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Please find enclosed the new version of the "Administrative Principles on Transfer Pricing - Principles for the Correction of Income pursuant to Section 1 AStG" together with the annexes.

On behalf of

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Transfer pricing management principles

Principles for the correction of income in accordance with Section 1 AStG

Following discussions with the supreme tax authorities of the federal states, the following principles apply to the international definition of income according to the arm's length principle in the provisions of domestic law and double taxation agreements:

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Chapter I Principles of income correction

A. Regulations on income correction and competition

1.1 In the case of a taxpayer's business relationships with related parties abroad, it must be examined whether the income based on these relationships has been determined in accordance with the arm's length principle. In the case of sole proprietorships and partnerships, the regulations on the

- contribution (Section 4 (1) sentence 8 of the Income Tax Act - EStG) and
- Withdrawal (section 4 (1) sentence 2 et seq. of the EStG)

must be taken into account. In the case of corporations, the regulations on

- hidden profit distribution (Section 8 (3) sentence 2 of the German Corporation Tax Act - KStG) and
- hidden contribution (section 8 (3) sentence 3 et seq. of the KStG).

Irrespective of the legal form of the taxpayer, Section 1 of the Foreign Tax Act (AStG) must also be observed in order to determine the applicable domestic income.

1.2 In the case of permanent establishments, Section 1 (5) AStG and the Ordinance on the Apportionment of Permanent Establishment Profits (BsGaV) must be observed. Accordingly, permanent establishments are largely treated as separate and independent companies for the purposes of the arm's length principle. In this context, reference is made to the administrative principles on the allocation of permanent establishment profits (VWG BsGa) dated December 22, 2016, BStBl 2017 p. 182, and to the BMF letter dated December 17, 2019, BStBl 2020 p. 84 on permanent establishments without a personnel function.

1.3 In principle, the income adjustment provisions are independent of each other and apply in parallel. The wording "without prejudice to other provisions" in Section 1 (1) sentence 1 AStG does not give rise to a right to choose whether to apply Section 1 AStG or another applicable income correction provision. § Section 1 AStG is to be applied in addition (see in particular para. 1.4) or in special cases instead of the other correction standards, insofar as these correction standards do not ensure that the correct domestic profit is recorded. The amount of the applicable domestic profit must be determined in an overall assessment, taking into account corrections and counter-corrections, whereby the effects on income within the meaning of Section 20 (1) no. 1 sentence 2 EStG must be disregarded. If the recognition of the

correct domestic profit is already ensured by the regulations on hidden profit distributions or hidden contributions, there is no need to apply Section 1 AStG. If the correction and counter-correction (consumption of benefits) offset each other in Germany, only Section 1 AStG is applicable and the application of the other correction standards - including at shareholder level - is suspended. Such a case exists if a benefit consumption resulting from a correction in accordance with section 8 para. 3 sentence 2 KStG would in turn have to be taken into account in Germany, as the hidden profit distribution and the resulting benefit consumption neutralize each other in this respect (see BFH of 27 November 2019, I R 40/19 [formerly I R 14/16], BFH/NV 2020 p. 1307).

- 1.4 If, in individual cases, the application of section 1 AStG only results in further legal consequences in terms of amount, the further adjustments must be made in addition to the legal consequences of the other provisions (section 1 (1) sentence 4 AStG).

Example (hidden profit distribution): M-AG (domiciled abroad) supplies goods to its subsidiary, T-AG (domiciled in Germany), at a price of ten million euros. A range of arm's length prices for these goods from five million euros to seven million euros is determined. The fair market value is said to be seven million euros. All goods were resold immediately, so no further intra-balance sheet adjustments are necessary. As part of the regulations on hidden profit distribution, an income adjustment is now made to the fair market value (in this case seven million euros), so that an income adjustment of three million euros must be made at T-AG in accordance with Section 8 (3) sentence 2 KStG. As the value applied by the taxpayer is outside the arm's length range and the taxpayer has not substantiated any other value in accordance with the arm's length principle, a further adjustment is made in accordance with section 1 AStG to the median (section 1 (3a) sentence 4 AStG); in this case, assumed to be six million euros. The further adjustment in accordance with Section 1 AStG therefore amounts to one million euros.

Example (hidden withdrawal): M-AG (domiciled abroad) supplies goods to its subsidiary, T-GmbH & Co. KG (domiciled in Germany), at a price of ten million euros. A range of arm's length prices for these goods from five million euros to seven million euros is determined. The partial value is said to be seven million euros. All goods were resold immediately, so no further intra-balance sheet adjustments are required. As part of the regulations on hidden withdrawals, an income adjustment is now made to the going concern value (in this case seven million euros), so that an income adjustment of three million euros must be made at T-GmbH & Co. KG in accordance with Section 4 (1) sentence 2 EStG. As the value used by the taxpayer is

outside the arm's length range and the taxpayer has not credibly demonstrated any other value in accordance with the arm's length principle, a further adjustment is made in accordance with section 1 AStG to the median (section 1 (3a) sentence 4 AStG); in this case, six million euros as assumed. The further adjustment in accordance with Section 1 AStG therefore amounts to one million euros.

Further examples of application competition on the merits:

Example (benefit of use): M-AG (domiciled in Germany) is the sole shareholder of both T1 GmbH (domiciled in Germany) and T2 s.r.o. with its registered office and place of management in the Czech Republic. T1 GmbH grants T2 s.r.o. an interest-free loan. The appropriate interest rate is ten million euros p.a.

Notwithstanding Article 9 DBA-Czech Republic, the income of T1 GmbH is to be increased off-balance sheet by ten million euros in accordance with Section 8 (3) sentence 2 KStG. As a result of this hidden profit distribution, M-AG receives other remuneration within the meaning of Section 20 (1) no. 1 sentence 2 EStG, Section 8 (1) KStG in the amount of ten million euros, which must generally be recognized as income in the balance sheet. However, as this is offset by a consumption of benefits in the same amount on the expense side, the tax balance sheet does not. The acquisition costs of the investment in T2 s.r.o. do not increase as the asset benefit cannot be contributed. Outside the balance sheet, the income of M-AG must be adjusted by the tax-free payments in accordance with Section 8b (1) sentence 1 KStG and, taking into account the non-deductible operating expenses in accordance with Section 8b (5) KStG, by a total of EUR -9.5 million.

Due to Article 9 of the DTA Czech Republic, the counter-adjustment must be made to T2 s.r.o. as the beneficiary and not to M-AG. In this respect, Section 1 AStG now takes precedence over Section 8 para. 3 sentence 2 KStG, so that there is only an off-balance sheet income adjustment in accordance with Section 1 AStG in the amount of ten million euros at T1 GmbH.

Example (contributable asset): M-AG (domiciled in Germany) is the sole shareholder of both T1 GmbH (domiciled in Germany) and T2 s.r.o. with its registered office and place of management in the Czech Republic (). T1 GmbH transfers an asset to T2 s.r.o. free of charge. The fair market value corresponds to the arm's length price and amounts to ten million euros.

Notwithstanding Article 9 DBA-Czech Republic, the income of T1 GmbH is to be

increased off-balance sheet by ten million euros in accordance with Section 8 (3) sentence 2 KStG. As a result of this hidden profit distribution, M-AG receives other remuneration within the meaning of Section 20 (1) sentence 2 no. 1 EStG, Section 8 (1) KStG in the amount of ten million euros, which must generally be recognized as income in the balance sheet. Outside balance sheet, the income of M-AG must be adjusted by the tax-free payments in accordance with Section 8b (1) sentence 1 KStG and, taking into account the non-deductible operating expenses in accordance with Section 8b (5) KStG, by a total of EUR -9.5 million. As this a contributable asset benefit, there is a hidden contribution and the acquisition costs of the investment in T2 s.r.o. are increased accordingly. The use of the benefit is therefore not to be recognized as an expense at M-AG. T2 s.r.o has a hidden contribution in the amount of ten million euros, which - if its income were taxable in Germany - would have to be deducted when determining income in accordance with Section 8 (3) sentence 3 KStG and added to the tax contribution account in accordance with Section 27 KStG.

On the basis of Article 9 DBA-Czech Republic, the counter-adjustment must be made at T2 s.r.o. as the beneficiary. As this is a hidden contribution, only Section 8 (3) sentence 2 KStG applies. There is therefore no further off-balance sheet income adjustment in accordance with Section 1 AStG.

1.5 The arm's length principle is contained in agreements concluded by Germany to avoid double taxation (DTAs) (in accordance with Article 9 (1) OECD/UN Model Tax Convention [MA]). The articles in the respective DTA that are modeled on Article 9(1) OECD/UN Model Tax Convention thus permit an adjustment of income on the basis of the arm's length principle. The legal basis for the adjustment of income is the regulations on income adjustment under national German tax law. § Section 1 AStG implements the international arm's length principle (see BT-Drucksache VI/2883, 23 ff.). The application of the arm's length principle also relates to the reason and other conditions of a business relationship and not just to the correction of a transfer price (see BFH of February 27, 2019, I R 81/17, BStBl II 2020, p. 443 and BFH of June 9, 2021, I R 32/17, BStBl II 2023, p. 686, para. 26 f.).

1.6 The rules on income adjustment under German national tax law also remain applicable in cases of a linking of interests that are not mentioned in the DTAs. Their application is not blocked by a DTA in this respect either.

B. Competition with add-back taxation

- 1.7 The regulations on income adjustment, with the fundamental exception of § 1 AStG (see BFH of April 20, 1988, I R 41/82, BStBl II 1988 p. 868), also apply to business relationships of intermediate companies within the meaning of § 5 AStG or intermediate companies within the meaning of §§ 7 ff. AStG.

Example: M-AG (domiciled in Germany) holds a 100% interest in T-AG in a low-taxing foreign country. This is an intermediate company within the meaning of §§ 7 ff. AStG; its entire income is to be classified as passive. T-AG has a business relationship with E-AG (domiciled in another foreign country). T-AG grants E-AG a loan in the amount of one million euros at an unreasonably low interest rate (one percent; ten percent would be customary for third parties). No correction was made by the foreign tax authorities. As part of the application of the regulations on add-back taxation, an increase in income of EUR 90,000 is not T-AG, as Section 1 AStG does not apply when determining the income on which the add-back amount is based. The requirements for an income adjustment in accordance with the principles of hidden contributions or hidden profit distributions are also not met. This means that only EUR 10,000 from the loan relationship is added to M-AG's income.

- 1.8 Any resulting double taxation of the same income must be appropriately resolved. For example, when determining the income of the intermediate company that must be added back (Section 10 (3) AStG), a counter-adjustment must be made if necessary (see BFH of March 19, 2002, I R 4/01, BStBl II 2002 p. 644).

Example: M-AG (domiciled in Germany) has a business relationship with its subsidiary (T-AG) abroad. This is an intermediate company within the meaning of §§ 7 ff. AStG; all of its income is to be classified as passive income. If the income of M-AG is reduced due to this business relationship, it must first be corrected in accordance with the arm's length principle.

Variant 1 (transfer for use): M-AG grants a loan of one million euros to T-AG at an unusually low interest rate (one percent; an arm's length rate would be ten percent). The adjustment in accordance with Section 1 AStG leads to an increase in income of EUR 90,000 for M-AG. No offsetting adjustment was made at T-AG abroad. For the purposes of applying the add-back taxation, a notionally corresponding counter-adjustment in the form of an interest deduction is to be made at T-AG in order to avoid double taxation of the income of the intermediate company within the scope of applying the regulations on add-back taxation. The taxes deductible under Section 10

AStG old version or to be credited under Section 12 AStG must be reduced accordingly, even if no counter-adjustment is made abroad.

If the initial adjustment is reversed in subsequent mutual agreement or arbitration proceedings, the notionally corresponding counter-adjustment may to be reversed in this respect and taken into account accordingly in the add-back taxation; is made to Sections 174 and 175a of the German Fiscal Code (AO). If the foreign state makes a counter-adjustment, the creditable taxes must also be adjusted.

Variant 2: M-AG transfers an asset with a partial value of EUR 900,000 to T-AG free of charge. The arm's length price is one million euros. The adjustment in accordance with Section 1 AStG leads to an increase in income of EUR 100,000 for M-AG (EUR 900,000 has already increased the acquisition costs of the investment in T-AG within the balance sheet, as it a hidden contribution of the asset). Abroad, the asset was recognized at T-AG at EUR 900,000 with no effect on income and is depreciated on a straight-line basis over ten years. For the purposes of applying the add-back taxation, a notionally corresponding counter-adjustment in the form of an additional annual depreciation amount of one tenth of EUR 100,000 = EUR 10,000 is to be made at T-AG in order to double taxation of the income of the intermediate company in the context of applying the rules add-back taxation. The taxes deductible under Section 10 AStG old version or to be offset under Section 12 AStG must be reduced accordingly, even if no counter-adjustment is made abroad.

C. Related parties (Section 1 (2) AStG)

- 1.9 An income adjustment in accordance with Section 1 AStG requires that this is based on a business relationship between the taxpayer and a related party (Section 1 (2) AStG). Persons related to the taxpayer in this sense can be natural persons and legal entities as well as partnerships or co-entrepreneurships pursuant to Section 1 (1) sentence 2 half-sentence 2 AStG.
- 1.10 Interdependence through controlling influence (see section 1(2)(2) and (3)(c) AStG) can be based on legal or factual grounds or the interaction of both. Natural persons can also under the controlling influence of others. The interconnectedness is already established by the possibility of exercising a controlling influence.
- 1.11 Direct and indirect shareholdings of a taxpayer are to be added together when assessing whether a close relationship within the meaning of Section 1 (2) AStG exists

(see BFH of June 28, 1978, I R 90/76, BStBl II 1978 p. 590).

Example: A holds a direct interest of 15% in the foreign company T1. In addition, A acquires a further direct interest of 20% in the foreign company T2, which in turn holds a 10% interest in the company T1. A therefore has both a direct and an indirect interest in T1. The shareholding ratio is determined from an economic perspective. This means that the participation ratios of the indirect participations are calculated on a pro rata basis. $10 \text{ percent} \times 20 \text{ percent} / 100 \text{ percent} = \text{two percent}$. A's direct and indirect shareholding in T1 therefore amounts to a total of 17% from an economic perspective.

