

INTRODUCTION

Recent years have witnessed a quickening pace of globalisation and a concomitant increase in cross-border business. In addition, competition between globally operating multinational enterprises (MNEs) continues to intensify. Digitalisation is accelerating these developments. We have also experienced an increasing amount of ‘competition’ between the tax administrations of the countries in which the MNEs operate, aimed at securing their ‘fair share’ of the taxable income generated along the value-creation chain. The OECD BEPS initiative and its final report in October 2015 containing measures against base erosion and profit shifting is one key element that needs to be mentioned in this context.

These developments have a tremendous impact on the arm’s length principle as the basic benchmark of globally applied transfer-pricing regulations. This principle governs the allocation of income within an MNE between the involved legal entities (including permanent establishments) in different jurisdictions and hence their tax liabilities in those jurisdictions.

However, what is lacking is one universally applicable set of rules. The OECD’s Transfer Pricing Guidelines, which the great majority of jurisdictions accept, are only guidelines and recommendations. Inevitably, therefore, the interpretation of those guidelines and the extent to which they are reflected in legislation and practice varies from country to country.

For these reasons, at Moore Global we believe it will be useful for you as member firms and your clients to have an overview on recent developments in key countries by means of this Transfer Pricing Brief, of which this is the first issue.

We hope that you may find it valuable for your practice. If you have any queries related to transfer-pricing matters, especially in relation to its key areas such as price setting, functional and risk analysis, benchmark analysis, preparing a Master File, a Country File and potentially even a Country-by-Country-Report, the Moore Global network and its strong Transfer Pricing Expert Group will be pleased to help and provide you with our professional services.

If you have any queries related to the particular issues and countries mentioned in this Brief, please do not hesitate to contact the experts whose names and contact details appear at the foot of each article.

Sven Helm
Global Chair Transfer Pricing
sven.helm@moore-tk.de

GERMANY

GERMANY’S TRANSFER-PRICING DOCUMENTATION RULES

In cases with cross-border transactions within a group of multinational enterprises involving Germany, checking whether the German transfer-pricing documentation provisions are applicable is highly to be recommended.

As a general principle, German tax law requires compliance with the arm’s length principle for transactions between related parties (section 1(1)(1) of the German CFC Rules (*‘ASTG’ – Außensteuergesetz*)).

Germany has also adopted in its CFC rules the OECD Transfer Pricing Guidelines, which are based on the arm’s length principle as a general rule (see also section 1(1) of the German CFC Rules).

Based on this provision and, of course, the general provisions of German corporate tax law, income-tax adjustments are possible. In terms of the general provisions from German income-tax law, the requirements and tax consequences of a so-called hidden profit distribution (section 8(3)(2) of the German Corporate Income Tax Act (*‘KStG’ – Körperschaftsteuergesetz*)) and of a hidden contribution have to be considered (section 8(3)(3) KStG).

The requirements of the hidden-contribution rule on the one hand and of an adjustment under German CFC rules on the other are not the same. A hidden contribution is only possible if there is the contribution of an asset that can be contributed (which is e.g. not the case in terms of the correction of interest expenses). Therefore, the applicability of section 1 of the CFC Rules is broader. In addition, section 1 of the German CFC Rules also contains a definition of business relationships, which is essential when dealing with transfer prices (see section 1(3) and 1(4) of the CFC Rules) and what a so-called related party is (see section 1(2) of the CFC Rules), both of which are of the utmost importance in such a context.

As regards the documentation of intra-group relations, Germany has long had documentation provisions in its tax law – these were introduced in 2003 and 2004. These documentation requirements include, principally, the following (Article 90(3) of the German General Fiscal Code ('AO' – *Abgabenordnung*):

- Taxpayers must prepare documentation regarding the manner and content of their business relationships with related parties (documentation of facts and documentation of the arm's length character of transfer prices)
- The documentation has to comprise all economic and legal information for the determination of an agreement that follows the arm's length principle and other terms of business agreed with related parties
- The taxpayers have to provide their documentation to the tax authorities within 60 days of their request
- In the case of so-called extraordinary transactions, this time limit is reduced to 30 days
- The submission period may be extended in exceptional cases
- Any extraordinary transactions must be documented contemporaneously (article 3(1) of the Profit Allocation Documentation Regulations (*Gewinnabgrenzungsaufzeichnungsverordnung* – *GaufzV* – an Order issued by the German tax authorities under article 90(3) AO), no later than six months into the following fiscal year
- The tax authorities may request transfer-pricing documentation only within the context of a tax field audit – this differs from many other countries, where transfer-pricing documentation must normally be filed together with the annual income tax returns.

The main source in German law for the documentation requirements is found in Article 90 (in conjunction with Article 88) AO:

- Article 90(1) AO contains legal wording on the duties of a taxpayer to cooperate with the tax authorities
- Article 90(2) AO comprises provision on extended duties to cooperate in cross-border cases and transactions
- Article 90(3) AO provides for the duty to prepare transfer-pricing documentation as described above if an MNE in Germany has cross-border dealings with a related party abroad; this provision also contains rules on if and when to file a so-called Master File and a Country File Germany
- Article 138a AO defines the prerequisites for filing a Country-by-Country report.

A failure to comply with the transfer-pricing documentation requirements may expose taxpayers to severe consequences. If the taxpayer does not provide the required documentation, if the submitted documentation is insufficient, or if the documentation for extraordinary transactions was not prepared contemporaneously, the German tax authorities are entitled to assume the taxable income is higher than the income the taxpayer has reported in his tax declarations (see Article 162(1), (2) AO).

One decisive legal instrument that the tax authorities in Germany have in order to make such an income adjustment is that they can use the most disadvantageous point in the arm's length range of profit results when adjusting the taxpayer's taxable income (Article 162(3) AO).

In addition to that, in cases where no documentation has been submitted or where the submitted documentation does not comply with the requirements as stipulated by German tax law, a penalty of 5% to 10% of the income adjustments may be imposed by the tax authorities (Article 162(4) AO).

Article 6(1) and 6(3) *GaufzV* provide for an important exemption from the duty to prepare and maintain up-to-date transfer-pricing documentation. They state that the duty applies only where the MNE has made cross-border supplies of goods to related parties for consideration greater than EUR 6 million or cross-border supplies of services to related parties for consideration greater than EUR 600 000 per annum.

Given this background, transfer-pricing corrections may not only trigger additional taxes but may also lead to significant penalties in cases where the documentation rules have not been complied with.

Another important aspect when preparing transfer-pricing documentation, i.e. a Country File Germany, is to determine and apply the 'right', i.e. acceptable, transfer-pricing method. The view of the German tax authorities in terms of a 'hierarchy' of methods and other requirements is contained in the tax-authority guidelines published in 1983 in a circular letter from the Federal Ministry of Finance (*Schreiben des Bundesfinanzministeriums* (BMF), BStBl. I 1983, S. 513 ff. '*Verwaltungsgrundsätze*').

Dr Sven Helm sven.helm@moore-tk.de