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Federal Central Tax Office

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at the Federal Ministry of Finance

SUBJECT **2020 Administrative Principles**[1]

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With reference to the outcome of the discussions with representatives of the highest revenue authorities of the *Länder*, the following applies for the examination of income allocation between internationally associated companies in relation to cooperation obligations and estimating tax bases and penalties:

## Contents



[1] This translation is provided merely for information purposes. Only the German language version is authoritative for the application of the law.

# 1. Obligation of participants to cooperate (section 90 of the Fiscal Code (*Abgabenordnung*))

## *1.1 General information on the obligation to cooperate*

1 The revenue authorities' duty to carry out investigations at their own initiative (*Amtsermittlungspflicht*), and the obligation of participants to cooperate, have equal status (Federal Fiscal Court judgment of 15 February 1989, X R 16/86, Federal Tax Gazette II p. 462). The participants' obligation to cooperate in clarifying the facts of the case is not dependent on the revenue authority requesting that participants cooperate.

2 The general obligation to cooperate contained in section 90 (1) sentence 1 of the Fiscal Code covers establishing the facts of the case and is extended for certain constellations

of circumstances by section 90 (2) and (3) of the Fiscal Code. In addition, the obligation to cooperate is defined in more detail in special procedural provisions (e.g. in sections 93 to 100, 140 et seqq., 149, 150, 153, 154, 160, 200, 210 et seqq. of the Fiscal Code) and in legal provisions relating to individual taxes (e.g. in sections 16 and 17 of the External Tax Relations Act (*Außensteuergesetz*); sections 33 and 34 of the Inheritance Tax Act (*Erbschaftsteuergesetz*); sections 18 and 19 of the Real Property Transfer Tax Act (*Grunderwerbsteuergesetz*) and section 22 of the VAT Act (*Umsatzsteuergesetz*)).

3 Section 200 of the Fiscal Code applies with regard to field audits in addition to section 90 of the Fiscal Code and supplements and expands the general cooperation obligation that exists pursuant to section 90 et seqq. of the Fiscal Code with regard to field audits (Federal Fiscal Court judgment of 6 June 2012, I R 99/10, Federal Tax Gazette II 2013 p. 196; Federal Fiscal Court judgment of 4 November 2003, VII R 28/01, Federal Tax Gazette II 2004 p. 1032). Similarly, taxpayers' obligations with regard to data access pursuant to section 147 (6) of the Fiscal Code are extended by section 200 (1) sentence 2 of the Fiscal Code. In addition, the submission obligation pursuant to section 200 (1) sentence 2 of the Fiscal Code also covers documents which, even though taxpayers are not subject to any statutory retention requirements in this respect pursuant to section 147 (1) of the Fiscal Code, are however available and hence can be submitted (Federal Fiscal Court judgment of 28 October 2009, VIII R 78/05, Federal Tax Gazette II 2010 p. 455).

4 With regard to the relationship between criminal proceedings and the taxation procedure, which is set out in section 393 of the Fiscal Code, and the associated obligations to cooperate on the part of taxpayers, please see number 16 of the 2020 edition of the Instructions for Criminal Proceedings and Proceedings for Collecting Fines (Taxes) (*Anweisung für das Straf- und Bußgeldverfahren (Steuer)* – AStBV (St) 2020).

5 The extent of the obligation to cooperate depends on the circumstances of the individual case. The responsibility of a participant to clarify the circumstances of the case increases in line with the amount of facts and evidence that belongs to the sphere of information or activities that is controlled by the participant (Federal Fiscal Court judgment of 15 February 1989, X R 16/86, Federal Tax Gazette II p. 462). The scope of the general obligation to cooperate is limited by the principle of proportionality.

6 If an authorised representative has been appointed, this person is the contact person for the revenue authority. Only if special reasons exist will the revenue authority contact the participant directly, e.g. to ask them for information which only the participant is

in a position to give. In this case, the authorised representative must be notified (cf. the Application Ordinance for the Fiscal Code (*Anwendungserlass zur Abgabenordnung*) on section 80 of the Fiscal Code).

7 Participants do not have the right to refuse to cooperate. Pursuant to sections 101 to 106 of the Fiscal Code, only third parties have the right to refuse to cooperate.