- 1.12 A controlling influence is not required for the existence of an influence outside the business relationship (see Section 1 (2) no. 4 first alternative AStG). However, the related party or the taxpayer must actually be in a position to exert a general influence on the other outside of the business relationship. There must therefore be a possibility that, due to the influence, there is no sufficient conflict of interests in the structuring of the respective business relationships for the arm's length negotiation of their conditions.
- 1.13 An own interest in the income of another person (see § 1 para. 2 no. 4 second alternative AStG) can be of both an economic and a personal nature (see BFH of January 19, 1994, I R 93/93, BStBl II 1994 p. 725). The interest must relate to the income to be reviewed itself.
- 1.14 All participants in networks and their organizational units can also be assumed to have their own interest in generating the income of others. A network exists if persons work together for a certain period of time in the exercise of their profession to pursue common economic interests (see Section 319b of the German Commercial Code). This means that legally independent companies in a global network, which are characterized in particular by close strategic and professional links within this network, can also be related parties.
- 1.15 can also be assumed in individual cases that pyramidal organizational structures have a vested interest in the income of another party. Pyramidal organizations are characterized, for example, by the fact that the members are subject to a uniform set of rules or statutes and pursue a common goal (e.g. holding a competition). It is generally in the interest of all members that the highest member in the hierarchy or pyramid structure is in a particularly good financial position, as this in turn can have a positive impact on all other members.

D. Business relationship (Section 1 (4) AStG)

1.16 Business relationships are individual or several related economic transactions (business transactions) between a taxpayer and a related party (see Section 1 (4) AStG). This includes, for example, deliveries of goods, services, financing relationships, the transfer or assignment of intangible assets, employee assignments and allocations. An economic view is decisive. It does not matter whether appropriate, inappropriate or no remuneration has been agreed.

1.17 Business relationships with foreign countries between related parties may also exist through domestic or foreign permanent establishments.

Example 1: A domestic company maintains business relationships with a related domestic company that are to be allocated to a foreign permanent establishment of the related company for tax purposes.

Example 2: A foreign company maintains business relationships with a related foreign company that are to be allocated to a domestic permanent establishment of the related company for tax purposes.

Example 3: A foreign company maintains a business relationship with a related foreign company that is to be allocated to a domestic permanent establishment of the foreign company for tax purposes.

Example 4: A domestic company maintains a business relationship with a related domestic company that is allocated to a foreign permanent establishment of the domestic company for tax purposes.

1.18 Business relationships with foreign countries may also exist if there is a business transaction between foreign related parties that affects the amount of domestic income of one of the persons (for example, in the case of leasing domestic real estate).

1.19 Company agreements are not business relationships. A partnership agreement within the meaning of Section 1 (4) AStG is an agreement that leads directly to a legal change in the shareholder position (e.g. the amount of the shareholding or the participation rights), i.e. an agreement that regulates the relationship between the company and the shareholder.

1.20 The formal inclusion of a business transaction or a business relationship in the articles of association does not in itself lead to an agreement in the articles of association that excludes the scope of application of Section 1 AStG, unless the business transaction or

the business relationship leads to an actual change in the material shareholder position. The mere inclusion in the articles of association cannot be sufficient because it would leave the characteristic of the business relationship and thus the facts of § 1 para. 4 AStG to the discretion of the parties involved. Rather, the decisive factor is whether the transaction is based on an agreement in the articles of association that is associated with a change in the material shareholder status, taking into account the company law applicable to the related party (see BFH of April 27, 2000, I R 58/99, BStBl II 2001 p. 168 on the "capital reserve" in foreign commercial and company law).

- 1.21 The transfer of voting rights may constitute a business relationship if it is accompanied by an economic advantage that would be remunerated between unrelated third parties.

Example: A GmbH holds a six percent interest in B Corp., which is domiciled abroad, and a 30 percent interest in C Corp., which is domiciled abroad. C Corp. in turn holds a 24% interest in B Corp. In order to achieve certain tax and economic advantages, C Corp. requires a blocking minority of the voting rights in B Corp. C Corp. could therefore join forces with A GmbH to form a shareholder pool and conclude a voting trust agreement.

- 1.22 As part of the business relationship, terms and conditions are agreed or imposed that are accessible at arm's length. These conditions include, in particular, agreements on prices, contract terms, (re)payment modalities, performance conditions, discounts or bonuses, price adjustment clauses, securities as well as contract amendment and termination options. The reductions in income caused by the lack of arm's length nature of individual conditions are subject to the adjustment order of Section 1 AStG (see BFH of June 9, 2021, I R 32/17, BStBl II 2023 p. 686 para. 34 f.). However, the unusual nature of individual conditions alone does not mean that the business relationship as such is to be classified as unusual. An assessment of all the circumstances in the individual case is required.
- 1.23 These conditions do not include circumstances that cannot be influenced by the related parties. They are to be accepted as given. Their effects on the price must be taken into account. These include, for example, legal framework conditions or the conditions of the respective market.

Chapter II Importance of the OECD Transfer Pricing Guidelines for the audit of cross-border business relationships

- 2.1 Please refer to Appendix 1 for an examination of the deferral of income in order to

ensure an international orientation and alignment with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Only in this way can it be ensured that the arm's length principle is implemented in an internationally uniform manner, thereby avoiding double taxation and (double) non-taxation.

- 2.2 The OECD Transfer Pricing Guidelines support both taxpayers and tax authorities in finding an appropriate solution for each individual case in the international context. Accordingly, the German tax authorities generally follow the OECD Transfer Pricing Guidelines within the framework of applicable domestic law, irrespective of whether a situation arises in which a DTA is applicable that has been agreed with an OECD member state or non-OECD member state, or whether no DTA is applicable.
- 2.3 Whether a static or dynamic interpretation of Article 9(1) OECD-MA or UN-MA articles in the respective DTAs is to be made (generally for a static interpretation of treaty provisions, for example, BFH of July 11, 2018, I R 44/16, BStBl II 2023 p. 430), is not relevant to the decision with regard to the arm's length principle (this assumption is based on BFH of October 17, 2001, I R 103/00, BStBl 2004 II p. 171 and of May 18, 2021, I R 4/17, BStBl II 2023 p. 678 para. 39). It only follows from an article modeled on Article 9 (1) OECD/UN-MA and Section 1 AStG that the arm's length principle must be applied. The arm's length principle is primarily based on the application of economic principles that are dependent on time and context (see Article 9 OECD Model Commentary 2017 para. 1). The arm's length principle therefore contains sufficient flexibility to react to current developments, such as the ongoing digitalization of the economy, and to be able to take these into account without further legal measures. The ongoing development of the OECD Transfer Pricing Guidelines should be understood accordingly. The ongoing revision of the OECD Transfer Pricing Guidelines takes place within the scope of the possible interpretations of Article 9(1) OECD-MA and therefore does not represent a new interpretation of this article in each case.
- 2.4 The following paragraphs contain more detailed specifications compared to the OECD Transfer Pricing Guidelines, which are necessary to ensure uniform taxation.
- 2.5 In addition, the pronouncements of the EU Joint Transfer Pricing Forum (JTPF) can also be helpful for auditing cross-border business relationships, especially if a situation relating to an EU member state is to be assessed.
- 2.6 The United Nations Practical Manual on Transfer Pricing for Developing Countries ()

also contains supportive, practical and helpful, but non-binding guidelines, particularly in relation to developing and emerging countries.

Chapter III Guidelines

A. Arm's length principle

- 3.1 Business relationships between a taxpayer and a related party are to be assessed for tax purposes according to whether the parties involved have behaved or are behaving like independent third parties (arm's length comparison). The standard of care of a prudent and conscientious business manager towards third parties is to be taken as a basis see BFH of March 16, 1967, I 261/63, BStBl III 1967 p. 626; BFH of May 10, 1967, I 187/64, BStBl III 1967 p. 498). A prudent and conscientious manager will derive the arm's length price with due care from the data available or accessible to him. Whether a remuneration is to be paid and, if applicable, the amount of the arm's length price to be applied, is always based on the concept of the double prudent and conscientious manager.
- 3.2 Pursuant to Section 1 (3) sentence 1 AStG, the business relationship between a taxpayer and a related party is determined by the actual circumstances underlying the respective business transaction according to its economic content (see BFH of July 30, 1965, VI 288/63 U, BStBl III 1965 p. 613; of February 26, 1970, I R 42/68, BStBl II 1970 p. 419 and of January 15, 1974, VIII R 63/68, BStBl II 1974 p. 606, i.e. the business relationship actually carried out). 419 and of January 15, 1974, VIII R 63/68, BStBl II 1974 p. 606), i.e. the business relationship actually carried out. The application of the arm's length principle therefore requires a comprehensive clarification of the facts by the taxpayer in order to enable a proper assessment of the individual case.
- 3.3 The arm's length principle as such is to be applied uniformly in inbound and outbound cases.
- 3.4 The taxpayer's membership of a multinational group of companies must be taken into account when examining transfer prices within the framework described below. It is not the profits that the taxpayer would have made if it had been completely independent that are to be determined, but those that it would have made as a company belonging to a group of companies if conditions had been agreed as between independent third parties (see, for example, recitals 3.71 and 3.126 on group retention). In this context, non-dispositive legal circumstances that influence the price between related parties must also be accepted (see recital 1.23). For example, if the

insolvency law of a state stipulates that related parties must always be satisfied subordinatedly, this circumstance must be taken into account appropriately when pricing the transaction (see BFH of May 18, 2021, I R 62/17, BStBl II 2023 p. 723 para. 15).

- 3.5 When carrying out the arm's length comparison, the first step is to carry out a functional and risk analysis of the parties involved in the transaction, Section 1 (3) sentence 2 AStG. The core of this is the risk control approach, according to which risks allocated on the basis of (personnel) functions to control the risks and financial means to assume risks. Control is defined as the ability to decisions, take risks and manage risks, and to exercise these decision-making functions (para. 1.65 of Annex 1).
- 3.6 It is therefore necessary to analyze which parties involved in the business transaction (in particular companies) have the human resources and the actual ability to control risks and the financial means bear risks (para. 1.61 of Annex 1). The prerequisite for this that the decision-makers have the necessary experience and skills and have a sufficient information base (point 1.66 of Appendix 1).
- 3.7 The functions, risks and assets assigned to a company according to this analysis are a measure of the value of the activity within the overall activity of the multinational enterprise group. A value creation analysis can be carried out on the basis of the description of the value creation process of the multinational enterprise group. This is the basis for the function- and risk-adequate allocation of the proportionate profit to the total profit of the multinational enterprise group.
- 3.8 When carrying out the arm's length comparison, the realistically available alternative courses of action must be taken into account. The recognition and observance of the affiliation to a group of companies as well as business policy strategies of the multinational group of companies do not conflict with the arm's length principle.

E. Transfer pricing methods and valuation techniques

- 3.9 The principles Chapter II of Annex 1 are to be applied for the determination and verification of transfer prices. Transfer pricing methods are in particular the
 - a) Price comparison method,
 - b) Resale price method,
 - c) Cost-plus method,
 - d) transaction-based net margin method and

- e) transaction-based profit split method (see also the working paper on the application of the profit split in the EU "The application of the profit split method within the EU, DOC: JTPF/002/2019/EN of the JTPF)" as a practical audit aid.
- 3.10 The methods listed are not exhaustive list. Although the OECD only lists these five methods as transfer pricing methods, a combination of methods may also be appropriate in individual cases.
- 3.11 When using net profit indicators to determine arm's length prices using the transaction-based net margin method, it should be noted that non-operating elements such as interest income and interest expenses, income and expenses from investments, securities and other financial assets as well as income taxes are generally excluded when net profit (para. 2.86 of Appendix 1). In individual cases, certain financing income or expenses may be appropriately taken into account (see point 2.87 of Appendix 1). Mathematical financing components of operating income and expenses (e.g. interest component of additions to pension provisions) may also be included in the calculation of net profit. This requires a precise determination of the facts with regard to the reasons for the financing requirement and the effect on pricing. With regard to the criteria for determining the appropriate reference value for the net profit, please refer to para. 2.92 ff. of Appendix 1.
- 3.12 If no comparative values can be determined for the determination of an arm's length price, the arm's length price is to be determined according to the hypothetical arm's length comparison within the meaning of Section 1 (3) sentence 7 AStG, taking into account Section 1 (1) sentence 3 AStG. This is generally to be assumed,
- a) if intangible assets or rights are the subject of a business transaction,
 - b) if a relocation of functions takes place or
 - c) insofar as no comparative values can be determined for the determination of values when applying the method mentioned in recital 3.9 letter e.
- 3.13 The hypothetical arm's length comparison is based on economically recognized valuation methods. Such recognized methods are, in particular, the income approach and discounted cash flow methods, which are based on the discounted value of projected future income streams or cash flows of the valuation object. In principle, all recognized valuation methods require, among other things, realistic and reliable values with regard to financial forecasts, growth rates, discount rates, useful lives and tax effects.

- 3.14 When examining a valuation method, the purpose of the valuation and, where applicable, the assumptions and valuation parameters in other valuations carried out by the taxpayer for non-tax purposes should be taken into account. In the event of inconsistencies between the assumptions in a valuation carried out for transfer pricing purposes and the assumptions in a valuation carried out for other purposes that are related in time, an explanation should be requested from the taxpayer.
- 3.15 A fair market value determined in accordance with sections 9 and 11 (2) sentence 2 of the German Valuation Act (BewG) for shares in corporations, participations in partnerships or estates can serve as a reference point for the arm's length price. The net asset value pursuant to section 11 (2) sentence 3 BewG is not normally an arm's length price. The simplified income capitalization approach pursuant to §§ 199 ff. BewG is a highly simplified valuation model in which the results of the past serve as an indication of the expected future results. It can be applied, for example, in the case of estimates due to a lack of cooperation on the part of the taxpayer, in the case of considerable difficulties in determining future results at the time of the transaction or implausible forecast calculations within the framework of the arm's length principle.
- 3.16 Please refer to the JTPF report on the use of economic valuation techniques in transfer pricing "Report on the use of economic valuation techniques in transfer pricing (DOC: JTPF/003/2017/FINAL/EN)" and Chapter VI of Annex 1, in particular D.2.6.3 - D.2.6.4.5.
- 3.17 If the minimum price of the supplier determined when applying the hypothetical arm's length comparison is higher than the maximum price of the recipient, it must be examined whether the reason for this is in a further business relationship. If this is not the case, the difference must be allocated between the companies involved in the transaction (para. 28 of the JTPF report on the use of methods for the economic valuation of transfer prices, at the location indicated).

