**Federal Ministry of Finance circular on the use of names within a group of companies**[1]

Federal Fiscal Court decision of 21 January 2016, I R 22/14;
Use of names within a group of companies

With reference to the outcome of discussions with the highest revenue authorities of the *Länder*, the following rules apply when applying section 1 of the External Tax Relations Act (*Außensteuergesetz*) with regard to the use of names and the granting of trademark rights between the taxpayer and parties related to the taxpayer as defined in section 1 (2) of the External Tax Relations Act:

## 1. Preliminary remarks

In its judgment of 21 January 2016, I R 22/14 (Federal Tax Gazette II 2017, p. 336), the Federal Fiscal Court ruled that, in cross-border cases, the "mere" use of a name within a group of companies does not qualify as a business relation as defined in section 1 (4) of the External Tax Relations Act (in the version of the Act to Reduce Tax Subsidies of 16 May 2003, Federal Law Gazette I, p. 660; hereinafter referred to as the External Tax Relations Act (old version)) which would justify the use of an adjustment as referred to in section 1 (1) of the External Tax Relations Act (old version). In accordance with the principles which the Federal Fiscal Court developed in its judgment of 9 August 2000, I R 12/99 (Federal Tax Gazette II 2001, p. 140) regarding the diligence of a prudent and conscientious manager in connection with the use of the group name and to which the Federal Fiscal Court expressly adheres in the above-cited judgment, the contested case (which refers to the year 2006) involved a partner merely allowing the company in question to use the company name as the subject matter of a partnership agreement, in the sense of an authorisation to use the name as part of the company's own company name and hence to use it as defined in German commercial law for the purpose of distinguishing companies from one another (section 18 (1) of the Commercial Code (*Handelsgesetzbuch*)). As a rule, licence fees (royalties) for this type of authorisation cannot be offset against tax. Only if an inseparable connection between the name right and the product-specific trademark right is created by means of a trademark licensing agreement which grants a right to use the company name and the company logo as a trademark for the products sold or offered for sale in the area – as was the case in the dispute covered by the Federal Fiscal Court judgment of 9 August 2000 (loc. cit.) –, can the granting of the trademark right, to the extent that a separate value for this right can be established, be paramount, and an arms-length remuneration can be demanded overall (uniformly) in accordance with the principle of the diligence of a prudent and conscientious manager.

Against the background of the Federal Fiscal Court ruling of 21 January 2016 (loc. cit.), this circular mainly provides information on the application of section 1 of the External Tax Relations Act in terms of distinguishing between, on the one hand, a "mere" use of the name and, on the other

[1] This translation is provided merely for information purposes. Only the German language version is authoritative for the application of the law.

hand, the granting of trademark rights and other intangible assets (e.g. know-how) that may be directly connected with the use of the name.

## 2. Partnership agreement as referred to in section 1 (4) of the External Tax Relations Act

The 2008 Business Taxation Reform Act (*Unternehmensteuerreformgesetz 2008*) of 14 August 2007 (Federal Law Gazette I, p. 1912) renumbered section 1 (4) of the External Tax Relations Act (old version) as section 1 (5) without changing its substance. Since then, the provision has been amended as follows:

- The Act Transposing the EU Mutual Assistance Directive and Amending Taxation Provisions (*Gesetz zur Umsetzung der Amtshilferichtlinie sowie zur Änderung steuerlicher Vorschriften*) of 26 June 2013 (Federal Law Gazette I, p. 1809) renumbered section 1 (5) of the External Tax Relations Act as section 1 (4) again and revised its contents, applicable as of the 2013 assessment period (section 21 (20), third sentence, of the External Tax Relations Act). In number (1) of the first sentence of this new version of section 1 (4) of the External Tax Relations Act, the term "business relations" is defined as individual or multiple connected economic transactions (business transactions) between a taxpayer and a party related to the taxpayer. If a business transaction is not based on an *in personam* agreement, then, pursuant to section 1 (4), second sentence, of the External Tax Relations Act, it is assumed, in the absence of evidence to the contrary, that an *in personam* agreement exists. The restriction that a business transaction is only deemed to exist if it is not based on a partnership agreement continues to be located, with its substance unchanged, in section 1 (4), first sentence, (1) (b) of the External Tax Relations Act.