8 The possibility of carrying out a mutual agreement procedure in accordance with a double taxation agreement, the EU Arbitration Convention (90/463/EEC; OJ L 225 of 20.8.1990, p. 10) or the EU Double Taxation Agreement Dispute Resolution Act (*Streitbeilegungsgesetz*) (12 December 2019, Federal Law Gazette I, p. 2103), or an application for the initiation, or the actual initiation, of a mutual agreement procedure or arbitration procedure during a field audit, do not release participants from their obligation to cooperate pursuant to section 90 of the Fiscal Code.

### *1.2 Enhanced obligation to participate in cases with a foreign dimension (section 90 (2) of the Fiscal Code)*

9 Section 90 (2) of the Fiscal Code sets out an enhanced obligation (compared with section 90 (1) of the Fiscal Code) to cooperate and clarify circumstances in cases with a foreign dimension (cross-border cases). Section 90 (2) is in particular intended to prevent the clarification of cross-border cases from failing to succeed or from being impeded due to the fact that the sovereignty of German courts and authorities is restricted to Germany. The participant is obliged to clarify cross-border cases and to procure the necessary evidence (Federal Fiscal Court judgment of 16 April 1980, I R 75/78, Federal Tax Gazette II 1981, p. 492) This requires a complete and truthful presentation of all the circumstances that are relevant to taxation, irrespective of whether the individual facts and circumstances are to the benefit of the participant or not. The question of whether evidence is required or not depends on the individual case (Federal Fiscal Court judgment of 3 June 1987, III R 205/81, Federal Tax Gazette II p. 675; Federal Fiscal Court judgment of 2 December 2004, III R 49/03, Federal Tax Gazette II 2005 p. 483).

10 With cross-border cases, participants are obliged in particular to clarify circumstances, procure evidence and ensure the future availability of evidence. In proceedings before fiscal courts, these obligations apply accordingly pursuant to section 76 (1) sentence 4 of the Code of Procedure for Fiscal Courts (*Finanzgerichtsordnung*).

11 Participants must therefore ensure, among other reasons for the purpose of ensuring the future availability of evidence within the scope of all legal and practical means

available to them (section 90 (2) sentence 2 of the Fiscal Code), that records, documents and data from a foreign related party that are relevant for the participant's taxation are not destroyed before the expiry of the German retention period.

12 In terms of clarifying circumstances and procuring evidence, it is not sufficient if the participant only specifies the evidence which is located or available in a foreign country. Participants must exhaust all legal and practical means available to them. Accordingly, participants must make every reasonable effort to clarify the cross-border case and to obtain the required evidence in the particular case. The enhanced obligation to cooperate in clarifying cross-border cases is subject to the principle of proportionality.

13 The evidence also includes accounts, records, business papers or other documents and data from foreign related persons that are required for a complete assessment of the circumstances to be possible. This also applies to documents and data from related persons that enable the revenue authorities to carry out validations of the appropriateness of prices or the outcomes of transactions, irrespective of the method used by the participant. The submission obligation also applies to expert opinions and reports relating to transfer prices (cf. section 1 (1) sentence 1 of the External Tax Relations Act (*Außensteuergesetz*)), to the extent that they are considered significant for determining transfer prices or for determining income in connection with transfer prices, as well as to emails, messages sent via instant messaging services, or messages sent via other electronic means of communication, to the extent that these have commercial content of relevance to taxation and as such must be viewed primarily as trade or business correspondence.

14 With cross-border cases, participants must ensure the future availability of evidence so that they are able to fulfil their enhanced cooperation obligation. Therefore, participants may not plead that they are unable to clarify a relevant circumstance or are unable to procure evidence if they, when arranging their circumstances, would have been able to arrange for that opportunity to be granted to them (section 90 (2) sentence 4 of the Fiscal Code). Participants are obliged during and after the realisation of a cross-border case to exhaust every possibility in order to be able to comply with their enhanced cooperation obligations in administrative procedures (Federal Fiscal Court judgment of 14 May 1982, VI R 266/80, Federal Tax Gazette II p. 772). The obligation to ensure the future availability of evidence is limited to the extent that is reasonable for the participant in the individual case and to the legal and practical possibilities for ensuring the future availability. Therefore, participants must, for example, already make the relevant contractual arrangements when concluding a contract to ensure that they can also access evidence located abroad at a later date, in

order to be able to submit this evidence to the revenue authorities. This applies in particular if business relations are agreed between related parties, because the submission of the evidence located abroad is a necessary precondition for verifying the appropriateness of the transfer prices that the business relations are based on, and it is also possible in legal and practical terms for the participants to ensure the future availability of evidence in this way. In individual cases, participants may be obliged to submit documents from a third party where the participant does not actually have a right to have the documents be surrendered, but where the participant is able in practice to procure the documents with reasonable effort. For example, a prudent business manager would in the following cases set out in contractual arrangements that the documents must be submitted if required:

a. proof of a related distribution company's selling prices in relation to unrelated third parties when applying the resale price method,
b. calculation documentation from a foreign service company when applying the cost plus method,
c. proof of the contributions made by the cooperating companies in the case of participation in a cost contribution arrangement (CCA),
d. in the event that intangible assets have been transferred in exchange for profit-based royalties, proof of the revenue generated by the licensee using these assets, or
e. documentation of total profits/losses and the allocation key when applying the transaction-based profit split method.