F. Comparability analysis

C.1 Principle

- 3.18 The principles of Chapter III of Annex 1 are to be applied for the comparability test pursuant to Section 1 (3) sentence 3 AStG. Special reference is made to the JTPF report on the use of comparables in the EU "Report on the use of comparables in the EU (DOC: JTPF/007/2016/FINAL/EN)".

3.19 A comparison of business relationships such as those between unrelated third parties on the one hand and between related parties on the other, and a comparison of the results of independent companies with those of the audited company are only meaningful if the circumstances underlying the business relationships have been identified and are comparable. All factors that could have an impact on pricing must be taken into account for the comparability test. This includes

- a) the contractual conditions on which the transaction is based (see paragraphs 1.42 to 1.50 of Appendix 1),
- b) the functions performed by the individual companies involved in the transaction, taking into account the assets used and risks assumed, including the links between these functions and the general value creation of the multinational group of companies to which the parties belong, the circumstances surrounding the transaction and customary industry practices (functional and risk analysis, see para. 1.51 et seq. of Annex 1),
- c) the characteristics of the transferred asset or the services rendered (see paragraphs 1.127 to 1.129 of Annex 1),
- d) the economic circumstances of the parties involved and the market in which they operate (see paras. 1.130 to 1.133 of Annex 1) and
- e) the business strategies pursued by the parties involved (see paragraphs 1.134 to 1.138 of Appendix 1).

These factors in particular must be recorded as part of the record-keeping obligation pursuant to Section 90 (3) AO (see Administrative Principles 2020 of December 3, 2020, BStBl I 2020 p. 1325).

3.20 The proper implementation of the comparability analysis requires

- a) a determination of the years that are recorded;
- b) a careful analysis of the taxpayer's circumstances;
- c) a functional and risk analysis;
- d) an assessment of existing internal comparative values;
- e) a determination of accessible sources of information on external comparative values;
- f) a selection of the most suitable transfer pricing method;
- g) identification potential comparative values;
- h) Determination and implementation of comparability adjustments;

i) interpretation and use of the collected data.

- 3.21 In principle, the principle of sectional taxation applies to the analysis. However, in order to take into account the economic effects of business, product and economic cycles as well as special effects, it may be expedient to carry out multi-year analyses. Averages of comparative values from several previous years may therefore be used if this leads to a better quality of comparative values than the consideration of comparative values from only one financial year (see points e) to i) of recommendation 6 of the JTPF report on the use of comparative values in the EU, at the location indicated).
- 3.22 Comparability is not given if business conditions or circumstances of a business transaction used for comparison, which have a not insignificant effect on the price or profit, differ so significantly that the differences cannot be eliminated by adjustment calculations. This applies in particular if special, particularly valuable intangible assets or rights thereto are the subject of the business relationship or if the relevant functions or risks in the context of business relationships differ significantly. The same applies if the data relevant for assessing the comparability of a business transaction used for comparison is so incomplete, unverifiable or unreliable in terms of its quality that it is not meaningful. In these cases, usable comparative values cannot be determined.

C.2 Summary of business transactions

- 3.23 The comparability analysis must always be carried out for each individual transaction. If individual transactions of a taxpayer are so closely linked or follow each other so closely that an appropriate assessment of each individual transaction is not possible, they should be assessed together using the most appropriate transfer pricing method (para. 3.9 of Appendix 1). This applies in particular in cases
- a) long-term contracts for the supply of goods and services,
 - b) uniform pricing for products that are closely related in terms of type, production or distribution (pallet approach).

If it is the taxpayer's business strategy to bundle certain transactions in order to an appropriate profit from the entirety of the transactions and not necessarily from a specific product within this portfolio (portfolio approach), these transactions must also be analyzed together (paragraphs 2.96 and 3.10 of Appendix 1). However, this does not mean that a uniform transfer pricing method must always be applied for these

business transactions grouped together for one taxpayer. In addition, it is not arm's length if, when applying the portfolio approach at group level, a taxpayer receives remuneration that is below the arm's length level in order to provide advantages to another company in the group (para. 3.10, para. 1.130 of Annex 1).

- 3.24 If several different services are provided as part of a contract as an overall package (package approach, para. 3.11 of Annex 1) and an overall price is agreed for this, the determination of individual prices for the individual services can only be waived if reliable external data is provided for the overall package or a value can be reliably determined on the basis of a hypothetical arm's length comparison.

C.3 Equalization of benefits

- 3.25 Compensation of benefits with disadvantages from business transactions is generally only at arm's length if the taxpayer has agreed disadvantageous conditions in business transactions with the related party with a view to receiving benefits in return from this related party as part of the business relationship in question (points 3.13 to 3.16 of Annex 1).

- 3.26 Benefit-sharing requires that

- a) the transactions are interrelated,
- b) the advantages and disadvantages of the individual business transactions can be quantified and
- c) the offsetting of benefits was consciously agreed or was part of the basis of the disadvantageous transaction.

- 3.27 If a loss or an unreasonably low profit is already incurred for a business transaction when determining the price, this disadvantage is only to be recognized if it is offset by another business transaction with the same contractual partner.

- 3.28 If the disadvantageous conditions have not been compensated for during the financial year in which they had an effect, compensation only prevents the actual income adjustment to be made if it has been determined by the end of this financial year at the latest when and through which advantages the disadvantages will be compensated for. The disadvantages must be offset within a reasonable period of time (para. 3.14 of Annex 1; see also principles in connection with losses Chapter III; C.5). Compensation is also given if the benefit justifying the advantage is capitalized.

C.4 Bandwidth analysis

- 3.29 The application of the arm's length principle regularly leads to a range of comparative values, all of which are more or less equally reliable (paragraphs 3.55 to 3.62 of Annex 1). If it can be determined that some of these values are based on transactions that have a lower degree of comparability than others, these should be excluded, Section 1 (3a) sentence 2 AStG. This is intended to ensure that only values that are most suitable for comparison remain in the range.
- 3.30 If the remaining values themselves do not provide any indication of a specific narrowing and if a number of values remain that allow statistical methods for narrowing the bandwidths to be applied in a meaningful way, the so-called interquartile method must be used to narrow the bandwidth in accordance with section 1(3a) sentence 3 AStG.

C.5 Losses

- 3.31 Independent companies would discontinue loss-making business activities if there is no reasonable, economically sound expectation of being able to generate a reasonable total profit within a reasonable period of time (see BFH of February 17, 1993, I R 3/92, BStBl II 1993 p. 457; BFH of October 17, 2001, I R 103/00, BStBl II 2004 p. 171; BFH of April 6, 2005, I R 22/04, BStBl II 2007 p. 658; para. 3.64 of Annex 1). In contrast, it may make economic sense for a multinational corporate group if a company belonging to the corporate group continues its uneconomic business operations (para. 1.149 of Annex 1). In such cases, this company must be remunerated by the companies benefiting from it. The decisive factor is the annual result before taxes and, if applicable, before profit transfer.
- 3.32 The organization of operational processes is at the discretion of the company. In the event of losses, it is necessary to determine not only the functions actually performed, risks assumed and assets used, but also the causes of the losses (e.g. local mismanagement or market conquest in the interests of the corporate group). If a company has neither the relevant decision-making powers to take or reduce risks nor the financial capacity to assume such risks, it is not usual for risks and the resulting expenses to be allocated to this company for tax purposes.
- 3.33 Independent companies that do not qualify as strategy drivers are therefore generally not permitted to accept a prolonged period of losses (para. 3.64 of Annex 1) without expecting a reasonable total profit within a certain manageable calculation period. If such a

comparable dependent company does not generate an appropriate total profit from a business relationship within five financial years, it must generally be assumed that

- a) the transfer prices are inappropriate,
- b) business transactions were not identified and priced, or
- c) Expenses caused by the interests of other group members are (e.g. brand advertising, representative function in a certain market). In such cases, the amount of an adjustment is based on the reimbursement of expenses plus a profit mark-up and not on any service fees paid to other group members (e.g. licenses, interest, purchase of goods).

Example (initial losses): T GmbH makes losses in the years 01 to 03 after the start of its business activities. In order to show an appropriate total profit over the period of the years 01 to 05, a sufficiently compensating profit is required in the years 04 and 05.

Modification: T-GmbH generates profits from its business activities in years 01 to 10 and losses in years 11 to 13 (e.g. due to the launch of a new product). In order to show an appropriate total profit over the period from years 11 to 15, a sufficiently compensating profit is required in years 14 and 15.

- 3.34 Due to special circumstances, the period may longer (e.g. in the case of business models that require high initial investments at the beginning or in times of difficult market conditions that cannot be influenced by the group of companies) or shorter (e.g. in the case of products with a short life cycle) than five years. If it is still uncertain at the time of the audit whether an appropriate total profit can be achieved, the tax assessments should be carried out provisionally (Section 165 (1) sentence 1 AO).
- 3.35 The examination of whether a company achieves an appropriate (total) profit from the performance of routine functions within a reasonable period of time also includes the question of whether the profit achieved is appropriately high in relation to the functional and risk profile of the company. In principle, the appropriate annual result under commercial law before taxes and, if applicable, profit transfer is decisive, whereby the result of each individual business relationship must be considered if there are several business relationships, unless the requirements of recital 3.23 are met.
- 3.36 The transfer prices applied by the taxpayer can also be adjusted if a sales company is supplied at the same prices as third parties, but the other business conditions differ (e.g. market conditions, sales or cost situation or contractual conditions, such as the obligation to purchase the entire product range).

- 3.37 If a company's losses are offset by capital injections or capital-replacing measures (e.g. debt waiver, letter of comfort) by other group companies, this is an indication that the continuation of the unprofitable business activity is in the (co-)interest of the multinational group.

C.6 Time of the arm's length comparison

- 3.38 The relevant point in time for the arm's length comparison is generally the conclusion of the contract, not the time of performance (see BFH of March 9, 1983, I R 182/78, BStBl II 1983 p. 744), § 1 para. 3 sentence 4 AStG. For this purpose, the taxpayer determine all information available at that time that is necessary to determine the price and only take this into account. The taxpayer may rely on external comparative values that subsequently become known, insofar as these relate to the time at which the transaction was agreed.
- 3.39 When negotiating contracts, a prudent and conscientious manager would also investigate the agreement of any termination and amendment options and, in particular, review agreements with a longer term to determine whether an amendment to the agreement is legally possible and economically advantageous for his company or whether there are other realistically alternative courses of action. In such cases, the arm's length comparison must generally be based on the point in time at which a prudent and conscientious manager would have restructured an existing business relationship or would have entered into a new business relationship on the basis of another realistically available alternative course of action.
- 3.40 Taxpayers can determine transfer prices taking into account internal planning data (e.g. sales figures and revenue, unit sales and production costs, distribution costs and other operating costs) and cautious profit forecasts (budgeting). The use of budgeted calculations is particularly relevant if the respective transfer pricing method does not directly determine arm's length prices, but only appropriate values for certain return ratios (e.g. gross profit margin, cost mark-up rate, operating margin, return on capital or return on assets).
- 3.41 Budget calculations must be based on the experience of previous periods and commercial, economically sound, cautious forecasts (see BFH of February 17, 1993, I R 3/92, BStBl II 1993 p. 457). The actual development of the underlying planning data and return ratios should be compared during the year (target/actual comparison) in

order to be able to react in good time to changes in the course of business. If no target/actual comparison is carried out during the year, a comparison of the budgeted figures with the actual result must be carried out at least at the end of the financial year.

- 3.42 If the actual result is outside the range of normal external results for the respective return ratio, the result must be adjusted retrospectively.
- 3.43 Budgeted calculations should reflect arm's length behavior. As an element of the comparability analysis, the budgeted calculations are intended to help identify the conditions that would arise in price agreements between independent companies. In business transactions between independent companies, each company, even if it only performs routine functions, has the opportunity and the risk achieving better or worse results due to its own business activities within a certain framework. With the transfer prices set and the forecast planning data, a cautious profit forecast should therefore achieve an average value within a range for the respective return ratio.
- 3.44 If subsequent adjustments after the target/actual comparison have been carried out result in a company being favored or disadvantaged (for example, by constantly focusing on the highest or lowest value of a range of appropriate results), such adjustments generally indicate arm's length (contractual) conditions.

D. Administrative approaches to avoid and resolve transfer pricing conflicts

- 3.45 Reference is made to the information sheet on international mutual agreement and arbitration proceedings (dispute settlement proceedings) in the area of taxes on income and wealth dated August 27, 2021 (BStBl I 2021 p. 1495) and the information sheet on coordinated tax audits with tax administrations of other countries and territories dated January 9, 2017 (BStBl I 2017 p. 89).

G. Documentation

- 3.46 Reference is made to the 2020 Administrative Principles of December 3, 2020 (BStBl I 2020 p. 1325) and the Application Decree to the Fiscal Code, in particular to Sections 90, 138a and 162.