- The Act Adapting the Fiscal Code to the Union Customs Code and Amending Further Tax Provisions (*Gesetz zur Anpassung der Abgabenordnung an den Zollkodex der Union und zur Änderung weiterer steuerlicher Vorschriften*) of 22 December 2014 (Federal Law Gazette I, p. 2417) revised section 1 (4) of the External Tax Relations Act, applicable as of the 2015 assessment period (section 21 (22) of the External Tax Relations Act). The revision had the effect of making section 1 (4), first sentence, (1) (b) of the External Tax Relations Act more specific, in order to clarify that a partnership agreement is to be understood as an agreement that directly results in a legal change in the partner status (e.g. the size of the shareholding or the ownership rights). The formal inclusion of a business transaction in the shareholders' agreement does not itself create a partnership agreement that excludes the application of section 1 of the External Tax Relations Act, unless the business transaction (also) results in a legal change in the partner status.

The business transactions that have actually been carried out are used as the starting point for the determination and checking of transfer prices. Therefore, the implied conclusion of a licensing agreement is sufficient to justify a transfer pricing adjustment, even for assessment periods prior to the 2013 assessment period.

## 3. Compliance with the documentation and cooperation obligations

The records that are generally required also include, in the case of business relations with related parties, an overview (list) of the key intangible assets held by the taxpayer and which the taxpayer uses, or transfers for the purpose of being used, in the context of the taxpayer's business relations with related parties (cf. section 4 (1) (2) (b) of the Ordinance on the Type, Content and Scope of the Records as Referred to in Section 90 Subsection (3) of the Fiscal Code (*Gewinnabgrenzungsaufzeichnungsverordnung*)). The corresponding usage agreements (contracts) are generally to be classified as exceptional business transactions as referred to in section 3 (2) of the above-mentioned Ordinance in connection with section 90 (3) of the German Fiscal Code (*Abgabenordnung*).

## 4. Use of uniform company symbols within a multinational group of companies

A multinational group of companies (*multinationale Unternehmensgruppe*) is any group comprised of at least two related parties as defined in section 1 (2) of the External Tax Relations Act that are resident in different countries, or any group comprised of at least one person with at least one permanent establishment in another country. According to this definition, the German term *multinationale Unternehmensgruppe* is not identical to the German term *Konzern* (company group).

A multinational group does not have a trade name (*Firma*) as defined in sections 17 et seqq. of the German Commercial Code (*Handelsgesetzbuch*); only the respective individual companies have trade names. In order to achieve a market presence with a uniform identity, it may be decided and/or permitted within the multinational group to use the name of the group as a component in the individual companies' own trade names.

In accordance with the above-cited Federal Fiscal Court ruling of 21 January 2016 (loc. cit), the "mere" use of the name without the granting of trademark rights and other intangible assets, which could be directly connected with the use of a name in a multinational group, is generally not eligible for remuneration, so that in cross-border cases of this kind it is not necessary to adjust income pursuant to section 1 of the External Tax Relations Act (this corresponds to paragraph 6.3.2 of the circular on the Principles for the Examination of Income Allocation in the Case of Internationally Associated Enterprises, 23 February 1983, Federal Tax Gazette I 1983, p. 218). This only applies if no economic benefit is obtained solely through the use of the name, in relation to which, in accordance with the arm's length principle, the party granting permission for use would demand remuneration and for which the user would be prepared to pay remuneration.

Whether the use of the name by itself needs to be remunerated under the arm's length principle therefore depends, from the perspective of the hypothetical concept of how a prudent and conscientious entrepreneur would act, on whether there is an exclusive right to use the name. If an unrelated third party company could be prevented from using the name, then giving permission for the use of the name, or tolerating its use by another party, constitutes the transfer of the use of an intangible asset, so that generally it must be assumed that this would be eligible for remuneration. An actual obligation to provide remuneration would however be dependent on the condition that the name in question has a value that is to be realised via market prices and that would be subject to remuneration between third parties that are independent of each other.

In a similar fashion, within a multinational group it can be decided and/or permitted that the individual companies of the group use common company symbols as defined in section 5 of the Trademark Act (*Markengesetz*). The deliberations that are taken into account pursuant to section 14 and section 4 of the Trademark Act with regard to the licensing of the right to a trademark must equally apply to the right to a company symbol pursuant to section 15 and section 5 of the Trademark Act. The requirements of the respective national legal system must also be complied with.

Often this kind of cross-border use of names is connected with the use of trademark rights and other intangible assets, so that the amount of remuneration that may have to be paid is related to the benefits to be gained from these rights.