15 If the participant is the direct or indirect majority shareholder in a company or controls the majority of voting rights in a company, it must be assumed that the participant has under (company) law the means to procure information and evidence from this related company. In these cases, the participant cannot legitimately plead that the related company refused to cooperate.

16 If a participant pleads that they are unable to provide information or submit evidence because only a related party has it at their disposal and this related party is refusing to share it, then the participant is only deemed to not have violated their obligation to cooperate if they have neither the legal (e.g. under company law) nor the practical means to obtain the information or the documentation from the related party, and it was also not possible or reasonable for the participant to ensure the future availability of evidence. The refusal to cooperate on the part of a related party can be credibly demonstrated by submitting the relevant correspondence. Even if it is proved that a related party is refusing to cooperate, the taxpayer must nevertheless comply with their enhanced obligation to cooperate as far as it is possible for them to do so. This does not affect the options of obtaining international legal and administrative assistance.

17 If the same natural persons work as managing directors in a German company and in a related foreign company between which business relations exist, then it can be assumed that these individuals have practical options for providing information and procuring evidence. If in such cases an audit order is issued not only in relation to the German company but also in relation to the foreign company, requests for information can be made to both the German company and the foreign company respectively regarding their own tax matters (including the tax aspects of the business relations with the other company) as participants pursuant to section 93 (1) sentence 1 of the Fiscal Code; in this respect it is irrelevant whether both companies are represented by the same person as managing director.

18 If the provision of certain information to the authorities is not permitted or is even punishable by law under the legal provisions of other countries, this ban does not release the participants from their obligation to cooperate pursuant to section 90 (2) of the Fiscal Code (Federal Fiscal Court judgment of 16 April 1980, I R 75/78, Federal Tax Gazette II 1981 p. 492; Federal Fiscal Court judgment of 31 May 2006, II R 66/04, Federal Tax Gazette II 2007 p. 49). The conflict of obligations that affects the participants is taken into account by the revenue authorities when undertaking the estimate pursuant to section 162 (1) of the Fiscal Code.

19 The revenue authority is responsible for taking into account foreign laws as well as interpreting and assessing contracts or similar documents. In this context, foreign laws are to be applied in the way that they are interpreted and applied by the foreign country. However, the enhanced obligation to cooperate pursuant to section 90 (2) of the Fiscal Code affects the participants to the extent that they must prove whether they fulfil the conditions of the foreign legal norms or not.

20 Section 90 (2) of the Fiscal Code covers all circumstances that are relevant for assessing taxes or ancillary tax payments as defined in section 3 of the Fiscal Code. If a circumstance that is relevant for the application of a tax provision only has a partial connection to a foreign country, this is irrelevant in terms of applying section 90 (2) of the Fiscal Code.

21 The revenue authority must grant participants an appropriate deadline for clarifying circumstances and procuring evidence.

22 The revenue authority may accept documents in a foreign language. These must be translated into German upon request, regardless of their form. Requests for translations must be limited to what is necessary. If, in the case of lengthy documents,

a translation into German is indeed necessary, then the translation request should as a rule be limited to the key sections.

If documents have only been partially translated, this does not mean that the revenue authority must regard information from the untranslated sections of the submitted documents as being known.

In justified cases, the revenue authority may require submission of a notarised translation or a translation by a publicly authorised or sworn interpreter or translator. If a translation that has been requested and which is necessary for the audit is not submitted without delay, the revenue authority may arrange for a translation to be carried out at the participant's expense (section 87 (2) sentence 3 of the Fiscal Code) or may treat the documents as irrelevant. The revenue authority should inform the participant in advance of these consequences.

The official language is German. As a matter of principle, revenue authorities do not communicate with foreign participants or their authorised representatives or advisers in a different language. For this reason, revenue authorities also do not engage interpreters at their own expense for negotiations with participants.