H. Intangible assets

F.1

Principle

- 3.47 The principles of Chapter VI of Appendix 1 are to be applied when examining the deferral of income with regard to the transfer or provision of intangible assets between related parties. Intangible assets are assets in accordance with Chapter VI of Appendix 1,
- a) which are neither tangible assets or investments nor financial assets
 - b) which can be the subject of a business transaction without having to be individually transferable, and
 - c) which can give a person a factual or legal position over this asset.
- 3.48 The transfer or assignment for use of an intangible asset must be remunerated if it is based on a business relationship and has a financial impact on the transferee, the user, the transferor or the assignor.
- 3.49 The amount of remuneration can therefore only be assumed if the user can expect an economic advantage from the actual or legal granting of the use, for example the use of a company name, a company or a trademark (see BFH of January 21, 2016, I R 22/14, BStBl II 2017 p. 336 analysis of the advantageousness specifically related to the entrepreneurial activity), regardless of whether this advantage actually occurs (ex-ante consideration). The valuation is then based on the expected benefit. If the expected economic benefit does not materialize, independent third parties would review their agreements (marg. no. 3.39).
- 3.50 The offsetting of usage fees does not comply with the arm's length principle if the transfer of use is in connection with deliveries or services for which the transfer of the intangible asset would be compensated in the price of the delivery or service among third parties. This can be assumed in particular for intangible assets that are only used in connection with sales activities of a company of a multinational group of companies that exclusively and recognizably sells products of the multinational group of companies. A balancing of advantages and disadvantages in the case of separate invoicing of goods and services on the one hand and for such transfers of use on the other is to be recognized.
- 3.51 Remuneration is only paid by a prudent manager up to the amount at which a reasonable operating profit remains for him from the use of the intangible asset.
- 3.52 The differentiation made in paragraphs 6.186 to 6.195 of Annex 1 between intangible

assets that are difficult to value and other intangible assets is irrelevant, as Section 1a AStG standardizes an independent price adjustment clause.

DEMPE functions

F.2
3.53 In principle, the allocation of income from intangible assets is based on the functions and risks assumed and their control and is therefore not based solely on ownership or ownership. Therefore, the value added contributions resulting from the performance so-called DEMPE functions must be taken into account. A separate function and risk analysis is for this descriptive consideration. The decisive factor is which companies perform the relevant (personnel) functions in relation to the development, enhancement, maintenance, protection and exploitation of intangible assets, have the personnel and financial capacity to assume and control the associated risks and the extent to which they use valuable intangible assets (para. 6.32 of Annex 1). This means that the holder or owner of an intangible asset is not necessarily entitled to conclusively collect the income from an intangible asset. If other companies assume DEMPE functions with regard to the intangible asset, they are entitled to an arm's length share of the income generated from the intangible asset (see also BFH of August 9, 2000, I R 12/99, BStBl II 2001 p. 140 on function-oriented remuneration). A specific transfer pricing method is not associated with this. The most suitable transfer pricing method must always be used.

3.54 The general provisions on the attribution of assets and income and on the determination of the tax base (e.g. Sections 39 to 42 AO) remain unaffected by this.

F.3 Use of company logos and trademarks

3.55 The mere use of a company logo within a multinational group of companies without the transfer of trademark rights or other intangible assets is generally not eligible for remuneration. This does not apply if economic benefits arise solely from the use of company logos and third parties can be excluded from this use.

3.56 The use of a trademark right within a multinational group of companies must be remunerated if economic benefits arise from the use of the trademark right and third parties could be excluded from this use under a legal system applicable to a geographical area in the use takes place.

3.57 Even in cases in which the trademark is identical with the company name or is inseparably linked in economic terms, the use of the trademark right may be eligible

for remuneration under the aforementioned conditions.

Example: A-GmbH (domiciled in Germany) grants the group company B-SARL (domiciled in France) a right to use the trademark A so that B-SARL may use it on the French market.

Option 1: Trademark protection for trademark A is only valid in Germany. In principle, the granting of the right of use is not eligible for a fee, as B-SARL could also use the trademark freely on the French market.

Option 2: Trademark protection for trademark A also applies in France. In principle, the granting of the right of use is eligible for a fee, as B-SARL is not permitted to use the trademark freely on the French market. A-GmbH could exclude B-SARL from using the trademark.

Variant 3: Like variant 2, but there is no economic advantage for B-SARL from using brand A on the French market, as the brand is completely unknown in France. B-SARL must first make the brand known through marketing measures. The transfer of use may therefore be eligible for remuneration in principle, but it is not valuable.

- 3.58 When distributing branded products, the use of brands and company logos does not generally have to be remunerated separately, as the economic benefit from this has already been taken into account in the selling price for these products.
- 3.59 The amount of any license fee is generally determined according to the hypothetical arm's length comparison.
- 3.60 The recognition of a claim for damages for any infringement of rights does not generally satisfy the arm's length principle, since
- a) would otherwise ignore the fact that the possibility of use is usually made possible by the beneficiary, and
 - b) otherwise only a one-sided view would be taken and the pricing process would not be reflected.
- 3.61 The principles of license analogy recognized by the Federal Court of Justice (see BGH of 29 July 2009, I ZR 169/07, GRUR 2010, p. 239) can serve as a starting point for the individual case examination to be carried out. Any infringer surcharges must be deducted.

G. Deliveries of goods and services

G.1 Deliveries of goods

- 3.62 If financing services (e.g. non-standard payment terms, customer financing), supplies or ancillary services are agreed in connection with the delivery of goods or merchandise, the arm's length price must take this into account. If separate contracts are concluded for these services, an equalization of benefits may be permissible.
- 3.63 If goods or merchandise have been manufactured using an intangible asset (e.g. an industrial property right, a design right, a copyright, an unprotected invention or other technology-enhancing achievement, a plant variety right, a trade or business secret or a similar right or asset), the acquisition and subsequent use or consumption of the intangible asset by the acquirer does not generally constitute a use of the intangible asset that is capable of and subject to payment.
- 3.63a For transactions that fall under the scope of Chapter 3 of Annex 4, it is not objectionable if the transfer price for these transactions is determined according to the simplified and coordinated approach described in Annex 4. This only applies if the business relationship with a tax jurisdiction within the meaning of Annex 5 with which a double taxation agreement exists and which is not a non-cooperative tax jurisdiction within the meaning of the Tax Havens Defense Act.

G.2 Services

G.2.1 Principle

- 3.64 The principles of Chapter VII of Appendix 1 are to be applied when examining the accrual of income for services between related parties.
- 3.65 A service is only eligible for remuneration (points 7.6 to 7.8 of Annex 1) if
- a) an independent third party service provider would be willing to provide this service for remuneration and an independent third party would be willing to pay remuneration for this service, or
 - b) an independent third party would provide the service in its own company as an in-house service.
- 3.66 The provision of a service constitutes an independent service. Only the costs of the brokerage activity are to be taken into account. The costs of the brokered service are not taken into account.

- 3.67 The services must actually been provided and required. The mere offer in a multinational group of companies is not sufficient. It is not objectionable if, in the event of a fluctuating flow of services, average fees are charged that correspond to the actual purchase over a period of several years.
- 3.68 On-call services can only be remunerated if an independent third party would also have been prepared to pay a fee for the possibility of availability when required (option value). An independent third party would generally not pay remuneration for on-demand services if
- a) the probability that the service will be required is low,
 - b) the benefit of services available on demand is insignificant or
 - c) the services in question could be obtained promptly from other sources and the total remuneration for this would be lower than that for the call-off.
- 3.69 Shareholder expenses are not chargeable. Shareholder expenses are expenses incurred as a result of the activities or services of a company in the multinational enterprise group that caused by the status or obligations of a capital or asset participation, para. 7.9 of Annex 1. In particular, these are activities or services
- a) of the Executive Board or the Supervisory Board or comparable foreign management or supervisory bodies;
 - b) in connection with shareholders' meetings, the issue of shares in the capital and the listing of the shareholder on the stock exchange;
 - c) in connection with the legal organization of the multinational group as such;
 - d) in connection with the protection and management of investments, including management and control activities;
 - e) in connection with the management of the Group.
- 3.70 A service provided by a company in the interest of the shareholder is to be remunerated by the shareholder to the service provider at arm's length.
- 3.71 Benefits that arise from belonging to the multinational group of companies and without active involvement, such as support within the multinational group of companies, are not eligible for remuneration.
- 3.72 The cost-plus method, including all necessary direct and indirect costs, must be used to determine the arm's length prices of services if the application of the price comparison method is not the most suitable method. This also applies in principle to financing services and insurance and reinsurance services.

- 3.73 If services are related to the delivery of goods, they cannot be invoiced separately if they are usually covered by the price of the goods between third parties (e.g. warranty, maintenance or industry-standard goodwill services).

G.2.2 Routine services with low added value

- 3.74 For a chargeable routine service with low added value within a multinational group of companies, the arm's length price is generally to be determined using the cost-plus method. A cost mark-up of five percent can generally be regarded as arm's length if it can be proven that this is actually implemented uniformly within the multinational group of companies (para. 7.61 of Annex 1).
- 3.75 A low value-added routine service (paragraph 7.45 of Appendix 1) is a service performed by one or more members of a multinational enterprise group on behalf of one or more other group members, and
- a) which has a supportive character,
 - b) which is not the object of the main activity of the multinational group of companies in its external relationship with third parties,
 - c) neither unique nor valuable intangible assets are used or created for their provision,
 - d) which is neither associated with the assumption or control of significant risks for the service provider nor results in the creation of significant risks.
- 3.76 Routine services with low added value can therefore be, for example, accounting services (including bookkeeping) or the fulfillment of public law obligations (for example, the preparation of tax returns) as well as human resources tasks (including recruitment) (para. 7.49 of Appendix 1).
- 3.77 The following activities in particular are not routine services with low added value (para. 7.47 of Annex 1):
- a) Research and development,
 - b) Manufacturing and production,
 - c) Sales, marketing and distribution.

G.2.3 Group allocations

- 3.78 In the case of group allocations, the general principles on services set out in this

chapter apply. If a company in a multinational group of companies performs central management and administrative tasks for other companies within the group, the allocation of the direct and overhead costs incurred in this context (e.g. general group administration, central financial management) to the companies receiving the services can be recognized on the basis of an appropriate allocation key (indirect accounting, group allocation) if a direct allocation to the companies involved would only have been possible with disproportionate effort (para. 7.24 of Appendix 1). Depending on the respective task, an appropriate allocation key can be, for example, the turnover, the number of employees or the number of computer workstations (para. 7.25 of Annex 1). In order to enable the tax authorities to assess the appropriateness of the group allocation and the allocation formula, the taxpayer must, in particular, explain the scope of the services actually provided in the interests of the respective recipient and the appropriateness of the transfer prices charged to the taxpayer or by the taxpayer for these services as part of its duty to cooperate.

- 3.79 The calculation must be based on actual costs. If a calculation initially made on the basis of planned costs, a comparison with the actual costs and a corresponding allocation must be made by the end of the year at the latest.

G.3 Employee postings

- 3.80 Reference is made to the BMF letter on the "Tax treatment of wages double taxation agreements" dated December 12, 2023 (BStBl I 2023 p. 2179). The arm's length principle must also be observed for employee assignments.

I. Cost allocations

- 3.81 The principles set out in Chapter VIII of Annex 1 are to be applied when examining the deferral of income through apportionment agreements between related parties.

- 3.82 Where several companies in a multinational group work together in the common interest, jointly assume risks and make contributions,

- a) to jointly develop assets (development cost allocation) or
- b) to make use of services (service cost allocation),

the contributions are to be valued at arm's length prices and remunerated by the companies on the basis of the benefits to be expected in each case (points 8.12 and

- 8.13 of Annex 1). Chapter I of Annex 1 must therefore also be applied to the valuation of the respective contributions (point 8.4 of Annex 1). Purely cost-based valuations of the contributions are generally not customary for third parties.
- 3.83 Special reference is made to the possible exceptions to this described in paragraphs 8.27 and 8.28 of Annex 1. The requirements for this may be met in particular if
- a) the cost-value difference is marginal (e.g. in the provision of services with low added value),
 - b) the administrative effort would be considerable, or
 - c) the values of the contributions correspond in terms of amount and are therefore balanced.
- 3.84 Only those can be recognized as participants in a development cost allocation who
- a) has a reasonable expectation of obtaining a benefit from the development cost allocation (para. 8.14 of Annex 1), and
 - b) has the ability to control the risks associated with such a development cost allocation (paragraph 8.15 of Appendix 1).
- 3.85 If companies terminate the development cost allocation, they are each entitled to an arm's length share of the results of the activity (paragraph 8.49 of Appendix 1). This applies accordingly if a company withdraws from the development cost allocation (paragraph 8.46 of Appendix 1). If a company participates in an existing development cost allocation, it must pay an arm's length fee to the other participants in the development cost allocation for its participation in the assets developed to date (paragraph 8.44 of Annex 1). It may also be in line with the arm's length principle to compensate for significant changes in the allocation of benefits according to the same principle.
- 3.86 The apportionment agreements should be regularly reviewed for any necessary adjustments to the apportionment key (para. 8.22 of Annex 1).

J. Relocation of functions

I.1 Principles

- 3.87 In addition, the principles of Chapters I, VI and in particular IX of Annex 1 in accordance with Section 1 (3) sentence 7 and (3b), Section 1a AStG and the provisions of the Functional Relocation Ordinance (FVerlV) are to be applied when examining the delimitation of income with regard to a functional relocation.

I.2 Definition of the function

- 3.88 Functions within the meaning of Section 1 (1) FVerlV are an expression of the division of tasks within a company. A function is an organic part of a company if it represents a purpose-oriented, definable activity using certain assets, intangible assets or other benefits to generate profit contributions, either for the transferring or the acquiring company. It is sufficient that the sub-tasks in question show an internal economic and organizational connection and therefore specific cash flows or properly definable profit effects can be determined for the business activity in question in the event of the transfer for the companies involved. This also applies to business activities within a group of companies.
- 3.89 The following functions, for example, may be considered: business activities of management, research and development, material procurement, warehousing, production, packaging, distribution, assembly, processing or finishing of products, quality control, financing, transport, organization, administration, marketing or customer service. The exercise of risk control and DEMPE functions (see para. 3.53 above) also constitute functions within the meaning of Section 1 (3b) AStG.
- 3.90 order to clearly differentiate a function from other business activities, it is necessary to define the function in question in relocation cases on the basis of the assets used and, in particular, the intangible assets and other benefits and the specific opportunities and risks associated with the particular business activity in relation to the activity and object. This understanding underlies Section 1 (2) sentence 1 FVerlV for the transfer of functions and Sections 2 and 3 (1) FVerlV for their valuation. In this respect, a function can be, for example, the production of a specific product or a specific product group, the distribution of a specific product, a specific product group or a specific business activity for a specific region.

