



Overview

Flick Gocke Schaumburg, Taxand Germany

Flick Gocke Schaumburg has been dedicated to tax-focused legal advice for 50 years with numerous offices in Germany. Our company was one of the first law firms in Germany to focus intensively on international tax law and international transfer pricing. Our transfer pricing expertise includes the planning, implementation, documentation and defence of transfer pricing systems as well as the conduct of mutual agreement procedures (MAPs), bilateral advance pricing agreements (bilateral APAs) and tax court proceedings, in particular. Through this focus, we have gained expertise that ensures comprehensive advice at the highest professional level for our clients. Our clients are domestic and foreign parented corporate groups as well as internationally active family-owned and medium-sized companies.

General : Transfer Pricing Framework

The arm's length principle is implemented in Section 1 of the German Foreign Tax Act (hereinafter referred to as "FTA"). Furthermore, the legal framework for transfer pricing in Germany is supplemented by various decree laws and administrative guidelines published by the German Federal Ministry of Finance (e.g. concerning business restructurings). For instance, Section 1(5) FTA contains rules specifically dealing with the attribution of profits among permanent establishments and the head office and with intracompany dealings, transposing the Authorised OECD Approach (AOA) into domestic tax law. These rules are supplemented by a Decree Law on the Profit Allocation of Branches and Administrative Guidance on the profit allocation of permanent establishments. Also, Section 1(3b) FTA specifically deals with the transfer pricing implications on business restructurings, which is supplemented by a recently amended Decree Law on the Transfer of Functions and administrative guidelines interpreting these provisions.

The general transfer pricing documentation requirements are laid down in Section 90(3), the Decree Law on the Documentation of Income Allocation, and 138(a) German Fiscal Code (hereinafter referred to as "GFC"). Moreover, Administrative Guidance on Documentation requirements and a taxpayer's duties of cooperation have been issued on December 3, 2020.

Section 89a GFC was introduced in 2021 to stipulate a domestic legal basis for advance pricing agreements (bilateral APAs).

Following the update of the OECD Guidelines Transfer Pricing (hereinafter referred to as "OECD Guidelines") in January 2022, an update of the Administrative Guidance on Transfer Pricing was published on 6 June 2023. The German Tax Authorities not only refer to the OECD Guidelines but have explicitly adopted the OECD Guidelines' view by attaching the OECD Guidelines as an annex to this Administrative Guidance on Transfer Pricing.

Accepted Transfer Pricing Methodologies

The OECD Guidelines are not incorporated in German legislation, however based on Section 1(3) FTA and the Administrative Guidance on Transfer Pricing, the OECD Guidelines are considered as internationally accepted guidance providing explanation and clarification of the arm's-length principle and its application. In essence, Section 1(3) FTA specifies that a transfer price and the other conditions of an intercompany transaction must be determined in accordance with the arm's-length principle and that the actual circumstances of the relevant transaction are to be decisive. Section 1(3) FTA applies the most appropriate method as a criterion for the selection of the applicable transfer pricing method.

Moreover, Section 1(3) FTA and the Administrative Guidance on Transfer Pricing also stipulates use of the income-based valuation methods and the discounted cash flow methods, which are based on the discounted value of the projected future income streams or cash flows for the subject of valuation, as recognized methods.

Additionally, Section 1(3) FTA and the Administrative Guidance on Transfer Pricing provide the hypothetical arm's-length test. If no comparable values from transactions between unrelated parties can be identified, a hypothetical arm's-length comparison must be applied to determine the arm's-length price on the basis of economically recognized valuation methods. When applying the hypothetical arm's-length test, the minimum price of the service provider or licensor and the maximum price of the service recipient or licensee regularly results in a "consensus" range, whereas the average value of the settlement range is to be taken as a basis if the taxpayer does not credibly demonstrate that another value within the "consensus" range complies with the arm's-length principle. In the view taken by the German Tax Authorities, the hypothetical arm's-length test prevails over the other transfer pricing methods in case of licensing of IP. The concept of the hypothetical arm's-length test is problematic because it opens the door to arbitrary results during tax audits.

