



Overview

Flick Gocke Schaumburg, Taxand Germany

Flick Gocke Schaumburg has been dedicated to tax-focused legal advice for more than 50 years and has numerous offices in Germany. Our firm 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 enshrined 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. In addition, the administrative guidelines issued by the German Federal Ministry of Finance, which were last updated on 12 December 2024, are of practical importance. The administrative guidelines contain a reference to the OECD Transfer Pricing Guidelines for further explanations, e.g. with regard to financial transactions and the transfer of business functions, and they refer to relevant case law.

The general transfer pricing documentation requirements are laid down in Section 90(3) of the German Fiscal Code (hereinafter referred to as "GFC"), the Decree Law on the Documentation of Income Allocation, and Section 38a GFC. Administrative guidance on documentation requirements and taxpayers' duties of cooperation was issued on 3 December 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 Transfer Pricing Guidelines (hereinafter referred to as "OECD Guidelines") in January 2022, an update of the Administrative Guidance on Transfer

Pricing was first published on 6 June 2023 and then again updated on 12 December 2024. 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 (see above).

Accepted Transfer Pricing Methodologies

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 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 stipulate 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.

Section 1(3) FTA and the Administrative Guidance on Transfer Pricing additionally 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 median 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 the 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. From the 2024 assessment period onwards, financing transactions are subject to the specific provisions of Section 1(3d) and (3e) of the FTC. According to Section 1(3d) FTC, the expenses arising from the financing transaction (in particular loans) in Germany may not be deducted as business expenses if the taxpayer cannot credibly demonstrate that he would have been able to service the debt for the entire term from the outset, that he economically needs the financing and that he is using it for business purposes. The same applies if the agreed interest rate exceeds the interest rate based on a group rating.



According to Section 1(3e) FTA, an activity is generally considered to be of a low-risk nature if it is about arranging or passing on a financing transaction within a multinational group of companies. Such a low-risk service is also generally assumed if a company performs cash management (e.g. liquidity management, financial risk management) for other companies in the group or acts as a financing company.

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 or the total remuneration from other services exceeds EUR 600,000 (combined view of all group companies). A Master File has to be prepared by a German taxpayer that 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 usually had to be submitted only during a tax audit and only upon request by German tax authorities and within a period of 60 days. As of 2025, a transaction matrix must be prepared. The transaction matrix and the Master File must be "proactively" submitted within 30 days of receipt of the announcement of the tax audit. The Local File must be submitted to the German tax authorities within 30 days upon request. Also, the tax authorities may request submission of transfer pricing documentation outside of a tax audit at any time.

In principle, there is no obligation to prepare contemporaneous documentation, with an 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 12 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 "CbC") reporting requirements if they prepare consolidated financial statements and their consolidated revenues in the previous year are equal to at least EUR 750 million. All businesses subject to CbC reporting requirements have to prepare and file a CbC report to the German Federal Central Tax Office one year after the end of the fiscal year for which the CbC report is generated.

Local Jurisdiction Benchmarks

Benchmarking helps to demonstrate that transfer prices are at arm's length. German taxpayers that use benchmark studies for this purpose 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 was conducted must be comprehensively documented.

Focus on Financial Transactions

German TP rules and the German tax authorities' administrative guidance on intercompany financial transactions places strong emphasis on the accurate delineation and economic justification of the transaction and on the consideration of a group credit rating and debt capacity analysis. The financial transaction must satisfy a real economic need and correspond to what an independent enterprise would have agreed to under comparable circumstances. This entails a comprehensive creditworthiness analysis of the borrower including any implicit support to rebuke the decisiveness of the group credit rating, verification of the borrower's capacity to be able to repay the principal amount and interest, and the determination of the interest rate (e.g. using internal comparables or benchmarking of the interest rate against comparable uncontrolled transactions, such as bonds or loans).

In addition, the German TP rules—reflecting the OECD 2020 guidance—require a close examination of treasury functions and substance within the group: entities performing limited financial intermediation functions (e.g. financing companies or cash pooling leaders without demonstrable decision-making capacity) should only earn a routine return.