I.3 Relocation of a function

- 3.91 The transfer of functions a restriction of functions or even the discontinuation of functions at the transferring company. This also includes the transfer of functions and risks from a company with a high function and risk profile to a company with a low function and risk profile. Reference is made to Chapter IX Section B.1.1. of Annex 1. Typical examples are in particular

- Conversion of an in-house producer to a contract manufacturer
 - Conversion of a proprietary trader to a commission agent
 - Conversion of an in-house researcher/developer to a contract researcher/developer
- 3.92 The results of the functional and risk analyses before and after the restructuring and the resulting changes (Chapter IX Section B of Annex 1) are decisive for the assessment of a relocation of functions.
- 3.93 The assessment of whether the acquiring company can perform a function does not depend on whether the acquiring company also performs the function in the same way as the transferring company. According to Section 1 (2) FVerlV, a transfer of functions also exists if the acquiring company has already performed a comparable function before and can expand this function by taking over the function from the transferring company.

Example: The company (X) based in Germany produces and distributes a product in the variants A, B and C for the domestic market and for foreign markets, including the foreign country Y. The worldwide distribution of all of X's products is carried out by its sales department. Company Y, a subsidiary of X, produces and distributes X's product in country Y in the local variants D and E. In addition, Y also distributes the variants A, B and C, which it purchases from X, in the local market. X discontinues its own distribution of variant A to state Y in financial year 01. This will be organized by Y in the future. In financial year 03, Y also takes over the production of variant A for the local market Y. Both the relocation of the distribution of variant A in state Y in the 01 financial year and the relocation of the production of variant A in the 03 financial year constitute a relocation of functions. It does not matter that Y has already performed comparable functions before. It is also irrelevant whether Y performs the transferred production function with its own machinery, production know-how, etc. or whether such assets are included in the transfer package. If such assets were transferred with the production function, they would belong to the function as a whole within the meaning of Section 1 (3b) sentence 1 AStG, i.e. to the transfer package.

- 3.94 If personnel of the transferring company work for the acquiring company in direct economic connection with a transfer of functions, it generally be assumed that they are providing services on behalf of the transferring company. Such services and the associated benefits for the acquiring company are part of the transfer package. The benefits may include, for example Knowledge of product or process know-how, knowledge of research projects, knowledge of the business organization, personal network relationships with other group companies, market or industry knowledge or

person-related assignments in the consulting business.

- 3.95 The secondment of personnel within the group does not generally constitute a transfer of functions as such. However, a transfer of functions can occur in cases of personnel secondment if, for example, the seconded personnel take their previous area of responsibility from the seconding company with them and carry out the same activity in the receiving company. This usually leads to a restriction of the posting company's business activities, assets and benefits are transferred or ceded for use or opportunities and risks are transferred. In such cases, the regulations on the transfer of functions apply with priority.
- 3.96 The process of a transfer of functions may extend over several financial years. According to Section 1 (2) sentence 3 FVerlV, business transactions that are carried out within five financial years and economically part of a single relocation transaction are to be combined. If it is subsequently determined that a transfer of functions has taken place, it is deemed to have taken place at the point in time at which the conditions of the facts are economically fulfilled by their joint realization, i.e. the facts have been completed. The assumption of a uniform transfer of functions extending over several assessment periods is based on objective criteria, not on the intention of the companies involved.

Example: Domestic company P is a manufacturer of certain components. In November 01, the management decides to set up a new local production site for the Asian market for a certain product range that was previously produced exclusively in Germany. The intention is to transfer the necessary intangible assets to the new foreign subsidiary T for use. In January 02, various external third parties are commissioned to draw up the basis for decisions on the choice of location. In December 02, the construction contract for T's new plant is awarded. Production is started by T in February 04, at the same time P ceases production in Germany. As the relocation of functions over several financial years, a summarized view is necessary. This already results from the planning of P. Insofar as individual business transactions do not constitute a transfer of functions when considered separately, the economic link leads to a uniform transfer of functions, which was realized in the financial year 04.

- 3.97 In cases of transfers of functions, intangible assets are material within the meaning of Section 1 (3) FVerlV if they are necessary for the transferred function (qualitative criterion) and their arm's length price amounts to more than 25 percent of the sum of the individual prices of all assets in the transfer package (quantitative criterion). In

order to determine whether the quantitative standard is met, the components of the transfer package (including, where applicable, the goodwill-forming factors) must be taken into account irrespective of their recognition as assets. If another benefit is part of the transfer package, the application of Section 1 (3b) sentence 2 AStG is not considered.

3.98 If an acquiring company also provides the routine services previously provided exclusively to the transferring company to other companies in the future as an independent contractual partner, in whole or in part, a distinction must be made between two cases:

- The acquiring company does not use any intangible assets or other benefits provided by the transferring company for its services. This is indicated by the fact that the remuneration paid by external third parties corresponds to what was previously paid by the transferring company for the services rendered. The regulations on the transfer of functions do not apply.
- The acquiring company achieves prices vis-à-vis the other companies that are higher than the remuneration previously paid by the transferring company for the services rendered, or the prices would have to be set higher in accordance with the arm's length principle (section 1(4) FVerlV). At the time of the first provision of services to the other companies, a charge must be made for assets and other benefits previously free of charge by the transferring company for the provision of services with regard to sales to these companies. The relevant assets and other benefits are deemed to be a transfer package if the conditions for this are met in the individual case, for example if a former contract manufacturer becomes an in-house manufacturer.

3.99 If, within five years of the acquiring company taking up a function, no corresponding restriction can be identified at the transferring company, there is no transfer of functions, but rather a duplication of functions within the meaning of Section 1 (5) sentence 1 FVerlV. A duplication of functions exists, for example, if the previous production and sales activities of the domestic company continue unchanged despite the commencement of production abroad. A transfer of functions, on the other hand, occurs if the distribution function is newly taken up abroad and the distribution function of the transferring company is restricted as a result (indicator: turnover), for example because the acquiring company supplies previous customers of the transferring company. The question of whether a function is discontinued or restricted

relates to the turnover achieved with the specific function and also includes cases where one function is substituted by another. According to Section 1 (5) sentence 2 FVerlV, there is no transfer of functions if the restriction is not directly economically related to the duplication of functions. This is the case, for example, if the restriction is due to force majeure (such as a fire in a production facility).

Example a (discontinuation of function without substitution): A product A, which was previously manufactured and sold exclusively by the domestic group parent company (M), will in future only be manufactured and sold by its foreign subsidiary (T). The tangible and intangible assets are to T. The manufacture and distribution of product A constitute functions. M ceases to perform these functions as part of the transaction.

Example b (discontinuation of function with substitution): Like example a, but the parent company (M) produces and sells the successor product B developed by it in the future, which is essentially based on other intangible assets. It generates a higher turnover with this product than with the predecessor product A with the same number of employees. A discontinuation of functions exists because the specific functions "production and distribution of product A" in Germany no longer exist. M no longer generates revenue from these functions. The production of product A and the production of product B are different functions, as essentially different intangible assets are used. It is irrelevant that M does not reduce its workforce and even generates a higher turnover with product B.

Example c (functional restriction): As in example a, but product A will in future be manufactured independently by both M in Germany and T abroad and sold by both M and T to M's existing customers. For M, this leads to a decline in production and a corresponding loss of sales. In this respect, there is a restriction of functions, as the exercise of the functions of production and distribution of product A by M is reduced as a result of the transaction.

- 3.100 For all assets, intangible assets or other benefits transferred or provided for use for the purpose of duplicating functions and for all services provided in this context, appropriate transfer prices must be recognized in application of the arm's length principle.

I.4 Transfer package and valuation

- 3.101 In principle, it will not be possible to determine unrestricted or limited comparable arm's length values for a transfer package. For this reason, the hypothetical arm's length comparison pursuant to Section 1 (3) sentence 7 AStG will generally have to be applied in cases of transfers of functions. When determining the transfer price in these cases, the expected future financial benefit from the transfer package, which results from a business valuation based on a net present value method that is recognized as a valuation standard and is also customary in ordinary business transactions for non-tax purposes, is decisive.
- 3.102 In a hypothetical arm's length comparison, elements of actual external behavior may have to be taken into account. This applies, for example, if an internal calculation scheme is used in comparable situations by taxpayers both vis-à-vis related companies and vis-à-vis unrelated third parties for transfers of functions (or for the transfer of use of assets, intangible assets or other benefits), such as a license system based on the licensee's expected income that complies with business principles. However, this does not mean that license rates can be derived from databases in a hypothetical arm's length comparison.
- 3.103 The taxes to be taken into account when determining the financial surpluses are the taxes on the income of the respective company that are expected to be assessed or actually assessed and paid and reduced by any existing entitlement to a reduction. The nominal tax rate is not relevant. Personal income taxes of the shareholders are not taken into account for corporations. In the case of partnerships, it is generally not possible to dispense with the consideration of personal income taxes. However, as a rule of thumb, the taxes to be recognized can be set at the amount of the income taxes that would have been incurred corporations had been involved in the transfer of functions instead of partnerships. A (possibly fictitious) tax burden on profit distributions is not to be taken into account.

I.5 Components of the transfer package

- 3.104 In the context of a transfer of functions, there will often be separate contracts for the transfer of assets (sale), for the transfer of use of assets (e.g. rent, licensing) and for the provision of services (e.g. personnel leasing) or these must be assumed in accordance with the arm's length principle (Section 1 (4) sentence 2 AStG). If the value of the transfer package pursuant to Section 2 FVerlV (value of the transfer package as a whole) exceeds the sum of the individual transfer prices, a correction must be made to

the value of the transfer package pursuant to Section 1 AStG.

- 3.105 In the cases specified in Section 3 (2) FVerlV, the transfer prices for the last realized transactions are to be applied in accordance with the arm's length principle so that, together with the first realized transactions, they correspond in total to the value of the transfer package (Section 2 FVerlV). In this way, changes to the transfer prices for the transactions realized first and thus international double taxation conflicts can be avoided.

I.6 Capitalization interest rate and capitalization period (Sections 4 and 5 FVerlV)

- 3.106 The appropriate capitalization rate represents the return on an alternative investment that is equivalent to the valuation object in terms of maturity, risk and taxation. Depending on the specific valuation method chosen, the return on equity or the return on equity and debt capital must be taken into account. The risk premium method is to determine the capitalization rate. Under this method, the capitalization interest rate is divided into its prime rate and risk premium components. The risk premium is calculated as the product of the market risk premium and the beta factor. For the period of a perpetual annuity, a growth discount must be taken into account in the capitalization interest rate.
- 3.107 In cases where functions are being eliminated, the contractual relationships of the routine functions remaining in Germany are regularly renegotiated. The contracts concluded in this respect often contain termination clauses with or without entitlement to compensation in the event of termination in accordance with the contract. These provisions must be examined from an arm's length perspective in accordance with Chapter IX Section F of Annex 1.
- 3.108 In cases in which an arm's length termination clause has been agreed, the valuation of the routine function must be based on expected values by way of a scenario analysis, which take into account both the financial surpluses if the function is continued and the financial surpluses in the event of termination of the routine contract (e.g. closure costs or compensation payments) in the amount of their respective probability of occurrence.
- 3.109 If the acquiring company's own expenses for the maintenance or replacement of intangible assets have been taken into account when determining the expectation of

financial surpluses, this indicates a longer period of use and therefore capitalization of the function. Irrespective of whether such expenses have been taken into account in the expectations of financial surpluses, it may be appropriate to assume declining expectations for material intangible assets within the useful life. If the expectations of the financial surpluses of the acquiring company do not include any expenses for the maintenance or replacement of intangible assets, this does not necessarily lead to a short capitalization period.

- 3.110 For reasons of simplification, a uniform capitalization period can be assumed for both the transferring and the acquiring company.

I.7 Determination of the agreement area

- 3.111 Examples for determining the scope of agreement are shown in Appendix 3.
- 3.112 For the transferring company, the results achieved from the function in the past can provide initial indications of the financial surpluses that will be lost (historical analysis). For the minimum price of the transferring company, it may also be relevant whether it was in a position at the time of the transfer of the function, for factual or legal reasons, to carry out the function in question without restriction in the future.
- 3.113 In cases of losses, the lower limit of the relocating company's agreement range is determined by the expected losses and the closure costs. An independent company would also be faced with the alternative of either continuing the function with ongoing losses or discontinuing it and accepting the closure costs.

Example 1: The present value of the results from the relocated function is EUR -0.5 million, the closure costs amount to EUR 1.5 million. If the closure costs (-1.5 million euros) exceed the expected losses (-0.5 million euros), an independent company will demand at least the excess amount (1 million euros) as consideration for the transfer of the function, as it will incur additional costs as a result of the transfer of the function. The minimum price is EUR 1 million.

Example 2: The present value of the results from the relocated function is -2.5 million euros, the closure costs are 1.5 million euros. If the closure costs (-1.5 million euros) are lower than the expected losses (-2.5 million euros), it may make economic sense for an independent company to discontinue this function. The relocation of the function therefore does not result in any economic disadvantages for the relocating company. The minimum price should be set at 0. An independent company would nevertheless try to reduce its costs with the help of the achievable proceeds for the

function. An external acquirer may well be prepared to pay a fee for the transfer package if it can make a profit from taking over the function.

Example 3: The present value of the results from the relocated function is -2.5 million euros, the closure costs due to the relocation amount to 1.25 million euros. If the function had not been relocated, closure costs of 1.75 million would have been incurred. Insofar as the relocation of the function avoids closure costs or expected ongoing losses from this function for the relocating company (here: lower closure costs of EUR 0.5 million), this must be taken into account when determining the minimum price. The minimum price is therefore -0.5 million euros.

