

Transfer Pricing Country Summary Germany

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Legislation

Existence of Transfer Pricing Laws/Guidelines

The German tax legislation has no special section for a transfer pricing regime, but rules on transfer pricing are established in different sections of the German tax laws, decrees and administration principles. The most important is Section 1 of the Foreign Tax Code (“Aussensteuergesetz”) which defines related party transactions. Section 8 Paragraph 3 of the corporate income tax law (“Körperschaftsteuergesetz”) defines hidden profit distributions. Furthermore, various regulations published by the German Ministry of Finance (BMF) and relevant provisions of the German Double Tax Treaties deal with transfer pricing issues. The documentation requirements on transfer pricing are enacted in Section 90 Paragraph 3 of the General Tax Code.

The most significant regulations are:

- The administrative principles, published on 23 February 1983;
- Principles on Cost Contribution Arrangements, published on 30 December 1999 (Expiry on 31 December 2018)
- Principles on international secondments of employees, published on 9 November 2001;
- German ordinance regarding the documentation of profit allocations, published on 12 July 2017;
- Administrative principles on procedures, published on 12 April 2005;
- Principles of APAs, published on 5 October 2006;
- Principles for the examination of income allocation between affiliated companies in the case of international relocation of functions, published in 13 October 2010; and
- Principles on foreign tax code to cases of marginal amortizations and depreciations on loans for foreign related entities, published in 29 March 2011.
- Administrative Guidelines on the use of the group name, published on 7 April 2017.

Germany has adopted the Authorized OECD Approach (AOA) into the national tax law, legislation which applies for business years beginning after 31 December 2014. According to AOA, the arm’s length principle applies to cross border profit allocation between entities and permanent establishments (PE). The assets and risks are allocated to the entities of the enterprise and to permanent establishments, according to the “people function” principle and, furthermore, the characterization of the business relationships and the arm’s length range is determined. As of 18 October 2014, permanent establishments are treated as independent and separate legal entities for tax purposes (this regulation applies again for business years starting 31 December 2014). A decree with further guidance on the implementation of the AOA has been finalized in October 2014.

On 15 July 2015, the federal cabinet adopted two draft bills that will enable Germany to exchange financial account information in tax matters automatically with other EU member states and non-EU countries from 2017 onwards.

On 31 December 2018 the MOF Principles on Cost Contribution Arrangements from 1999 will expire and be replaced by Chapter VIII of the OECD Guidelines.

The definition of related parties is established in Section 1 of the Foreign Tax Act, which states that parties are regarded as related if one party participates directly or indirectly in the management, control or capital of the other, or where a third party participates directly or indirectly in the management, control or capital of both of them, or where the same persons or their close relatives participate in management or control of the other. A minimum direct or indirect participation of 25% is required in order to create an affiliate.

Transfer Pricing Scrutiny

Transfer pricing has been an area of high interest for tax administration in the last years in Germany. The risk of transfer pricing audits has increased lately, as the German tax authorities consider transfer pricing as part of a taxpayer's tax audit or risk assessment.

Looking at past audits, companies that have received particular attention are entities that incur losses or that earn relatively low margins. Also, a special focus has been offered to scrutinize transfer and licensing of Intellectual property (IP) between related parties. Tax authorities have strict requirements regarding transfer pricing documentation and in compliance to the requirements entities the tax authorities to perform transfer pricing adjustments to the less favorable end of the range for the taxpayer or assess penalties. Financial transactions are also under high scrutiny, looking at examples of exit taxation, cash pool synergy profits and umbrella brand names licensing,

Transfer Pricing Penalties

Germany has established a penalty regime in 2003 in Section 162 of the General Tax Code, with effect from 2004. Penalties must be raised as a surcharge of 5 to 10% of a profit adjustment with a minimum of €5,000. In cases where a taxpayer presents documentation which is in general usable for a tax auditor, but presented after a set deadline, penalties of up to €1 million are possible, with a minimum of €100 for each day the 60-day time limit is exceeded.

Advance Pricing Agreement (APA)

On 5 October 2006, the German tax authorities published Administrative principles on APAs in order to give tax authorities and the taxpayer better guidance for the handling of APAs. APA agreements are valid between 3 and 5 years.

Section 178a of the General Tax code contains a fee of generally €20,000 for an APA request, €15,000 fee for the renewal of APAs and a €10,000 fee for the modifications during the term of the APA. Reduced fees for SMEs are possible.

Documentation And Disclosure Requirements

Tax Return Disclosures

Taxpayers are neither obliged to deliver transfer pricing documentation nor obliged to disclose transactions with related parties together with the tax return. The deadline to fill the corporate tax return is 31 of May for ordinary transactions. On request this deadline can be extended.

Level of Documentation and Content Requirements

The German documentation rules oblige taxpayers to document the nature, content and extent of cross-border transactions with related parties, as well as the economic and legal basis for the determination of prices, which are in line with the arm's length principle. The taxpayer has to prepare the documentation contemporaneously for extraordinary transactions, such as restructuring or a shift of functionality.

