

TRANSFER PRICING DOCUMENTATION RULES

German tax auditors increasingly focus on cross border transactions between German companies and other affiliates or permanent establishments. Within the scope of tax audits companies are often asked by the tax auditor to submit the transfer pricing documentation according to section 90 paragraph 3 German Tax Code [Abgabenordnung - "AO"]. From 2017 on taxpayers may be obliged to prepare a three-tiered approach of transfer pricing documentation consisting of Master File and Local File as well as Country-by-Country Reporting.

1. MASTER FILE (OVERVIEW OF THE GROUP'S GLOBAL BUSINESS)

Taxpayers who are part of a multinational group with total (unconsolidated and not limited to intragroup provision of goods and services) revenues of at least **EUR 100 million** in the prior fiscal year are according to amended § 90 paragraph 3 AO obliged for fiscal years that commence after 31 December 2016 to create an overview of the group's global business as well as the system used by the group to determine transfer prices. In its explanatory notes the legislator calls this document "**Master File**". In accordance with the explanatory notes such document shall, in particular, include a presentation of

- ▶ the organizational structure,
- ▶ the group's global business,
- ▶ the overall strategy for the utilization of intangible assets in the value chain and
- ▶ a general description of group financing.

2. LOCAL FILE (COUNTRY-SPECIFIC DOCUMENTATION)

German documentation regulations (like before 2017) apply to companies with cross border transactions, if the sum of the remunerations for the **delivery of goods or commodities** from transactions with related parties in the prior fiscal year exceeded **EUR 5 million** or if the sum of remunerations for **other transactions**, especially services with related parties exceeded EUR 500,000 (for fiscal years beginning after 31 December 2016: **EUR 6 million** or **EUR 600,000** respectively). In connection with the ceilings services provided and received respectively deliveries provided and received have to be added. When examining if the ceilings are exceeded the cross-border transactions of all German group companies and otherwise related German group companies have to be added. These regulations apply accordingly to permanent establishments.

A transfer pricing documentation must include at least the following aspects:

- ▶ general information, e.g. organizational structure, market analysis,
- ▶ description of business relations with affiliates,
- ▶ function and risk analysis and value chain analysis,
- ▶ description of the transfer pricing method employed and its application,
- ▶ transfer pricing analysis on the basis of comparable data (normally database research),
- ▶ information on the point of time of determination of transfer prices,
- ▶ extraordinary transactions.

3. CONSEQUENCES OF MISSING OR INSUFFICIENT DOCUMENTATION (MASTER FILE AND LOCAL FILE)

If upon request by the tax auditor the taxpayer either does not submit a documentation or submits an insufficient documentation according to section 162 paragraph 3 German Tax Code a rebuttable assumption is created that the taxpayer has underreported his taxable income derived from transactions with related parties. As a rule the German tax authorities will **estimate** the taxable income in such a case. The transfer prices of the German entity can be adjusted based on an estimation applying the upper or lower range depending on what is most disadvantageous for the company. The rebuttable assumption **reverses the burden of proof** and the taxpayers have to prove that the transfer prices are arm's length. If the documentation suffices, the burden of proof remains with the tax authorities, unless extraordinary transactions were not prepared within a reasonable short period.

If a taxpayer did not submit a documentation or submitted a documentation that in essence can be regarded as insufficient a **penalty** between a minimum of 5% and a maximum of 10% of the income adjustment must be raised (with a minimum of EUR 5,000) according to section 90 paragraph 3 German Tax Code. As this surcharge only applies to the income adjustment it will also be raised in case that the taxpayer does not have to pay a tax on income as a consequence of loss carried forward.



4. DELAYED DOCUMENTATION (MASTER FILE AND LOCAL FILE)

If adequate transfer pricing documentation is not provided to the tax authorities within **60 days** respectively 30 days regarding extraordinary transactions after request, the penalty amounts to at least **EUR 100** for each full day beyond the deadline but to a maximum of EUR 1 million (see section 162 paragraph 4 German Tax Code).

5. COUNTRY BY COUNTRY REPORT

A domestic company has to prepare a so-called CbCR if it has to prepare consolidated financial statements ("Ultimate Parent Entity") and if its annual **consolidated group revenue equalled or exceeded EUR 750 million** in the prior fiscal year (§ 138a AO). In some circumstances, the responsibility to submit the CbCR can be delegated to a group entity ("**Surrogate Parent Entity**"). In addition, each domestic enterprise ("**Constituent Entity**") that is neither Ultimate Parent Entity nor Surrogate Parent Entity is obliged to file a CbCR if the Federal Central Tax Office [Bundeszentralamt für Steuern – "**BZSt**"] does not receive a CbCR from another group company. If the domestic company is unable to meet this request, it has to inform the BZSt and to provide all information it can possibly obtain. The CbCR has to be prepared for the first time for fiscal years beginning after 31 December 2015 and has to be submitted one year after the end of the fiscal year, i.e. until 31 December 2017, at the latest.

6. VIOLATIONS OF THE COOPERATION OBLIGATIONS ACCORDING TO SECTION 138A AO (CBCR)

If the taxpayer does not meet his reporting obligations in accordance with § 138a AO fully/partly or fails to do so in time (either intentionally or negligently) the taxpayer commits an administrative offence. The penalty amounts to up to EUR 10,000 and can be directed at the enterprise or the (non-) acting persons.

7. EXPERIENCES AND RECOMMENDATIONS FOR ACTIONS

According to our experience the time limit for submitting the documentation of 60 days respectively 30 days in case of extraordinary transactions is not sufficient to prepare a transfer pricing documentation. Especially the preparation of the documentation of facts is very time consuming due to the fact that there are several years between the date of transaction and its documentation. Indeed, in case of missing or insufficient documentation the penalties and the reversal of the burden of proof can often be avoided if the transfer pricing documentation is either submitted subsequently or supplemented. However, this is often not possible within the legal deadline. According to our experience due to late submission of the transfer pricing documentation the tax authorities also assessed penalties to medium sized companies between EUR 50,000 and EUR 100,000 that did not take action and instead decided to "wait and see".

Ignoring the problem until the beginning of the next tax audit is connected with high tax risks. To avoid any tax related disadvantages we highly recommend that all companies with cross border transactions with affiliated companies (parent, subsidiary or sister company) or permanent establishments comply with the documentation requirements. As it cannot be excluded that in other countries the transfer pricing documentation has to be prepared or/ and be submitted earlier and it is advisable to check the deadlines in all countries involved to prepare the transfer pricing documentation contemporaneously.

8. BDO CONTACTS

The **international tax services department** of BDO in Frankfurt am Main would be pleased to support you in planning, documenting and defending the agreed transfer prices.



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