Example 4: The present value of the results from the relocated function is -1.5 million euros, the closure costs due to the relocation are 1.25 million euros. Without the relocation, the closure costs would have amounted to 3 million euros. Relocation (-1.25 million euros) is the more favorable alternative to continuing the loss-making function (-1.5 million euros). Closure without relocation (-3 million euros) would not be a serious option. The minimum price should be set at -0.25 million euros in the amount of the savings.

- 3.114 When calculating the minimum price of the relocating company, the expected tax burden with regard to the relocation of the function must also be taken into account (tax surcharge, tax gross-up/exit tax, see para. 9.56 in conjunction with para. 6.178 of Annex 1).
- 3.115 In cases of substitution of a technically or economically obsolete product, it is not objectionable if a minimum price of zero is assumed for the transferring company under the following cumulative conditions:
- The product is no longer being sold in the main markets supplied to date due to a successor product.
 - The relocation was necessary in order to be able to start production of a direct successor product with higher profit expectations in Germany.
 - The intangible assets required for the relocated production, including process know-how, are not sold but licensed.
- 3.116 A case in which the transferring company is no longer in a position to perform the function with its own resources within the meaning of Section 6 (2) FVerlV may arise, for example, if a customer urgently requires the transfer or if direct supply by the transferring company is no longer reasonable in the future due to the geographical

distance to the market. The liquidation value within the meaning of Section 6 (2) FVerlV is the difference between the liquidation proceeds of the transferred assets and intangible assets less the associated debts to be repaid and the closure costs. The liquidation value can also be negative.

- 3.117 When calculating the maximum price of the acquiring company, the tax effects of the takeover of the transferred function must also be taken into account (e.g. depreciation on acquired assets, tax amortization benefit, para. 9.56 in conjunction with para. 6.178 of Annex 1).
- 3.118 If there is a negative agreement range, the reasons for this may lie in incorrect assumptions in the valuation model. Reference is also made to note 3.17.

I.8 Claims for damages, compensation and indemnification

- 3.119 Reference is made to para. 9.79 of Annex 1. Claims for damages, compensation and indemnification are for example:

- statutory compensation claims of the commercial representative, commission agent, agent or authorized dealer from Section 89b HGB or from its analogous application,
- contractually agreed compensation, for example for unamortized investments made by an authorized dealer at the instigation of the manufacturer,
- contractually agreed compensation, for example for lost profits and for closure costs incurred (e.g. ongoing rent) in the event of premature termination of the contract,
- Claims based on a breach of a non-competition clause.

In addition, claims arising from a contractual or actual exclusion of existing alternative courses of action for one of the companies involved - such as between independent third parties - are also conceivable. In these cases, a two-sided consideration is necessary (para. 9.116 of Annex 1).

I.9 Application to permanent establishment cases (Section 8 FVerlV)

- 3.120 The rules on the transfer of functions also apply to transfers of functions between a permanent establishment and the rest of the company or between permanent establishments of a company. Reference is made to the OECD Permanent Establishment Report 2010. The VWG BsGa (BMF letter dated December 22, 2016,

BStBl I 2017 p. 182) remain unaffected.

J. Financing relationships

J.1 General

- 3.121 The principles of Chapter X of Annex 1 are to be applied in accordance with Section 1 (3d) and Section 1 (3e) AStG when examining the deferral of income in the case of financing relationships between related parties.
- 3.122 As with other intra-group business relationships, the proper delineation of transactions in connection with financing activities must be based on a functional and risk analysis.

J.2 Financing relationship on the merits (section 1 (3d) sentence 1 no. 1 AStG)

- 3.123 The following explanations relate to the correction of non-arm's length expenses for financing with borrowed capital. Whether and to what extent a relevant financing relationship exists must be examined in the light of the respective circumstances in relation to the actual transaction (paragraphs 10.4, 10.6, 10.8 and 10.11 of Appendix 1).
- 3.124 The key criteria are the credible expectation that the debtor will be able to service the debt (in particular in the form of interest and repayments) and the serious agreement to provide capital for a certain period of time (Section 1 (3d) sentence 1 number 1 letter a) AStG). In particular, it must therefore be determined whether sufficient assets or cash flows can be expected from the outset to satisfy the lender; i.e. the assets acquired with the capital provided or other assets of the debtor can be included in the consideration. The transfer of the capital is not unusual for third parties simply because follow-up financing becomes necessary. This must be assessed in the overall view of the circumstances. Further indicators are the existence of a fixed repayment date (see also BFH of 6.11.2003 IV R 10/01, BStBl II 2004 p. 416 and BFH of 17.12.2014 I R 23/13, para. 26, BStBl II 2016 p. 261), the obligation and the modalities for the payment of interest, the right to enforce the payment of capital and interest as well as the ability of the recipient of the financial resources to take out loans under comparable conditions from independent third parties (para. 10.12 of Annex 1).
- 3.125 This does not rule out the possibility that particularly risky financing relationships, such as those that are customary in the market for start-up financing, may be at arm's length. For example, financing is provided in the early stages of companies when their

risks, but also their growth opportunities, are particularly high.

- 3.126 The financing must also have been economically necessary (Section 1 (3d) sentence 1 number 1 letter b) AStG). This is particularly the case if the financing is necessary for the operation or maintenance of the business activity. This may, for example, involve the financing of operating resources or investments in equipment. A prudent and conscientious manager will not borrow capital on the market if there is not at least a reasonable prospect of a return that covers the financing costs. In principle, an after-tax approach must be assumed, unless the analysis is carried out uniformly in the group of companies on the basis of pre-tax figures. A prudent and conscientious manager would also analyze what realistic alternative courses of action are available to the borrower.
- 3.127 The use borrowed capital must also be in line with the purpose of the company. A prudent and conscientious manager will endeavor to use the capital for the purpose of the company. An investment in an overnight money account or a deposit in an internal cash pool, especially if no higher return is expected, is generally not compatible with the company's core business. However, this does not preclude the holding of liquidity reserves or capital buffers that are customary for third parties. Borrowing for the purpose of a profit distribution does not generally contradict the purpose of the company within the framework of the distributing company's normal distribution policy.
- 3.128 The economic need and the use of the capital are regularly interrelated. For example, if a company raises capital from a related party in order to finance an acquisition, it will generally be customary for third parties to plan with a capital buffer and invest this in the short term, for example in the Group's internal cash pool. Depending on the functional and risk profile, it may also be customary to raise capital to meet regulatory requirements or to be able to make planned investments.
- 3.129 The taxpayer must fulfill the cumulative requirements set out in section 1 (3d) sentence 1 no. 1 AStG. To establish credibility, the specific circumstances must be substantiated and presented in a conclusive manner. It is therefore sufficient that it is more likely than not that the criteria are met. The taxpayer must therefore demonstrate whether and how the debt service can be provided.

The rating used to determine the interest rate at the time the financing relationship was concluded can be used as evidence, provided the rating classification investment grade. In

the case of short-term capital transfers, in particular from a cash pool, it can regularly be assumed that the debt service has been provided. In addition, the taxpayer must show what purpose it is pursuing with the capital provided and how the capital will be used. For example, forecast or investment calculations, which can also include follow-up financing, can be for this purpose.

3.130 If the taxpayer cannot credibly that the requirements are met, the financing relationship does not comply with the arm's length principle in accordance with section 1(3d) sentence 1 no. 1 AStG. According to Section 1 (1) AStG, the reduction in income caused by the financing relationship must be reversed in the amount of the non-arm's length portion; this also includes subsequent costs such as commitment interest, prepayment penalties and other ancillary loan costs (see para. 10.13 of Annex 1).

3.131 § Section 41 AO remains unaffected.

J.3 Arm's length interest rate (section 1 (3d) sentence 1 no. 2 AStG)

3.132 determining the remuneration for a capital transfer (interest rate), the specific debtor risk of the borrower (creditworthiness) in particular must be taken into account in addition to other factors such as the purpose of the loan, regulatory framework conditions, term, currency risks, ESG risks (, social, governance), loan volume or collateralization (see also points 10.88-10.108 of Annex 1). Only if the overall view results in an arm's length interest rate that is outside the range of arm's length interest rates (cf. Section 1 (3a) AStG), and the income is thereby reduced in an arm's length manner, is a correction to be made in this respect.

3.133 In accordance with section 1 (3d) sentence 1 no. 2 AStG, the creditworthiness of the corporate group is generally decisive, unless the creditworthiness of the borrower in question is better. The creditworthiness of the corporate group reflects the (credit default) risk that exists in a corporate group and that a market player assumes when providing capital to one or more companies in a corporate group. In principle, the interest rate to be determined is therefore based on the creditworthiness of the entire group of companies.

3.134 The rating of the group of companies should also be synonymous with the rating of the group. In cases where the scope of the companies to be included in a group of companies differs from that of a group, attention must be paid to how rating agencies deal with such a situation; reference is made to margin no. 3.136 .

- 3.135 If the group of companies has a rating in accordance with Article 2(1) of Regulation (EC) No 1060/2009, as amended, this rating shall be used. Private ratings which are issued by rating agencies on the basis of an individual order and which are passed on exclusively to the person who issued the order and which are not intended for public disclosure or for passing on to subscribers are to be used subordinately for this purpose. A rating can also be prepared using rating software commonly available on the market. In this case, however, the taxpayer must document how qualitative factors were properly taken into account in the rating.
- 3.136 If the corporate group does not a rating, an existing rating of the ultimate group company can also be used as a basis. If the ultimate group company does not a rating, it can be accepted for reasons of simplification that a corporate group rating is determined at the time the loan is granted on the basis of the group's financing costs vis-à-vis third parties. In addition, a credit rating analysis prepared by the Deutsche Bundesbank for the group of companies at the time of the conclusion of the financing agreement must be recognized.
- 3.137 Only if the taxpayer can prove that a rating derived from the corporate group rating complies with the arm's length principle can this used to determine the interest rate. Accordingly, the credit rating, including the usual external quantitative and qualitative factors, as well as the effects of the existence of the corporate group (group backing, see recital 3.138) must be presented.
- 3.138 The group backstop merely describes the legal and economic framework of the corporate integration. The group backstop is therefore not an independent legally enforceable security and is not to be used as a substitute for this. However, the group backing important when assessing the subjective probability of default of the borrower and thus has a de facto effect on the borrower's creditworthiness (BFH of May 18, 2021, I R 4/17, BStBl II 2023 p. 678). Depending on the economic position and significance of the respective borrower within the corporate group - also taking into account the purpose of the loan - the borrower would be supported in the event that it suffers economic difficulties. The more important the borrower is for the corporate group, the more likely it is to receive support from the corporate group. To the same extent, the isolated consideration of the borrower takes a back seat in assessment of creditworthiness.
- 3.139 The following aspects in particular must be taken into account when analyzing the

Group's retention:

- the economic importance of the company for the Group;
- the economic and strategic importance of the project to be financed for the Group;
- the probability that the company will be sold within the next twelve months;
- the company makes a significant economic contribution to the Group;
- the company uses the name and/or brand of the group of companies;
- the company makes a significant contribution to the Group's overall profit;
- the company is entrusted with products and/or services of the corporate group that generate the highest sales revenues within the corporate group; and
- the company operates in important geographical markets for the Group.

3.140 The borrower's function and risk profile must also be taken into account when assessing creditworthiness.

3.141 The result of the analysis is to determine whether and to what extent the company is strategically important for the group. This has a corresponding effect on the rating of the specific company.

Strategic importance of the borrower for the corporate group	Explanation of the (strategic) importance	Potential creditworthiness of the borrower
Top-down approaches		
Core area	An integral part of the Group's current identity and future strategy. The Group is likely to support this company in all foreseeable circumstances.	Approximately corresponds to the Group's credit rating

Very strategic	Almost an integral part of the Group's current identity and future strategy. The Group will probably support these units.	Generally one notch below the Group's credit rating
Bottom-up approaches		
Strategically important	Less integral part of the Group than highly strategic units. The rest of the group is likely to provide additional liquidity or capital to support. However, some factors cast doubt on the extent of the group' support	Generally three notches above the borrower's individual rating; limited to the corporate group rating.
Moderate /less strategic	Not important enough to justify additional liquidity, capital or risk transfer from the rest of the group. Nevertheless, there is the possibility of some support from the Group	Generally one level above the individual rating

Appendix 2

Non-strategic	No strategic importance for the Group. These companies could be sold in the short to medium term	As a rule, the individual rating of the company
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3.142 With regard to the preparation of the rating, recital 3.135 applies accordingly. In order for the taxpayer to be able to provide evidence, it is necessary that

- qualitative and quantitative factors are appropriately included in the rating for the specific borrower;
- distortions of the key financial figures relevant for the rating due to transactions with related parties have been eliminated and, as a result, only key figures that are in line with the arm's length principle are used;
- the rating is comprehensible and reproducible, and
- the standard market rating methodology is applied at the time the loan is granted.

If, in a comparable situation, particularly with regard to the loan volume and term, and close in time to the time of the conclusion of the contract for the intra-group financing relationship, an external third party has used a rating that differs from the group rating, this can be used as evidence. This only applies if the financing relationship with the third party actually implemented. In addition, a creditworthiness analysis prepared by the Deutsche Bundesbank for the time the financing relationship was concluded must be recognized.

3.143 An advantage in knowledge resulting from the influence and control possibilities established under company law would be priced in between unrelated third parties if it were based on a contractually granted position. The extent and the effects of the knowledge advantage resulting from the corporate interdependence must be considered appropriately in each individual case.

