

Germany

LEGISLATION	
Existence of Transfer Pricing Laws/Guidelines	<p>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 a related party and the application of transfer pricing methods. Section 8 Paragraph 3 of the corporate income tax law (“Koerperschaftsteuergesetz”) 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.</p> <p>The most significant regulations are:</p> <ul style="list-style-type: none"> • The <i>administrative principles</i>, published on 23 February 1983; • <i>Principles on cost sharing arrangements</i>, published on 30 December 1999; • <i>Principles on international secondments of employees</i>, published on 9 November 2001; • <i>Administrative principles on procedures</i>, published on 12 April 2005; and • <i>Principles of APAs</i>, published on 5 October 2006. <p>Germany has implemented as part of the tax reform 2008, new legislation for the taxation of transfers of functions outside of Germany. The relocation of functions is taken to lead to a profit realization. The value of a so-called transfer package is determined as the positive difference between the value of the transfer package calculated before and after the transfer of functions. Administrative principles for a more detailed description are still in discussion and are expected to be published in the second half of 2010.</p> <p>Germany is a very active member in the EU Joint Transfer Pricing Forum and supports the Code of conduct of the European Union (published in June 2006) for the application of the Master File concept in transfer pricing documentation.</p>
Transfer Pricing Scrutiny	<p>Transfer pricing issues presently are mostly dealt with as part of routine tax audits. The risk of transfer pricing audits has increased following the introduction of statutory documentation requirements in 2003. The German tax authorities will review transfer pricing as part of a taxpayer’s tax audit or risk review.</p> <p>Areas that receive particular attention are royalties and intangibles, services, companies undergoing supply chain restructuring, shift of functionality, transactions of taxpayers that do not achieve a commercially realistic result, and specific industries such as oil, motor vehicles, pharmaceuticals, distributors, banking and insurance. In general, any multinational with international related party dealings and incurring losses or low profits can expect to be scrutinized by the German tax authorities at some point.</p>
Definition of Related Party	<p>The definition of related parties is established in Section 1 of the Foreign Tax Act. A minimum direct or indirect participation of 25% is required in order to create an affiliate.</p>

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)	<p>The instrument of APA is available for several years but has not been actively promoted by the German tax authorities in the recent years. 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.</p> <p>Section 178a of the General Tax code contains a fee of generally €20,000 for an APA request. Reduced fees for SMEs are possible.</p>
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. Transfer pricing documentation has to be provided to the tax authorities only on request in a tax audit.
Level of Documentation	<p>The German documentation rules oblige taxpayers to document the type, contents and scope 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.</p> <p>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.</p> <p>The taxpayer has to present transfer pricing documentation on request of the tax auditor within 60 days. Extensions may be granted for special reasons.</p>
Record keeping	Taxpayers have in general to keep records for ten years (Section 147 General Tax Code). The <i>Administrative Principles on Procedures</i> 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: <i>Grundsätze Ordnungsgemässer DV-Gestuetzter Buchfuehrungssysteme</i> (GoBS), published on 7 November 1995.
Language for documentation	In general, documentation must be prepared in the German language but normally documents in English are accepted by the tax inspector.
Small and medium sized enterprises (SMEs)	<p>A simplified transfer pricing documentation system for SMEs was released in 2005, although in practice it is of relatively limited availability. The <i>Administrative Principles On Procedures</i> and the <i>Administrative Principles On APAs</i> contain specific sections for SMEs, which include reliefs regarding the complexity of transfer pricing documentation or reduced fees for an APA request.</p> <p>The German SME definition follows in general the SME definition of the European Union:</p>

