judgment of May 31, 2018 -C-382/16: Restriction of economic reasons justifying the conclusion of a transaction not being at arm's length.	Since December 6, 2018 for all open cases.
16.	BMF Circular - IV B 6 - S 1315/13/10021 :050	State exchange list for automatic exchange of information on financial accounts.	As of September 30, 2018.
17.	BMF Circular - IV B 5 - S 1341/0:003	Income allocation by cost allocation agreements. The principles of Chapter VIII of the OECD Transfer	For Fiscal Years beginning after December 31, 2018; Transitional period

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	<b>Law or Rule affected</b>	<b>Content</b>	<b>Date of Application</b>
		Price Guidelines 2017 now apply.	for existing cost allocation agreements until December 31, 2019.
18.	BMF Circular - IV B 2-S 1304/17/10001	Updated BMF circular on international mutual agreement and arbitration proceedings.	Since October 9, 2018.
19.	Supreme Tax Authorities of the Federal States	Circular concerning gifts involving of corporations or cooperatives.	Since April 20, 2018.

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## II. Implemented legal changes

Since our January 2018 overview, the following measures have been implemented:

1. Introduction of an obligation for taxpayers or tax intermediaries (usually tax advisers) to report cross-border tax arrangements and EU-wide exchange of information on the notified tax arrangements. Application of national implementing legislation from July 1, 2020. Mandatory disclosure shall apply to cross-border arrangements implemented after June 24, 2018. It is yet under discussion whether the German legislator will also introduce mandatory disclosure rules for purely domestic tax arrangements.
2. Binding dispute resolution procedures in cases of double taxation within the EU in implementation of the EU Directive on the Settlement of Double Taxation Disputes: The Directive entered into force on November 3, 2017. It shall be implemented into national law by June 30, 2019 and applied to double taxation of profits realized in tax years starting on or after January 1, 2018.
  - a. The dispute settlement procedure is to be based on the EU Arbitration Convention and extends its scope of application beyond transfer pricing disputes.
  - b. The Directive is particularly relevant to disputes concerning the existence of permanent establishments.
3. The extension of the EU ATAD I Directive including additional provisions on hybrid financing and hybrid structures (EU ATAD II Directive) entered into force on June 27, 2017: It shall be implemented into national law by December 31, 2019 with effect from January 1, 2020; for reverse hybrid structures arrangements, the Directive shall be implemented by December 31, 2021 with effect from January 1, 2022.

The table below provides an overview of all regulations in question, their content and date of application:

	<b>Law or Rule Affected</b>	<b>Content</b>	<b>Date of Application</b>
1.	EU directive on automatic information exchange	Intermediaries or taxpayers must notify cross-border tax arrangements; Member States must exchange information on notified tax arrangements within the EU.	In force; obligation to implement by December 31, 2019, obligation to apply as of July 1, 2020. Applicable for tax arrangements implemented after June 24, 2018.
2.	EU council directive on Double Taxation Dispute Resolution Mechanisms in the European Union	EU Directive on the resolution of double taxation disputes in the EU.	From July 1, 2019 on double taxation of profits from tax years from 1 January 2018 onward.
3.	EU - ATAD II Directive	Additional rules on hybrid financing and hybrid structures.	From January 1, 2020, partly from January 1, 2022.

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