3.144 Both collateralization and non-collateralization of loans can be at arm's length. Whether

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a lack of loan collateralization is at arm's length depends on whether an unrelated third party would also have extended the loan under the same conditions - taking into account any possible risk compensation (BFH of 13 January 2022, I R 15/21, BStBl II 2023 p. 675). The extent to which non-collateralization between related parties can be at arm's length depends on the circumstances of each individual case. The following aspects are of particular importance when making an overall assessment:

- Behavior of the corporate group towards third parties: If liabilities are generally collateralized in the external relationship, non-collateralization within the corporate group appears to be unusual for third parties.
- Economic advantage: If the agreement collateral is advantageous from an economic point of view, for example to achieve a lower interest rate, third would not waive collateral in order to maximize its profit.
- Realistically available alternative courses of action: If, for example, the borrower would still need a loan from an unrelated third party at the same time and the provision of collateral to the unrelated third party would lead to an increased cost reduction compared to the related party, it would be economically more advantageous to collateralize this loan. Collateral would therefore no longer realistically be available for the loan between the related parties (assuming the borrower had no other assets that would be suitable as collateral).
- Expected satisfaction of claims: It is important whether sufficient assets are available or whether sufficient assets would be available in the event of insolvency to the corresponding claims (see, among other things, section 39 InsO).
- Loan amount: Not every capital transfer is collateralized between third parties. Decisive criteria are also the amount of the loan, granted by the lender, and the lender's risk-bearing capacity.
- Business strategy of the lender: If the lender typically does not pursue (risky) financial investments as part of its normal business activities, it will regularly attempt to minimize its risk based on these activities. This may include providing collateral for capital transfers.

In these case constellations, the alternative courses of action available to the related parties and whether these would have led to more advantageous conditions for the

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debtor must also be taken into account in each case (see para. 10.19 of Annex 1)

- 3.145 If the corporate group consistently applies the rating of the corporate group with regard to all financing relationships with Germany (both inbound and outbound), a remuneration for increased creditworthiness (see marginal no. 3.150) is also not to be applied with regard to the financing relationships within the corporate group.
- 3.146 See section 21 (1a) sentence 2 AStG for the temporal scope of application. In the case of an intra-group cash pool, it is not the date of implementation of the cash pooling system as such that is decisive, but the date of the respective capital transfer and borrowing, as these are usually short-term loan relationships (see recital 3.154). If the financing relationship is continued in the form of a continuing obligation beyond December 31, 2024, it is not objectionable for the application of section 1 (3d) sentence 1 no. 1 letter a) AStG if it can be credibly demonstrated that the conditions are met as at December 31, 2024. If affected financing relationships are significantly after December 31, 2023 and before January 1, 2025, section 1(3d) AStG does not apply to expenses incurred before the significant change (see section 21(1a) sentence 3 AStG). If the financing relationship is significantly changed, it is not objectionable for the application of Section 1 (3d) sentence 1 number 1 letter a) AStG if it is credibly demonstrated that the conditions are met at the time of the significant change.

J.4 Financing relationships as a low-function, low-risk service (section 1 (3e) AStG)

- 3.147 The determination of an arm's length price for the transfer of debt capital between related parties is generally based on the price comparison method (BFH, May 18, 2021, I R 4/17 BStBl II 2023 p. 678). Decisive comparability factors for this are listed in recital 3.132. If a group-affiliated financing company that does not have the ability and authority to control or bear the risk of this financing transaction is interposed, it is only entitled to a risk-free return as remuneration for the brokerage, provision or on-lending of the capital and the associated low-function, low-risk service (paras. 1.100, 1.103, 1.108 to 1.116, 10.25 of Annex 1). Accordingly, if the granting of the loan and the actual control of the functions or risks associated with it are different, there is a further transaction between the financing company and the company that exercises the actual control of the functions or risks associated with the granting of the loan (BFH, May 18, 2021, I R 4/17 BStBl II 2023 p. 678). The risk associated with the transfer of capital is

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decisive for this assessment. If the latter company is a domestic company, the remuneration to be allocated to it must be examined. In principle, this is determined by the difference between the arm's length interest rate and the risk-free return. The taxation of add-backs in the case of a controlled foreign financing company (BMF circular dated December 22, 2023, BStBl 2023 I Sonder Nummer 1 p. 2) and the documentation obligations (Section 90 (3) AO, GAufzV, BMF circular dated December 3, 2020, BStBl I 2020 p. 1325) and the exchange of information in the context of international administrative cooperation (BMF letter dated August 17, 2017, BStBl I 2017 p. 1228).

- 3.148 Section 1(3e) AStG does not change the approach described in para. 3.147. § Section 1(3e) AStG merely describes that the activities mentioned therein, such as the activities of a financing company, are generally to be regarded as a low-risk service in terms of function and (para. 10.45, 10.46, 10.130 of Annex 1). Financing functions generally represent support functions for the value-adding core business (para. 10.45 of Annex 1). The situation is different in particular if the financing function is a primary function and therefore a core component of the value creation model, such as in the banking or insurance sector (para. 10.47 of Appendix 1)

The transfer pricing provision follows the system set out in particular in Section 1 (3) AStG.

- 3.149 If one of the activities listed in Section 1 (3e) AStG is carried out in Germany, this does not mean that the competent tax authority must assume a low-function and low-risk service for the transfer pricing determination. It can also use a functional and risk analysis to prove that the specific activity not a low-function, low-risk service; the documentation requirements remain unaffected by this. The same requirements for proof must be as for the taxable person. This includes the specific circumstances being substantiated and presented in a conclusive manner. It is therefore sufficient that it is more likely than not that the criteria are met.

J.5 Remuneration for increased creditworthiness

- 3.150 A transfer price in line with the arm's length principle is to be applied for the benefits of a company's proven increased creditworthiness. The benefits may result from the

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fact that at least one member of the multinational group of companies assumes the obligation towards a third party to secure the company's payment obligations. This can take form of a guarantee, a surety, a loan agreement, a hard letter of comfort or real collateral. A transfer price is only to be recognized if the obligor assumes an actual risk position. When determining the arm's length price to be applied, must generally be assumed that the benefits of increased creditworthiness are limited to the difference between the conditions for the multinational group of companies as such and the conditions for the company assuming the obligation.

- 3.151 If a company is only put in a position to raise capital by the obligation of the multinational group of companies or a member of this multinational group of companies towards a third party, the assumption of obligation in EU/EEA cases is a shareholder contribution (para. 3.69) if there is an economic reason within the meaning of the ECJ ruling of May 31, 2018 in case C-382/16 (Hornbach).

J.6 Cash pool as a financing relationship within a multinational group of companies

- 3.152 Cash pooling represents a pooling of liquidity in multinational groups of companies. In principle, the cash pool manager only provides a low-function, low-risk service (point 10.130 of Annex 1), whereby the function and risk profile decisive in each individual case. Accordingly, the remuneration of the cash pool manager is generally determined on the basis of a cost-oriented method. It is not objectionable if the cost mark-up on the directly attributable costs is between five percent and ten percent. Financing costs are not included in the assessment basis.
- 3.153 The companies participating in the cash pool must pay the transfer price in proportion to the total number of participants. Cash pooling structures are an example of the generation of synergy effects in multinational groups of companies (para. 1.177 ff. of Annex 1). However, the allocation of these synergy effects to the individual business units is not possible on a causation basis. Accordingly, a special assessment must be made in each individual case, taking into account the acceptance of the structure abroad. Please to Chapter X Section C.2.3.2. of Annex 1 for information on the remuneration of cash pool participants.

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Example: M-AG (domiciled in Germany) provides FinCo. (domiciled abroad) with 100% equity. FinCo. acts as cash pool manager and organizes the cash pool within the multinational group of companies without controlling or assuming risks. The remuneration on the result of the function and risk analysis. The remuneration for the activities of a cash pool manager is generally limited to the directly attributable operating costs, such as personnel costs, including a customary profit mark-up. The costs, including the profit mark-up, could be allocated on a pro rata basis based on the number of participants, in particular by means of a group allocation.

- 3.154 If the respective cash deposits and borrowings of the cash pool participants are not short-term cash deposits and borrowings, they do not constitute a component of the cash pool from an economic perspective, but rather individual longer-term loan relationships, which are to be treated accordingly (point 10.122 of Annex 1).

J.7 Other financing instruments and self-insurers

- 3.155 The use of financial instruments within the meaning of Section 1 (11) of the German Banking Act within multinational groups of companies must be remunerated in accordance with the market conditions prevailing at the time the transaction is concluded and in accordance with the arm's length principle, taking into account the distribution of risk between the contracting parties.
- 3.156 A self-insurer is to be remunerated for the assumption of its activity in accordance with the conditions existing on the market at the time the transaction is concluded and in accordance with the arm's length principle, taking into account the assumption of risk, the capital adequacy requirements and the synergy effects resulting from the group affiliation.

K. Price adjustment clause

- 3.157 In cases where an appropriate price adjustment clause has been contractually agreed, the application of Section 1a AStG is excluded.

Chapter IV Further general principles

Appendix 2

A. First correction

- 4.1 Reference is made to the 2020 Administrative Principles dated December 3, 2020 (at the location indicated).
- 4.2 A correction must be made for the assessment period in the respective reduction in income occurred. The correction amount must be allocated to the same type of income as the corrected income.

B. Treatment of compensation payments

- 4.3 If the parties involved in transfer pricing cases offset a correction made by the German tax authorities by making compensation payments to bring about the situation that would have arisen if the arm's length principle had been observed, this compensation is to be treated as an adjustment.
- a) In the case of a correction due to the assumption of a hidden profit distribution by a domestic corporation, the profit distribution must generally be treated as a contribution (see BFH of May 29, 1996, I R 118/93, BStBl II 1997 p. 92),
 - b) In the event of a correction due to the assumption of a hidden contribution to a foreign corporation, this must generally be treated as a benefit that results in remuneration for the shareholder within the meaning of Section 20 (1) no. 1 EStG,
 - c) The taxable income is to be treated as a contribution in the case of a correction due to the assumption of a withdrawal and as a withdrawal in the case of a correction due to a contribution,
 - d) in the case of transactions that have led to an adjustment based on § 1 AStG, to offset the surcharge made for the purposes of the adjustment outside the balance sheet for reasons of equity (see BFH of May 30, 1990, I R 97/88, BStBl II 1990 p. 875). This only applies if the compensation payments have actually been made within one year of notification of the corrected tax assessment.
- 4.4 If an investment in a related foreign company is sold or such a company is liquidated and transactions in previous assessment periods have led to an adjustment for the shareholder in accordance with Section 1 AStG that has not yet been offset (marginal no. 4.3 letter d), the assets of the foreign company are higher than they would be if the

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company had paid an arm's length price to the shareholder. To avoid double taxation, the adjustment amount recognized outside the balance sheet can be deducted in these cases on equitable grounds (Section 163 AO). The reduction can also lead to a negative amount. If a capital gain or liquidation gain reduced by the adjustment amount pursuant to section 1 AStG in accordance with this equitable provision is subject to the provision of section 8b KStG, the flat-rate non-deductible operating expenses within the meaning of section 8b (3) sentence 1 and (5) sentence 1 KStG are only to be determined from the reduced profit. A disposal or liquidation loss resulting or increasing from the application of this equitable rule must be added off-balance sheet in accordance with Section 8b (3) sentence 3 KStG, so that in the event of a loss, there is no effect on the income of the shareholder corporation despite the application of the equitable rule. If the partial income method (sections 3 no. 40c, 3c (2) EStG) is applicable at shareholder level, only 60% of the adjustment amount pursuant to section 1 AStG can be taken into account when determining the profit or loss, applying section 3c (2) EStG analogously. The same applies to the shareholder if the adjustment pursuant to Section 1 AStG was not made at the shareholder itself but at its subsidiary and if Section 1 AStG takes precedence over Section 8 (3) sentence 2 KStG.

- 4.5 In the event of liquidation, the reduction must be made in the assessment period in which any liquidation proceeds are to be recognized in profit or loss in accordance with generally accepted accounting principles. A reduction at the time of the liquidation resolution can therefore only be considered if liquidation does not take place due to a lack of assets and no liquidation proceeds are generated.

C. Counter-adjustment

- 4.6 An adjustment of income by a foreign tax administration can lead to double taxation with regard to the income of the domestic related taxpayer. If the taxpayer then adjusts its future transfer prices, the transaction is subject to the recording obligation pursuant to Section 90 (3) AO. A subsequent counter-adjustment is only to be recognized if it is permitted under German tax law in terms of substantive and procedural law. Under German tax law, the counter-entitlement must be carried out in the substantive manner in which the arm's length principle would have been correctly taken into account from the outset; accordingly, national deduction restrictions such as the interest barrier (Section 4h EStG, Section 8a KStG) must be observed in the counter-adjustment. The

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principle of sectional taxation must be observed. Under treaty law, the articles in the respective DTA that are modeled on Article 9 OECD-MA (in particular Article 9 para. 2 OECD-MA) open up a claim for a counter-adjustment in the other contracting state, provided that the initial adjustment is justified in the opinion of the tax administration of this other contracting state. Within this framework, in addition to the domestic delimitation rules, Section 164(2) and Section 173(1)(2) AO can also be applied as an amendment provision on the German side without a mutual agreement or arbitration procedure having been carried out beforehand (unilateral remedy). For the purpose of implementing a mutual agreement or an arbitration award, which may also lead to a more extensive counter-adjustment, section 175a AO is applicable in this respect.

D. Customs

- 4.7 The arm's length price relevant for the determination of income may deviate from the customs value on which customs clearance is based within the meaning of Article 70 of the Union Customs Code (UCC; Regulation (EU) 952/2013 of the European Parliament of October 9, 2013, OJ L 269, p. 1) or from the import VAT value on which the import VAT is based. Irrespective of this, the customs valuation can provide additional assistance in determining arm's length prices.
- 4.8 Subsequent transfer price adjustments in the form of subsequent debits by the seller must be reported immediately by the declarant to the responsible main customs office (Section 153 AO). In the case of subsequent transfer price adjustments in the form of credit notes from the seller, there is sometimes a claim for reimbursement. However, this is subject to the condition that the adjustment was contractually agreed between the parties to the purchase contract prior to the imports in terms of reason and amount and is product-related.

Chapter V Glossary

- 5.1 Reference is made to the glossary in Appendix 2 and the OECD Glossary of Tax Terms.

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Chapter VI Repeal of BMF circulars and application regulations

6.1 The BMF circular of November 9, 2001 concerning the "Principles for the examination of the delimitation of income between internationally affiliated companies in cases of employee secondment" (administrative principles - employee secondment)", BStBl I 2001 p. 796, is repealed.