## 5. Use of a trademark right within a multinational group of companies

A trademark serves to distinguish the goods or services of one enterprise from those of other enterprises on the market (section 3 of the Trademark Act). The trademark is, among other things, intended to create an emotional link to, or an image of, a particular product or service, conveying e.g. reliability, technical quality and confidence in certain characteristics. Hence, it also represents the intangible assets contained in the product or service. Trademarks can have the effect of e.g. promoting sales (volume premium) or helping products or services sold under the trademark to achieve a higher price on the market (price premium).

If the company name whose use is being allowed (see paragraph 4) and the trademark are identical then no differentiation needs to be made during the evaluation, meaning that a uniform evaluation must be carried out.

## 6. Criteria-based eligibility for remuneration

An indicator that the maintenance of a uniform company designation, the use of uniform company signs and the use of a trademark right within a multinational group is fundamentally eligible for remuneration is provided if the owner of the name, trademark or company sign has the right, or the effective capability, to prevent a third party from using the name, trademark or company sign. A prudent and conscientious business manager would, from the perspective of the owner, generally demand remuneration for granting another party the use of this kind of exclusive right and/or allowing the actual use of this right. Conversely, a prudent and conscientious business manager would, from the perspective of the user, generally only be willing to provide remuneration if he or she could be prevented, legally or in practice, from using the name, trademark or company sign.

For example, registering a trademark creates a situation where the owner of the trademark has the exclusive right to use this trademark. If, for example, a German trademark is infringed, then the owner of the trademark has the right to an injunction or compensation claim (section 4 and section 14 of the Trademark Act). In this kind of situation, the granting of a trademark right to another company in the multinational group generally constitutes a business activity (business transaction) as referred to in section 1 (4), first sentence, (1) of the External Tax Relations Act. If no verifiable *in personam* agreement exists for this kind of business transaction, then, pursuant to section 1 (4), second sentence, of the External Tax Relations Act, it is to be assumed, in the absence of evidence to the contrary, that an *in personam* agreement exists. A similar situation applies in the case of unprotected know-how, where in practice a competitor can be prevented from using the know-how (e.g. by keeping it confidential).

## 7. Amount-based eligibility for remuneration

Even where criteria-based eligibility for remuneration exists, it should only be assumed that amount-based eligibility for remuneration exists if the user can expect to derive an economic advantage from an effective or legal granting of the right to use e.g. an intangible asset (e.g. a company symbol, a registered trade name or a trademark), irrespective of whether this advantage actually materialises (ex ante approach). In this case, the evaluation is based on the benefits that are expected to occur. Unrelated third parties would review their agreements in the event that the expected economic advantage does not materialise.

If the use of the intangible assets only occurs in connection with the sales activities of the respective company in the multinational group, and if this company clearly only sells products from the multinational group, then generally no separate significance is attributed to the use of the company symbol, registered trade name or trademark. This is because remuneration for the use of these intangible assets is already included and covered in the purchase price paid by the distribution company for the goods that enter into circulation through the sale to the distribution company.

The situation is somewhat different if the company belonging to the multinational group produces goods, or offers services on the market, and an independent economic use of the intangible assets of the multinational group is of significance in this respect.

Here it must be borne in mind that, in general, intangible assets are to be individually examined in terms of their value. However, an exception would exist if the individual intangible assets are mutually dependent on each other, because when several intangible assets are closely connected from a business perspective, the total value of these assets is generally higher than the sum of the values of the individual assets.

If the usage is indeed eligible for remuneration based on criteria (licence) then generally the party that is eligible to receive royalties is the party that actually created the intangible assets in question and that has the exclusive right to prevent other parties from using these intangible assets.

## 8. Note on calculating amount-based remuneration

The amount of the royalties that are to be paid is, generally speaking, based on the hypothetical arm's length method as referred to in section 1 (3), fifth and following sentences, of the External Tax Relations Act.

The application of a damages claim for a possible violation of rights does not, in general, satisfy the requirements of the arm's length principle,

- because this otherwise ignores the fact that the rights holder generally permits the usage, and
- because only a one-sided perspective is used and the price-determination process is not replicated.

The principles of the licence analogy recognised by the Federal Court of Justice (Federal Court of Justice ruling of 29 July 2009, I ZR 169/07) could be used as a starting point for reviewing the individual cases. Any supplementary damages must be deducted.

It should be noted that offsetting royalties can be inappropriate if it is apparent that the licensee experiences an ongoing loss-making situation as a result.

## 9. General applicability

The principles contained in this circular are applicable to all comparable cross-border cases, irrespective of whether the licensee or licensor are German or foreign companies.