For financing transactions, the CUP method or the cost of funds method is normally regarded as the most appropriate method.

Transfer Pricing Documentation Requirements

The general transfer pricing documentation requirements are laid down in Section 90(3) GFC, the Decree Law on the Documentation of Income Allocation, and the Administrative Guidance on Documentation. A Local File has to be prepared by a German taxpayer (i.e., subject to unlimited and limited tax liability in Germany) if the threshold for remuneration for supply of goods exceeds EUR 6 million and the total remuneration from other services exceeds EUR 600,000 (combines view of all German group companies). A Master File has to be prepared by a German taxpayer who belongs to a multinational group and has stand-alone revenues of at least EUR 100 million in the previous fiscal year. Until 2024, Local Files and the Master File are usually to



be submitted only during a tax audit and only upon request by German Tax Authorities and within a time period 60 days. As of 2025, the Local Files and the Master File must be "pro-actively" submitted within 30 days after the receipt of the announcement of the tax audit.

In principle, there is no obligation to prepare contemporaneous documentation with the exception for extraordinary transactions. For example, extraordinary transactions include the conclusion and amendment of long-term agreements having a significant impact on the income generated therefrom with related parties, and any business restructurings.

Furthermore, Section 12 of the Tax Havens Prevention Act stipulates an increased obligation to electronically provide documentation within twelve months after the end of the fiscal year, which exceeds the regular transfer pricing documentation requirements vis-à-vis tax jurisdictions that qualify as non-cooperative.

According to Section 138a GFC, German-based companies are subject to country-by-country (hereinafter referred to as "CbCR") reporting requirements, if they prepare consolidated financial statements and whose consolidated revenues in the previous year is equal to at least EUR 750 million. Such businesses subject to CbCR reporting requirements have to prepare and file a CbCR report to the German Federal Tax Office one year after the end of the fiscal year for which the CbCR report is being generated.

Local Jurisdiction Benchmarks

Benchmarking helps to demonstrate that transfer prices are at arm's length. If a German taxpayer uses benchmark studies for the demonstration of arm's-length prices, the German taxpayer must comprehensively disclose the search process, including the definition of the applied search strategy to identify potential comparable companies, the search result and the selection process. The entire search process must be transparent and, at the time of a tax audit, verifiable. Moreover, the configuration of the database with which the search process has actually been conducted must be comprehensively documented.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

Since 2021, Section 89a GFC regulates the availability and access to APA proceedings, the resolution of APA cases and implementation of APAs reached. An APA procedure is only possible in Germany if there is a risk of double taxation regarding the specific facts of the case and it is likely to avoid double taxation through the APA procedure and to reach a consensual agreement interpretation with the competent authority of the other contracting state. The initiation of an APA proceeding requires a formal request made by the taxpayer and the holding of a pre-filing meeting with the German competent authority.

The German APA procedure is then limited to a certain period of validity, which in general should not exceed five (5) years. Once an APA has been concluded, subsequent renewals are also possible. In addition, the German APA procedure enables the German taxpayer to request for a retroactive application of the APA to previous tax years (so called "rollback"). In practice, the entire APA procedure might take two (2) to four (4) years and a fee is charged by the German Tax Authorities in the amount of EUR 30,000 for each APA request and in the amount of EUR 15,000 for each renewal APA request in case of transfer pricing matters. If the German APA procedure relates to matters other than transfer prices, the fee charged by the German Tax Authorities is reduced to EUR 7,500 (first application) and to EUR 3,750 (renewal).

Transfer Pricing Audits

As a standard procedure, the German tax auditor requests the taxpayer's comprehensive transfer pricing documentation covering all cross-border intercompany transactions or just specific parts therefrom. Afterwards, the tax auditor selects those transactions that may require an in-depth examination.

German tax auditors are likely to examine in detail the following situations:

- ❖ when the profitability of non-German subsidiaries has increased significantly;
- ❖ when the German taxpayer has entertained a transfer of functions involving substantial operations (e.g. the conversion of fully-fledged distributors into limited-risk distributors, sales agents, or commissionaires for a related person that may operate as a principal);
- ❖ when the German taxpayer's income has declined sharply or the German taxpayer has suffered permanent losses;
- ❖ when the German taxpayer has carried out intercompany transactions with related parties situated in low-tax countries;
- ❖ when the German taxpayer has applied the TNMM and year-end adjustments; and
- ❖ when the taxpayer has carried out corresponding or secondary adjustments.