APAs and Bilateral APAs

Since 2021, Section 89a GFC regulates the availability and access to APA proceedings, the resolution of APA cases and implementation of APAs reached. On 26 June 2024, the German tax authorities have updated their administrative guidelines on Sec. 89a GFC. An APA procedure is possible in Germany only if there is a risk of double taxation regarding the specific facts of the case and it is likely that double taxation will be avoided through the APA procedure and a consensual agreement interpretation will be reached with the competent authority of the other contracting state. For an APA proceeding to be initiated, the taxpayer must make a formal request and a pre-filing meeting must be held 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 possible. In addition, the German APA procedure enables the German taxpayer to request a retroactive application of the APA to previous tax years ("rollback"). In practice, the entire APA procedure might take two to four years. The German tax authorities charge a fee of EUR 30,000 for each APA request and EUR 15,000 for each renewal of an APA request in 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

Based on the taxpayer's comprehensive transfer pricing documentation the tax auditor selects those transactions that may require an in-depth examination. Since 2025, tax authorities first analyse the transaction matrix and then request further documentation with regard to specific transactions or the comprehensive transfer pricing documentation.

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 issues related to transfer pricing, such as withholding taxes, creation of permanent establishments, the effective place of management and the general anti-abuse rule.

Burden of Proof in Transfer Pricing: Theory versus Practice

In Germany the burden of proof in transfer pricing matters is as follows: The tax authorities are required to investigate the facts of the case and they bear the responsibility of demonstrating that the prices set by a taxpayer are not

at arm's length. However, taxpayers have obligations to cooperate and to provide information and documentation, particularly in tax audits and in matters relating to foreign countries. If taxpayers fail to comply, the level of evidence required by the tax authorities may be reduced. In particular, if a taxpayer fails to comply with the transfer pricing documentation requirements, the German tax authorities may rebuttably presume that the income generated in Germany is higher; if income can be determined only within a certain range, this range may be used to the detriment of the taxpayer. The reversal of the burden of proof applies only if no transfer pricing documentation is submitted or if the documentation submitted is 'unusable', whereby the term 'unusable' is prone to dispute.

In practice, the German tax authorities often complain about the taxpayers' transfer pricing documentation and argue that it is too vague or incomplete, with the result that taxpayers have to demonstrate the appropriateness of the transfer prices by means of additional information. Consequently, the burden of proof is effectively shifted to the taxpayer in many cases.

Transfer Pricing Penalties

If the German taxpayer does not submit comprehensive transfer pricing documentation 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 compliance with the arm's-length principle, the German tax authorities will impose a penalty of EUR 5,000 in any case; this also applies if the transaction matrix is not submitted. 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 more than 10% of the income adjustment.

If the transfer pricing documentation is submitted late, the penalty is EUR 100 per day that the German taxpayer is late and can amount 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 event of non-compliance pursuant to Section 146(2c), 200(1) GFC.



Local Hot Topics and Recent Updates

Transfer pricing (and its documentation) is subject to aggressive tax audits in Germany. Taxpayers have to deal with ever increasing and complex documentation requirements and obligations to submit documents and data. In particular, based on recent case law tax auditors are increasingly demanding submission of (TP related) emails and messages. Providing and selecting such information can require an immense amount of effort. Moreover, German tax authorities demand access to information located abroad allowing the scrutiny of transfer pricing.

Given the recent legislative focus on financial transactions implies that tax audits are putting a particular emphasis on this area.

Also, taxpayers are increasingly being confronted with requests for the international exchange of information, as well as with the cross-checking of information against CbCR and DAC6 filings. The first-time application of Pillar II has also brought with it the need to reconcile this data from a transfer pricing perspective.

Furthermore, the taxpayer is obliged to document the appropriateness of the applied transfer pricing method. The German tax authorities have the discretion to choose an alternative transfer pricing method if they consider it more appropriate. 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 litigation.

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 or the total remuneration from other services exceeds EUR 600,000
Enhanced TP Documentation	Any transactions involving non-cooperative tax jurisdictions
CbCR	Turnover EUR 750 million

Submission deadline

Master file	Submission within 30 days after receipt of the announcement of the tax audit.
Transaction Matrix	Submission within 30 days after receipt of the announcement of the tax audit.
Local File	Submission upon request within 30 days.
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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