



LEGAL BACKGROUND

- Arm's Length Principle:
"Transactions should be priced as if the parties were independent"
- Transfer Pricing Methods are provided to ensure arm's length prices

National Law

- § 1 AStG
- Verwaltungsgrundsätze

International Law

- Art. 9 OECD MTC
- Transfer Pricing Guidelines

PROFIT SPLIT METHOD

Two Step Approach:

1. Identify profits to be split from controlled transaction
2. Split them between associated enterprises on an economically valid basis

Ongoing work of OECD to improve guidance on this method
(latest document: Discussion Draft 2017)
→ recent work is analysed

RESEARCH QUESTIONS

1. Are there any rules on when and how the profit split method can be applied, in an international and national context?
2. Are these rules feasible or do they need concretion to be applicable?
3. If improvements are necessary, which are the main weaknesses?
4. What further advice and suggestions can be given?

SCOPE OF PROFIT SPLIT METHOD

National Law

- hierarchy of methods, § 1 III AStG:
profit split as default method
- applicable for parties that can be characterised as entrepreneurs according to the functional analysis

International Law

- rule of most appropriate method: methods are equally treated
- three indicators for profit split:
 - unique and valuable contributions by each of the parties
 - highly integrated transactions or
 - sharing of same economically significant risks or closely related risks

RULES ON APPLICATION

National Law

- no guidance on application
- reference to Transfer Pricing Guidelines

International Law

- different steps of application are regulated
- profit to be split
 - ⊙ actual vs. anticipated profits
 - ⊙ operating vs. gross profits
- different approaches of splitting the profit
 - ⊙ contribution analysis vs. residual analysis
- splitting factors
 - ⊙ asset based factors vs. cost based factors vs. other profit indicators

CRITICISM

- no full conformity of national and international regulations
- use of vague legal concepts
- high leverage of subjectivity
- tax uncertainty because of many ways to apply the method
- documentation requirements are high (especially for developing countries costly)

SUGGESTIONS FOR IMPROVEMENT

- from national perspective: aligning national rules with international standards
- from international perspective:
 - ⊙ reduce subjectivity by giving clear and objective measurable guidance
 - ⊙ improve examples – show when profit split should be applied and when not – give a step by step example
 - ⊙ provide safe harbours?
 - ⊙ provide decision-making aids for usage