23 If taxpayers breach their obligations under section 90 (2) of the Fiscal Code and the circumstances cannot otherwise be clarified, then it can be assumed, to the detriment of the taxpayer, that the circumstances are those which can be assumed to exist with a certain level of probability, taking into account the taxpayer's proximity to the evidence and their obligation to clarify the circumstances. If, in particular, the obligation to cooperate relates to facts and evidence that fall under the taxpayer's sole responsibility, revenue authorities may draw conclusions from the breach of this obligation that are to the taxpayer's disadvantage. See in particular section 162 (2) of the Fiscal Code regarding estimates (cf. the Application Ordinance for the Fiscal Code on section 162 of the Fiscal Code).

24 If the obligation to cooperate is not complied with, then coercive measures (section 328 of the Fiscal Code) or a fine for delay (section 146 (2b) of the Fiscal Code) may be applied.

### *1.3 Special obligations to participate (section 90 (3) of the Fiscal Code)*

1.3.1. Principles of the record-keeping obligation (section 90 (3) sentence 1 of the Fiscal Code)

25 The Ordinance on the Type, Content and Scope of the Records as Referred to in Section 90 (3) of the Fiscal Code (Ordinance on the Documentation of Profit Allocations, *Gewinnabgrenzungsaufzeichnungsverordnung*, 12 July 2017, Federal Law Gazette I, p. 2367) governs the type, content and scope of the records that are to be kept. In addition to this, Annexes I and II to Chapter V of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 (OECD Transfer Pricing Guidelines 2017) contain lists of information that should as a rule be included in the transfer pricing documentation.

26 As a special instance of the general obligation to cooperate, the record-keeping obligation is in particular intended (see also paragraph 5.5 et seqq. of the OECD Transfer Pricing Guidelines 2017) to ensure that

a. taxpayers give appropriate consideration to the requirements of the arm's length principle,
b. tax administrations obtain the information necessary to conduct an informed transfer pricing risk assessment,
c. tax administrations obtain the tax-related information that they need to conduct an audit of the cross-border business relations between related parties (transfer pricing audits).

Consequently, the records pursuant to section 90 (3) of the Fiscal Code (transfer pricing documentation) help to ensure that it is possible for a competent third party to determine within an appropriate period of time which of the taxpayer's circumstances have actually been realised in connection with their business relations and whether and to what extent the taxpayer has observed the arm's length principle in the process (Bundestag printed paper 15/119, p. 52).

27 The record-keeping obligation is compatible with EU law (Federal Fiscal Court judgment of 10 April 2013, I R 45/11, Federal Tax Gazette II p. 771).

28 Section 90 (3) of the Fiscal Code covers a taxpayer's business relations as defined in section 1 (4) of the External Tax Relations Act. In accordance with section 1 of the External Tax Relations Act, a taxpayer in this sense can also be a partnership or co-entrepreneurship.

29 Agreements in articles of association (e.g. capital contributions) do not form part of the business relations. To enable the revenue authority to check whether an operation is to be viewed as an agreement under company law or as a business relation, the

taxpayer must present the relevant documentation from all participants (e.g. financial statements).

30 The record-keeping obligations also apply to dealings between a permanent establishment and the rest of the company pursuant to section 1 (4) no 2 of the External Tax Relations Act.

31 The record-keeping obligation pursuant to section 90 (3) of the Fiscal Code does not replace the obligation to prepare auxiliary and ancillary accounts pursuant to section 3 of the Ordinance on the Allocation of Profits of Permanent Establishments (*Betriebsstättengewinnaufteilungsverordnung*; 13 October 2014, Federal Law Gazette I p. 1603, as last amended by Article 5 of the Ordinance of 12 July 2017, Federal Law Gazette p. 2360) and vice versa.

32 The arm's length principle must be applied to cross-border business relations between a partnership or co-entrepreneurship and related parties; accordingly records as referred to in section 90 (3) of the Fiscal Code and in the Ordinance on the Documentation of Profit Allocations must be submitted. This applies accordingly to cross-border relations involving business assets of a partnership owned by one of the partners (*Sonderbetriebsvermögen*).

33 The partnership or co-entrepreneurship itself is also obliged to keep records for the business relations of a partnership that is not required to keep accounts. If a fiduciary or another representative has been appointed for a German partner in the partnership, it is sufficient if the records are produced by this person and the German partner ensures that the records are submitted before the deadline.