From a transaction perspective, German tax auditors commonly focus on the following types of controlled transactions:

- ❖ licensing of IP;
- ❖ provision of intragroup services;
- ❖ financing transactions (e.g. shareholder loans, cash-pooling, factoring);
- ❖ business restructuring;
- ❖ distribution and procurement functions.

In addition, German tax auditors are increasingly focusing on transfer pricing related issues, such as withholding taxes, creation of permanent establishments, the



place of effective place of management and the general anti-abuse rule.

Transfer Pricing Penalties

If the German taxpayer does not submit a comprehensive transfer pricing documentation at all or if the transfer pricing documentation submitted is mostly “unusable” for the tax authorities, it is rebuttably presumed that the taxable income of the taxpayer is higher than the declared income. If the German taxpayer is able to rebut the presumption and can demonstrate the compliance with the arm’s-length principle, the German Tax Authorities will impose a penalty of EUR 5,000 in any case. If the German taxpayer is unable to rebut the presumption, the penalty imposed by the German Tax Authorities amounts to at least 5% but not exceeding 10% of the income adjustment.

In case of late submission of the transfer pricing documentation, the penalty is EUR 100 per day that the German taxpayer is late and can be up to EUR 1,000,000.

Any failure to provide information or documents within an appropriate time frame that has been requested by the German Tax Authorities during a tax audit can trigger a penalty of up to EUR 250,000 per non-compliance pursuant to Section 146(2c), 2000(1) GFC.

Local Hot Topics and Recent Updates

Transfer pricing and the documentation of arm’s-length transfer prices are currently subject to aggressive tax audits in

Germany. Taxpayers have to deal with increasing and complex documentation requirements. Administrative guidance provides for an expanded obligation to submit documents and data, such as expert opinions, emails and messaging services. Moreover, the German tax authorities demand access to information located abroad allowing the scrutiny of transfer pricing.

In particular, the introduction of the best-method approach puts the burden of proof directly on the taxpayer. Furthermore, the taxpayer is obliged to document why it considers the applied transfer pricing method in each case to be the most appropriate method. The German tax authorities have also the discretion to choose an alternative transfer pricing method, if they consider it to be the most appropriate method.

It is highly doubtful that such an approach would be accepted by the tax authorities of the respective foreign-related party. This will result in an increasing number of double taxation cases leading to costly and time-consuming MAPs or litigations.

Consequently, taxpayers have to prepare thorough factual documentation and to treat the transfer pricing system as part of the tax compliance of the multinational group.

Finally, rather recently German legislation introduced more specific transfer pricing rules and implemented the OECD transfer pricing guidelines in German law.

GERMANY



Documentation threshold

Master file	Turnover EUR 100 million of individual entity, i.e. no group perspective
Local file	Remuneration for supply of goods exceeds EUR 6 million and the total remuneration from other services exceeds EUR 600,000 (combined view of all German entities, i.e. no stand-alone perspective)
Enhanced TP Documentation	Any transactions involving non-cooperative tax jurisdictions
CbCR	Turnover EUR 750 million

Submission deadline

Master file	Until 2024: Submission only upon request by German Tax Authorities within 60 days. As of 2025: Submission within 30 days after the receipt of the announcement of the tax audit.
Local file	Until 2024: Submission only upon request by German Tax Authorities within 60 days. As of 2025: Submission within 30 days after the receipt of the announcement of the tax audit.
Enhanced TP Documentation	12 months after the end of the fiscal year
CbCR	Submission within 12 months after end of the tax year

Penalty Provisions

Documentation – late filing provision	Penalties up to EUR 1,000,000
Tax audit – lateness in cooperation	Penalties up to EUR 250,000
Tax return disclosure – late/incomplete/no filing	Penalties up to EUR 25,000
CbCR – late/incomplete/no filing	Penalties up to EUR 10,000



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