The taxpayer has to document if the outcome of those transactions follows the arm's length standard, including a detailed analysis of business functions performed, assets used, and risks assumed, selection and application of the most appropriate transfer pricing methodology.

Germany follows generally the BEPS approach and has implemented a three tier approach consisting of Masterfile, Local file and Country-by-Country-Reporting (CbCR).

According to § 4 of the German ordinance regarding the documentation of profit allocations a local file needs to provide the following information:

1. A description regarding shareholdings, business operations, organizational structure
2. A description of the business and business strategy pursued by the local entity
3. A functional and risk analysis
4. An indication of the most appropriate transfer pricing methods
5. Information regarding special circumstances such as measures to be implemented in respect of benefit-sharing
6. Contracts concerning cost allocation
7. Information on arbitrations board proceedings
8. A documentation regarding price adjustments
9. A documentation regarding losses
10. A documentation regarding adjustments of function and risk in the context of R&D
11. A description of the search methodology, search criteria and search process in case a database study is used

A Masterfile requires specification regarding the following 18 articles:

1. Chart illustrating the group's legal and ownership structure and geographical location of operating entities

2. Important drivers of business profits
3. A description of the supply chain for the group's five largest products/services
4. A description of the supply chain for any other product/service amounting to more than 5 percent of the group turnover
5. An indication of significant business restructurings
6. A description of the main geographic markets for group's products/services
7. A brief written functional analysis
8. A description of significant restructuring transactions, acquisitions and divestitures
9. A general description of the corporate group's overall strategy for intangibles
10. A list of intangibles or groups of intangibles that are important for transfer pricing and which entities legally own them
11. A list of important agreements among identified associated enterprises regarding intangibles
12. A description of the transfer pricing policy regarding intangible assets
13. A description of important transfers of intangible assets
14. A description of financing of the corporate group
15. A description of centralized financing, cash management- or asset management functions
16. A general description of the MNE's transfer pricing policies related to financing arrangements between associated enterprises
17. An annual consolidated financial statement of the corporate group
18. A list and brief description of existing unilateral advance pricing agreements (APAs)

Record Keeping

Taxpayers have in general to keep records for ten years (Section 147 General Tax Code). The Administrative Principles on Procedures follow this general rule and require that relevant transfer pricing documents have to be stored in this manner – therefore, transfer pricing documentation has to be stored in electronic or written form in general for ten years. For the use of electronic records, there exists a separate administrative regulation: Grundsätze ordnungsmäßiger DV-gestützter Buchführungssysteme (GoBS) last amended in 2015.

Language for Documentation

In general, documentation must be prepared in German language, but documents in English are accepted by the tax inspector. Taxpayers need to be prepared to provide a translation of the documentation, upon request.

Small and Medium Sized Enterprises (SMEs)

A simplified transfer pricing documentation regime for SMEs was released in 2005, although in practice it is of relatively limited availability. The Administrative Principles on Procedures and the Administrative Principles on APAs contain specific sections for SMEs, which include reliefs regarding the complexity of transfer pricing documentation or reduced fees for an APA request. The German SME definition follows in general the SME definition of the European Union.

Deadline to Prepare Documentation

There is no deadline for preparation of a TP documentation in general. A contemporaneous documentation for extraordinary transactions has to be prepared within 6 months after the end of the fiscal year. The documentation is expected to be readily available within 60 days at the time the tax auditor requests it. The documentation for extraordinary business transactions has to be submitted, when requested by the tax auditor within 30 days. Therefore, it is recommended to prepare it in advance at the time when the transaction takes place. Extraordinary business transactions are of an extraordinary nature, i.e. those that have a substantial impact on the amount of the taxpayer's income. For example, corporate restructurings, material long-term contractual relationships, a shift of functionality, cost contribution arrangements, significant change of business strategy.

Deadline to Submit Documentation

Documentation is generally required to be submitted to the tax auditor within 60 days. The documentation for extraordinary business transactions has to be prepared contemporaneously, and to be submitted, when requested by the tax auditor, within 30 days. Extensions may be granted for special reasons.

Statute of Limitations

Sections 170 following of the General Tax Code regulate the statute of limitation, which is in general four years. In cases of fraudulent intent, the statute of limitations is extended to ten years.

Transfer Pricing Methods

Germany is a member of the OECD and follows the guidelines on transfer pricing in general. The transfer pricing methods specified in the German transfer pricing regulations are the same as in the OECD Guidelines: CUP, resale minus method, cost plus method, TNMM and, in special cases, profit split methods. German tax authorities expect the most appropriate method to be applied, but not more than one method has to be applied to confirm that transfer prices are in line with the arm's length principle. Since 2008 the tax authorities have been making available a hypothetical arm's length test in case no other method is applicable. Taxpayers can apply this test especially for cases treating intangibles.

Comparables

If the tested party is located in Germany, comparables should ideally come from the German market, but Pan-European comparables are accepted. The administrative principles on procedures contain a special section with requirements for database searches.

Detailed information and data on German companies is available from a number of databases such as the Amadeus and other databases.