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New German transfer pricing regulations from 2025

Implications of the new administrative principles on Transfer Pricing 2024 and stricter documentation obligations

On December 12, 2024, the Federal Ministry of Finance (BMF) published the finalized version of the „Administrative Principles on Transfer Pricing – Principles for the Correction of Income pursuant to Section 1 FTA" (VWG VP 2024) based on the draft from August 2024. Therein, the BMF extends the version of the administrative principles from 2023 (VWG VP 2023) with its interpretation of Section 1 (3d) and (3e) of the Foreign Tax Act (FTA), which were introduced as part of the Growth Opportunities Act in March 2024. In addition to the new VWG VP 2024, stricter documentation obligations apply to taxpayers in Germany since the beginning of 2025.

A. Administrative principles on transfer pricing 2024

The main changes to the new administrative principles compared to the previous version from 2023 are the additions relating to financing relationships (chapter J.), which set out the interpretation of the German tax authorities (BMF) on the application of Section 1 (3d) and (3e) FTA. Compared to the draft version of the VWG VP dated August 14, 2024, the final version contains only a few, but nevertheless relevant, changes.[1]

According to the BMF, intercompany financing is now also economically justifiable if it is necessary for the operation or maintenance of business activities, whereby it is still assumed that a prudent and conscientious businessman would not take on debt if there were not a reasonable prospect of a return that at least covers the financing costs (Sec. 3.126). With regard to the use of debt, it is still assumed that it must be in line with the overall purpose of the company, with investments in overnight money accounts or intragroup cash pools with no expectations of a higher return regularly failing to meet this criterion (Sec. 3.127). In this context, however, the tax authorities do not fundamentally rule out the raising of debt to hold liquidity reserves at arm's length or to hold capital buffers. Further explanations on borrowing for the purpose of profit distribution are provided by the tax authorities on the grounds that this must be in line with the company's usual distribution policy. Regarding the permissible use of debt, the canon is supplemented by the fulfilment of regulatory requirements, provided that this is covered by the functional and risk profile (Sec. 3.128). The debt capacity analysis and the reliance on the group rating or the consideration of group support remain an integral part of the VWG VP 2024 and should therefore be taken into account by the taxpayer, whereby the BMF provides for simplifications. For example, in the case of short-term capital transfers, particularly in connection with intragroup cash pools, it can now regularly be assumed that it is possible to provide the debt service although, in line with the previous explanations, the taxpayer's purpose for the provision of capital must still be demonstrated (Sec. 3.129).

If the underlying rating used to determine the interest rate of an intragroup loan is based on an investment grade rating (i.e. at least BBB- at S&P and Fitch, or Baa3 at Moody's), a debt capacity analysis is generally no longer required. However, there is a significant tightening of the rules when debt capital is reclassified as equity, as the associated related secondary costs (in particular commitment fees and prepayment penalties) are no longer deductible (Sec. 3.130). With regard to the rating to be used in determining an arm's length interest rate, the tax authorities have added credit ratings prepared by the Deutsche Bundesbank to the previous test scheme in cases where the group or the ultimate group company does not have a rating (Sec. 3.136).

Last but not least, the application rules for the amendments to Section 1 FTA dated March 28, 2024 (i.e. the implementation of (3d) and (3e) and the amendment of (6)) are aligned with Section 21 (1a) sentence 2 FTA. Accordingly, in the case of cash pools, the date on which the funds were drawn down is to be used as the basis, and not the date on which the cash pool was implemented. For intragroup loans that were granted before 2024 and that continue beyond December 31, 2024, there is no objection to the use of December 31, 2024, as the date for establishing credibility with regard to compliance with Section 1 (3d) FTA.

1 *For an overview of the draft, see John, Ronny & Mölleken, Christoph: „Konzerninterne Finanzierungsbeziehungen", RE Tax News – 2nd issue 2024.*

