



Germany publishes new guidance on cost sharing arrangements

Global Transfer Pricing Alert 2018-019

Germany's Federal Ministry of Finance on 5 July released a circular that adopts the arm's length standard for the examination of cost sharing arrangements (CCAs) and incorporates by reference the principles of Chapter VIII of the OECD's transfer pricing guidelines.

The new circular repeals a prior circular, dated 30 December 1999, and applies to new agreements entered into after 31 December 2018. The previous circular will continue to apply to existing agreements until 31 December 2019.

Both the old and the new circulars deal with CCAs, agreements whereby business enterprises agree to share the contributions and risks involved in the joint development of intangibles, tangible assets, or services, with the understanding that those assets are expected to create benefits for the participants.

The new circular does not make drastic changes to the guidance regarding CCAs, because the previous circular did not contradict the OECD transfer pricing guidelines in principle. By incorporating the recently updated OECD transfer pricing guidelines, the new circular reflects the general development of the international tax environment.

Key change

Under the old circular, CCA participants were only allowed to bill the CCA for their services at cost (although in practice this rule was not applied strictly).

Under the OECD transfer pricing guidelines, on the other hand, these services are generally valued at arm's length (typically

with a surcharge rather than at cost). However, the guidance also allows reimbursements for contributions at cost under specific circumstances (see Paragraph 8.27 of the OECD transfer pricing guidelines).

The 5 July circular now stipulates that "contributions must be valued at arm's length prices," which at first glance seems to contradict the OECD guidance, which in principle does not rule out allocations at cost. The language in the new circular should probably be understood to mean "arm's length" in the sense the OECD guidelines interpret the term. That is, if the OECD guidance classifies an allocation at cost as arm's length, the cost value should be deemed arm's length under the 5 July circular.

Practical considerations

For planning purposes, the following information should be taken into account:

- The CCA rules require that participants come together for a common benefit, and that all participants provide services; a small participation in the provision of services is sufficient in principle, as long as there is an expectation of a benefit to the participants. The repealed circular also required that the participants have similar interests; the OECD guidance (which the new circular adopts) requires only a common expectation of benefit, and is thus broader. However, from the OECD's point of view, effective "control" of the pool is also required, as is the proportionate management of risks and the ability to bear risks.
- The repealed circular contained helpful information on the application of accounting regulations and the selection of GAAP, which is now no longer (officially) applicable.
- The former circular denied the deduction of operating expenses if the contract contained serious defects. This regulation, which is now no longer applicable, is likely to have been rendered moot by the Fiscal High Court's recent case law holding that income tax treaties take precedence over domestic formal requirements. Under the OECD guidance, the contract is also the starting point of the examination and can be recharacterized or ignored and replaced, depending on the level of accurate reflection of the circumstances of the case.
- The OECD guidance points out that management of the pool itself can be a functionally important contribution (see Paragraph 8.31 of the transfer pricing guidelines), which should require a corresponding remuneration or a higher share of future benefits.
- An important aspect is the influence of the discussion regarding hard-to-value intangibles (HTVI), which also has an effect here. The repealed circular authorized pricing adjustments triggered by changes in economic conditions. The HTVI framework of Chapter VI of the OECD transfer pricing guidelines, including the

implementation guidance released June 21 by the OECD, appears to go further by authorizing pricing adjustments triggered in certain cases merely by an ex-post result (after risk resolution) “too far” from its asserted ex-ante average. In addition, certain changes in economic conditions that were not reasonably foreseeable at the time of the transaction may be excused from the HTVI framework (provided the taxpayer can establish the unforeseeable nature of the change in condition), which in certain cases could potentially have been subject to pricing adjustments under the circular.

The new circular provides a good opportunity for taxpayers to review existing CCA structures, which should be updated, if necessary, to reflect the modern international tax framework.

[Back to top](#)

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[Back to top](#)

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