	<table border="1"> <thead> <tr> <th>Enterprise category</th> <th>Headcount</th> <th>Turnover</th> <th>or</th> <th>Balance sheet total</th> </tr> </thead> <tbody> <tr> <td>medium-sized</td> <td>< 250</td> <td>≤ € 50 million</td> <td></td> <td>≤ € 43 million</td> </tr> <tr> <td>small</td> <td>< 50</td> <td>≤ € 10 million</td> <td></td> <td>≤ € 10 million</td> </tr> <tr> <td>micro</td> <td>< 10</td> <td>≤ € 2 million</td> <td></td> <td>≤ € 2 million</td> </tr> </tbody> </table>	Enterprise category	Headcount	Turnover	or	Balance sheet total	medium-sized	< 250	≤ € 50 million		≤ € 43 million	small	< 50	≤ € 10 million		≤ € 10 million	micro	< 10	≤ € 2 million		≤ € 2 million
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Deadline to Prepare Documentation	There is no deadline for preparation of documentation in general, but contemporaneously documentation for extraordinary transactions is necessary. The documentation is expected to be in existence at the time the tax auditor asks for it, but not necessarily when the tax return is filed.																				
Deadline to Submit Documentation	Documentation is generally only 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.																				
Taxation of Business Restructurings	<p>The Foreign Tax Act explicitly addresses in Section 1 Paragraph 3 business restructurings where business function(s), e.g. production, distribution or procurement, is transferred from Germany to a foreign country as a taxable event. In this case, an exit charge will be applied in determining the taxable income of the transferring German enterprise. The provision also covers the cases where business functions will be reduced in Germany and subsequently carried out elsewhere, e.g. transforming a fully fledged manufacturer to a contract manufacturer.</p> <p>In determining the exit charge, the provision has established a new valuation concept for these transfers of functions whereby a ‘transfer package’, including all business opportunities and risks (profit potential of the transferred function) as well as underlying tangible and intangible property and ‘other advantages’ associated with the operative function will be valued. A complex exit clause for a valuation based on single assets instead of the ‘transfer package’ is in place.</p> <p>In case the actual profit from the business transferred significantly differs from the initial expectation, the new Section 1 (3) Foreign Tax Act includes a reputable presumption that unrelated parties would have included a retroactive adjustment clause due to the uncertainty associated to the transaction. If the parties did not agree on such an adjustment clause and the actual profit development materially deviates from the presumption, the German tax authorities are in this case entitled to carry out a one-off adjustment within the first 10 years from the transaction date. Therefore, to manage the risk, it is recommended that taxpayers include an adjustment clause in the contract of a business transfer transaction.</p> <p>The legislation is effective since 1 January 2008, including all business years starting prior to but ending during 2008. The compliance of this new concept with internationally accepted taxation standards seems nonetheless to be questionable. Administrative guidelines are still in draft and are expected to be finalized till the end of the year 2010.</p>																				
STATUTE OF LIMITATIONS																					
Sections 170 following of the General Tax Code regulate the statute of limitation, which is in general four 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 price, cost plus, profit split, and TNMM under specific circumstances. The 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. Under certain circumstances, profit split may also be acceptable.

The German corporate tax reform 2008 includes significant changes to transfer pricing legislation. The terms "transfer price" and "arm's length standard" have been taken up and defined by Section 1 of the Foreign Tax law. When determining transfer prices at arm's length, the managing directors of the related companies have to comply with the (double) prudent business manager standard. This principle is based on the need for two perspectives to a transaction in order to ensure that the pricing is at arm's length:

1. Perspective of the provider of a service or the good; and
2. Perspective of the recipient of a service or the good.

Transfer prices should ideally be determined by the comparable uncontrolled price method (CUP), if reliable arm's length prices are available. Furthermore, the range of the transfer prices at arm's length has to be narrowed by the application of the inter-quartile method. The first and the fourth quartile have to be excluded. The *Administrative principles on procedures* deliver guidance in Section 3.4.12.5. If the taxpayer's transfer prices are found to be outside of the narrowed range, the adjustment should be to the median.

COMPARABLES

Where the tested party is located in Germany, comparables should ideally be from the German market, but Pan-European comparables are increasingly accepted. The administrative principles on procedures contain special sections 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.

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