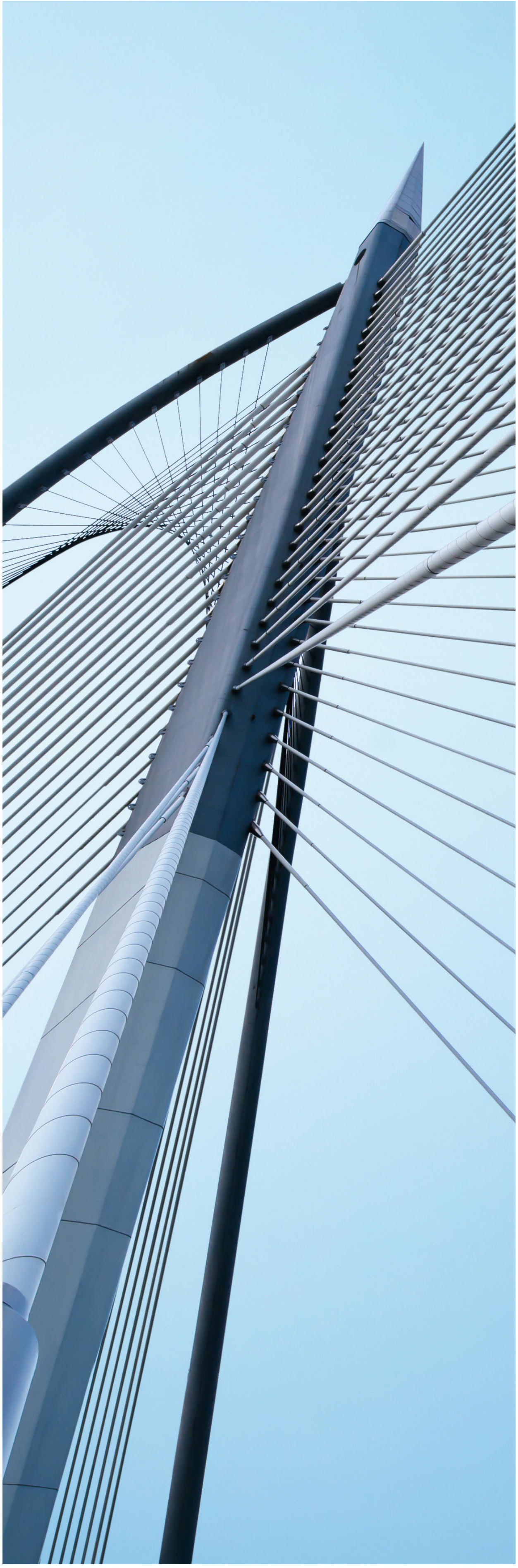
In practice, the new VWG VP 2024 makes it clear that taxpayers should document their intragroup financial transactions (loans and cash pool transactions) much more extensively and precisely than before, especially if the pricing methodology used differs from the outlined view of the German tax authorities. This is particularly important for the real estate sector, where the assessment of the creditworthiness used for subordinated intragroup financing is rarely in the investment grade range and, at the same time, the group rating can usually not be used to derive an arm's length interest rate. In addition, many investment projects have no positive cash flow in the initial financing period, which makes it more difficult to prove debt capacity. Nevertheless, the simplification rules for the proof of debt capacity via an investment grade rating as well as the specification of individual explanations by the BMF (e.g. proof of the business purpose of debt financing) are to be welcomed from the taxpayer's perspective.

B. Stricter documentation obligations

In addition to the publication of the VWG VP 2024 at the end of the year, stricter documentation obligations apply from January 1, 2025, onwards. The documentation on the nature and content of the business relationships within the meaning of Section 1 (4) FTA must be submitted within 30 days of the application or notification of the audit request. It should be noted that, in addition to the assessment period from 2025, this also applies to tax audit requests from this year onwards that relate to a period prior to 2025. Furthermore, in accordance with Section 90 (3) sentence 2 no. 1 of the German Fiscal Code („AO") the transaction matrix must also be submitted from January 1, 2025, in addition to the documentation of the factual background and the economic and legal basis for the application of the arm's length principle. The transaction matrix must include the following points:

- the nature of the business relationship;
- the service recipient(s) and provider(s) involved;
- the volume and remuneration;
- the contractual basis;
- the transfer pricing method applied;
- the affected tax jurisdictions; and
- whether transactions are not subject to standard taxation in the relevant tax jurisdiction.

According to the 4th Bureaucracy Reduction Act, as part of an efficient and risk-oriented audit approach,



not all transfer pricing records are to be submitted without a separate request, but initially only the transaction matrix, the master file and any records of extraordinary business transactions within a period of 30 days. However, the tax authority still has the right to request the submission of further records in accordance with (3) at any time during the external audit in accordance with the deadline in sentence 2 (4) of Section 90 AO. In justified individual cases, the deadline for submission may be extended.

Conclusion / Key facts

Intragroup financial transactions have been a major focus during German tax audits of real estate companies for many years. With the publication of the VWG VP 2024 and the stricter documentation obligations, taxpayers now receive the German tax authorities' interpretation of Section 1 (3d) and (3e) FTA and are thus required to document their intragroup financial transactions promptly and more comprehensively. The new VWG VP 2024 indeed brings more clarity to the interpretation of the issues of accepting the financing relationship on the merits and the determination of arm's length interest rates. However, it remains to be seen how the potential for disputes will develop in the context of tax audits on the subject of financing relationships. Experience has shown that a complete, meaningful and promptly provided transfer pricing documentation is a good starting point for tax audits.

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