6.2 With the exception of margin no. 3.63a, this letter is to be applied for the first time for the 2024 assessment period. Recital 3.63a of this letter is to be applied for the first time for the 2025 assessment period.

The BMF letter dated June 6, 2023 regarding the "Principles for the correction income pursuant to Section 1 AStG dated June 6, 2023, BStBl I 2023 p. 1093 (Administrative Principles for Transfer Pricing 2023) is to be applied for the last time for the 2023 assessment period.

This letter will be published in the Federal Tax Gazette Part I. It is now available for download on the website of the Federal Ministry of Finance.

Annex 1 of this letter corresponds to Annex 1 of the BMF letter of June 6, 2023 regarding the "Principles for the correction income pursuant to Section 1 AStG of June 6, 2023, BStBl I 2023 p. 1093 (Administrative Principles for Transfer Pricing 2023), printed in BStBl 2023 I number 15 p. 1130.

The definitions in the glossary in Appendix 1 apply accordingly. The following glossary therefore only contains definitions that are not included there.

Cash pool	A cash pool exists if the balances of the payment transaction accounts of participating companies in a multinational group of companies are regularly consolidated virtually or actually in a collective account of a company in this multinational group of companies.
Cash pool manager	The company of the multinational group of companies that manages the omnibus account.
EBT	Earnings Before Taxes

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Self-insurer	A company belonging to a multinational group of companies or several multinational groups of companies which offers more than 50 of its insurance policies to companies belonging to these multinational groups of companies. This assessment is based in particular on the premiums earned for own account (net premium).
Arm's length price	The transfer price corresponding to the arm's length principle.
Function	A business activity that consists of a combination of similar operational tasks that are carried out by certain units or departments of a company. It is an organic part of a company without necessarily being a business unit in the tax sense.
Inbound facts	Business relationship in which a service is received by a domestic taxable person.
Multinational group of companies	Consists of at least two related parties within the meaning of Section 1 (2) AStG resident in different countries or at least one person with at least one permanent establishment in another country. The term multinational group of companies is therefore not congruent with the term corporate group.
Net margin	The net profit of a business transaction in relation to a reference value appropriate to the circumstances of the individual case.
Outbound facts	Business relationship in which a service is provided by a domestic taxable person.

Risk	The possibility inherent in a business transaction within the meaning of Section 1 (4) of the Foreign Tax Act that events resulting from the unpredictability of the future may occur that could lead to a deviation from planned target values. The term risk also includes the opportunity that represents a positive deviation from planned target values.
Routine company	A company that, as a result of a functional and risk analysis for the respective business transaction alone or together with other related parties a. performs routine functions, b. only uses assets to a limited extent and c. bears only minor risks.
Backing in the multinational group of companies (group backing)	The topos of the so-called group backstop merely describes the legal and economic framework of corporate interdependence.
Strategy carrier	A company that, as a result of a functional and risk analysis for the respective business transaction alone or together with other related parties a. performs the essential functions, b. utilizes the material tangible assets and intangible assets and c. assumes the material risks.
Comparative values	In particular, prices and other terms and conditions, cost allocations, profit mark-ups, gross margins, net margins, profit allocations used for comparison, if the conditions of the underlying transactions are comparable.
Ratios	Are in particular a. the contractual conditions of a business transaction, insofar as these correspond to the actual behavior of the parties involved in the respective business transaction, the functions performed by the parties involved in the transaction, taking into account the assets used and the risks assumed, including the links these functions and the overall value creation of the multinational group, the circumstances surrounding the transaction and industry practice, c. the characteristics of assets transferred or

	provided or services rendered, d. the economic circumstances of the parties involved in the transaction and the circumstances of the market relevant to the transaction, including locational advantages and the legal framework, and b. the business strategies pursued by the parties involved in the transaction.
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Assets	Assets and benefits. Assets include, in particular, tangible assets, intangible assets including intangible assets, investments and financial assets.
Advantages	Among other things, a well-established company organization, a well-established workforce/employee base (assembled workforce). They represent the possibility of increasing income or liquid funds.
Added value	Measures the income from economic activity as the difference between the output of an economic unit and the inputs required to produce the output.

Appendix 3

Example of value determination for relocation of functions¹

Facts and general assumptions

A domestic parent corporation (MG) transferred a transfer package to a newly founded foreign subsidiary corporation (TG) on January 1 of the year.

The sustainably achievable financial surplus (FÜ) within the meaning of Section 2 FVerlV from the transferred function from the perspective of the transferring MG is expected to amount to EUR 600 thousand per year. The acquiring TG, on the other hand, expects an annual FÜ of EUR 700 thousand. The domestic income tax burden of the MG is expected to be 25% (s_{U_MG}), the foreign burden of the TG 20% (s_{U_TG}).

The following additional assumptions apply equally to both companies:

- In arrears inflow of the above-mentioned CVA from the valuation date.
- Complete equity financing (MG and TG are debt-free).
- Application of the Capital Asset Pricing Model (CAPM).
- Maturity-equivalent capitalization interest rate (i) of all future periods (T):

Market risk premium before personal income tax	MRP_{vst}	8,00%
× Beta factor for equity	β_{EK}	1,00
= Risk premium		8,00%
+ Risk-free (base) interest rate	r_f	2,00%
= Expected return on equity investors	$r_{EK} = i$	10,00%

Case variant A

- Consideration of exemplary synergy and tax effects (§ 2 FVerlV) - -

In addition to the general information (see above), an unlimited capitalization period should be assumed. In addition, the book values (BW_{MG}) of the assets contained in the transfer package should be fully depreciated for tax purposes in Germany. Abroad, these assets should be depreciated on a straight-line basis over 3 years ($stl_{ND_{TG}}$) for tax purposes. The sum of the values of these assets should correspond to the total value of the transfer package.

a) Determination of the minimum price for MG (example EXIT tax)

aa) Net present value (NPV) from the perspective of MG

$$\text{NPV}_{MG} = \frac{F\ddot{U}_{MG}}{i_{MG}} = \frac{600 \text{ KEUR}}{10\%} = 6,000 \text{ KEUR}$$

ab) Minimum price MG taking into account the EXIT tax from the transfer

$$\text{Mindestpreis}_{MG} = \frac{\text{NPV}_{MG} - (s_{U_MG} \times BW_{MG})}{(1 - s_{U_MG})} = \frac{6,000 \text{ KEUR} - (25\% \times 0 \text{ KEUR})}{1 - 25\%} = 8,000 \text{ KEUR}$$

¹ The calculation variables in the examples were assumed to be simplified and are therefore not comparable with real market conditions.

b) Determination of the maximum price for TG (example tax amortization benefit):

$$\text{NPV}_{\text{TG}} = \frac{\text{FÜ}_{\text{TG}}}{i_{\text{TG}}} = \frac{700 \text{ KEUR}}{10\%} = 7,000 \text{ KEUR}$$

bb) Maximum price TG taking into account the "Tax-Amortization-Benefit" (TAB)

Period _{nt1_to_t3}	1	2	3
Discount rates: $1 \div (1 + i_{\text{TG}})^t$	0,9091	0,8264	0,7513
× Depreciation in % p.a. for $\text{stl_ND}_{\text{TG}}$	33%	33%	33%
= Present values of depreciation	0,3030	0,2755	0,2504
× $s_{\text{U_T G}}$	20%	20%	20%
= Tax savings from depreciation	0,0606	0,0551	0,0501

→ Sum of these tax savings (StE): 0,1658

→ **Step-Up-Factor_{TAB}**: $1 \div (1 - \text{StE}) = 1 \div (1 - 0,1658) = 1,1987$

$$\begin{aligned} \text{Maximum price}_{\text{TG}} &= \text{NPV}_{\text{TG}} \times \text{Step-up factor}_{\text{TAB}} \\ &= 7,000 \text{ KEUR} \times 1,1987 = 8,391 \text{ KEUR} \end{aligned}$$

c) Determination of the settlement value:

The minimum price is assumed to be EUR 8,000 thousand and the maximum price EUR 8,391 thousand. As there is no evidence to suggest that the mean value of the agreement range should not be assumed as the agreement value, this corresponds to a value of EUR 8,196 thousand.

Case variant B

- Limited capitalization periods -

In addition to the general information (see above), it should be assumed that the capitalization period for MG be limited to 3 years ($t_{\text{MG}} = 3$) and for TG to 5 years ($t_{\text{TG}} = 5$) due to expected future developments. The reasons for this have been credibly explained (§ 5 FVerlV). The annual FÜ should continue to be incurred in each period (t) to the extent stated above. In addition, the book values (BW_{MG}) of the assets contained in the transfer package in Germany should still amount to EUR 1,000 thousand. The step-up $\text{factor}_{\text{TAB}}$ for the TG is still 1.1987.

a) Determination of the minimum price (example limited capitalization period):

aa) Net present value (NPV) from the perspective of MG

Period _{nt1_to_t3}	1	2	3
Discount rates: $1 \div (1 + i_{\text{MG}})^t$	0,9091	0,8264	0,7513
× Payment surpluses (FÜ_{MG})	600 KEUR	600 KEUR	600 KEUR
= Present values in t_0	545 KEUR	496 KEUR	451 KEUR

→ Sum of the present values in $t_0 = 1,492 \text{ KEUR}$

NPV_{MG}:

ab) Minimum price MG taking into account the EXIT tax from the transfer

b) Determination of the maximum price for TG (example tax amortization)

$$\text{Benefit step } s_{\text{MG}} = \frac{\text{NPV}_{\text{MG}} - (S_{\text{U_MG}} \times \text{BW}_{\text{MG}})}{(1 - s_{\text{U_MG}})} = \frac{\text{EUR 1,492 thousand} - (25\% \times \text{EUR 1,000 thousand})}{1 - 25\%} = \underline{\underline{1,656 \text{ EUR thousand}}}$$

Unofficial English Translation

b) Determination of the maximum price for TG (example tax amortization)

ba) Net present value (NPV) from

Period t_1 to t_5	1	2	3	4	5
Discount rates: $1 \div (1 + i_{TG})^t$	0,9091	0,8264	0,7513	0,6830	0,6209
× Payment surpluses ($F\ddot{U}_{TG}$)	700 KEUR	700 KEUR	700 KEUR	700 KEUR	700 KEUR
= Present values in t_0	636 KEUR	579 KEUR	526 KEUR	478 KEUR	435 KEUR

→ Sum of the present values in t_0 = **2,654 KEUR**
NPV_{TG}:

bb) Maximum price TG taking into account the "Tax-Amortization-Benefit" (TAB)

→ **Step-up factor** TAB unchanged compared to case variant **1,1987**
A:

$$\begin{aligned} \text{Maximum price}_{TG} &= \text{NPV}_{(TG)} \times \text{Step-up factor}_{TAB} = \\ &= 2,654 \text{ KEUR} \times 1,1987 = \mathbf{3,181 \text{ KEUR}} \end{aligned}$$

b) Determination of the settlement value:

The minimum price_{MG} is EUR 1,656 thousand and the maximum price_{TG} EUR 3,181 thousand. As there is no evidence against the mean value (EUR 2,419 thousand) of the settlement range for determining the settlement value, this value is to be used as the basis for taxation.

Modification of case variant B - price adjustment clause -

In the follow-up audit, it is determined that the TG - in deviation from the original planning (see case variant B, letter b)) - has actually generated FM in the amount of EUR 805 thousand (instead of EUR 700 thousand) and is still generating FM in the sixth year (now $t_{TG} = 6$). In the future, however, no further CVAs are to be expected from the transfer package. The parties (MG and TG) had neither concluded a price adjustment clause nor a license agreement. The taxpayer was unable to rebut the statutory presumption under Section 1a sentence 1 AStG that there were uncertainties regarding the price agreement at the time the transaction was concluded and that independent third parties had agreed an appropriate adjustment arrangement. The previous minimum value $_{MG}$ of EUR 1,656 thousand continues to apply unchanged. The new maximum price_{TG} is calculated as follows:

a) New net present value (NPV) from the perspective of TG

Period t_1 to t_5	1	2	3	4	5	6
Discount rates: $1 \div (1 + i_{TG})^t$	0,9091	0,8264	0,7513	0,6830	0,6209	0,5645
× Payment surpluses ($F\ddot{U}_{TG}$)	805 KEUR	805 KEUR	805 KEUR	805 KEUR	805 KEUR	805 KEUR
= Present values in t_0	732 KEUR	665 KEUR	605 KEUR	550 KEUR	500 KEUR	454 KEUR

→ Sum of the present values in t_0 = **3,506 KEUR**
NPV_{TG}:

b) New maximum price TG taking into account the "tax amortization benefit" (TAB)

→ **Step-up factor** TAB unchanged compared to case variant **1,1987**
A:

b) Determination of the maximum price for TG (example tax amortization)

$$\begin{aligned} \text{Maximum price}_{\text{TG}} &= \text{NPV(TG)} \times \text{Step-up factor}_{\text{TAB}} \\ \text{ba) Net present value (NPV) from} &= 3,506 \text{ KEUR} \times 1,1987 = 4,203 \text{ KEUR} \end{aligned}$$

Unofficial English Translation

Based on the actual profit development of TG, the new maximum price is 4,203 KEUR. The mean value of the new agreement range (EUR 1,656 thousand to EUR 4,203 thousand) is t EUR 2,930 thousand. A significant deviation within the meaning of Section 1a sentence 1 AStG is given, as the actual value of EUR 2,930 thousand is higher than the value of EUR 2,903 thousand (EUR 2,419 thousand previous hypothetical settlement value plus 20% of this) (Section 1a sentence 3 AStG). In accordance with section 1a sentence 5 AStG, an appropriate adjustment amount of EUR 511 thousand (EUR 2,930 thousand less EUR 2,419 thousand) can be determined. The income must be adjusted accordingly in accordance with section 1 (1) sentence 1 AStG.

Appendix 4

OECD Amount B guidance

Unofficial English Translation