34 Records are generally to be submitted in German. Upon application by the taxpayer, the revenue authority may permit the submission of records in another living language (particularly English) if it can be ensured that the documents will be properly understood within an appropriate period of time. This applies in particular with regard to records pursuant to section 90 (3) sentence 3 of the Fiscal Code (master file).

This type of application is, however, only to be granted under the condition that any translations that are requested by a revenue authority at a later stage will be submitted within an appropriate period. A decision on the application must be made without delay by the revenue authority which has, at the time when the application is received, territorial and subject-matter competence for assessing or determining the revenue that the application relates to. If the application is submitted after the audit order has been served, then the revenue authority that is responsible for the audit makes the decision.

If the application is granted, this does not free the taxpayer from the obligation to submit the records in German in any fiscal court proceedings that take place; section 52 (1) of the Code of Procedure for Fiscal Courts (*Finanzgerichtsordnung*), section 184 of the Courts Constitution Act (*Gerichtsverfassungsgesetz*).

The application can already be submitted before the records are prepared. The application must by submitted by taxpayers at the latest without delay following the revenue authority's request for the records. The submission of an application has no impact on the deadlines specified in section 90 (3) sentences 7 and 8 of the Fiscal Code.

The principle of proportionality must be observed when requesting translations. Records that are submitted in a foreign language may be of no use. For example, transfer pricing documentation is essentially of no use if the records are submitted in a foreign language without the consent of the revenue authorities and the taxpayer does not get these documents translated, despite being requested to do so.

35 For the preparation of the records, what is decisive are the economic and legal circumstances at the time when the contract (contractual obligation) for the transaction was concluded or when the economic conditions changed so significantly that third parties would have agreed an adjustment to the business conditions or terminated the contract. In this context, it is irrelevant whether the contract was verbal, written or implied.

36 The records pursuant to section 90 (3) of the Fiscal Code must demonstrate that the taxpayer is making a serious effort to organise their business relations on the basis of the arm's length principle (section 2 (1) of the Ordinance on the Documentation of Profit Allocations). The serious effort must be credibly established on the basis of objective circumstances.

37 Please refer to section 162 (3) and (4) of the Fiscal Code (point 80 et seqq.) for information about the consequences if the record-keeping obligation is breached.

38 The simplifications set out in section 6 (1) of the Ordinance on the Documentation of Profit Allocations consist primarily of allowing the obligation to submit records to also be fulfilled by providing verbal information by the deadline (section 90 (3) sentence 7 of the Fiscal Code) and submitting the existing documentation. Section 93 (4) sentence 2 of the Fiscal Code remains unaffected.

39 When checking whether the threshold specified in section 6 (2) of the Ordinance on the Documentation of Profit Allocations has been exceeded, the amounts received for supplies and services of all related German companies as referred to in sections 13, 18 and 19 of the General Administrative Provision for Tax Audits (*Betriebsprüfungsordnung*, 2000 Tax Audit Code of 15 March 2000, Federal Tax Gazette p. 368, as last amended by the general administrative provision of 20 July 2011, Federal Tax Gazette I p. 710) which have been received from and made to foreign related parties must be added together. Goods as referred to in the provision can include all tangible and intangible assets. Business relations with domestic related parties are not taken into account in the calculation.

### 1.3.2. Documentation of facts and commensurateness (section 90 (3) sentence 2 of the Fiscal Code)

#### 1.3.2.1. Documentation of facts

40 For the documentation of facts, taxpayers must produce records on the type, content and scope of their business relations with related parties and on the economic and legal frameworks of these relations (cf. section 1 (2) and section 4 of the Ordinance on the Documentation of Profit Allocations).

41 For example, the following information could be of particular significance, depending on the type of business relations:

| **Activity** | **Functions** | **Assets used** | **Risks** |
|---|---|---|---|
| **Research and development (as a stand-alone activity)** | Basic research, product development, product design, licensing, patent development, control and management of risks | Patents, licences, key intangible assets | Failed research, market advantages from successful research, opportunities for royalty income, substitution risk, market risk, patent risks |
| **Manufacturing of products** | Design, research and development, product management, production planning, purchasing of raw materials etc., storage of raw materials etc., production, packaging, assembly, quality assurance, procurement, storage of products, logistics, sales and marketing (if applicable), administration, control and management of risks | Licences, product and/or process know-how, trademarks, real estate, production facilities, purchasing guarantees | Investment risks, capacity or utilisation risks, quality risks, environmental risks, product liability risks, risks relating to government interventions (e.g. environmental legislation, minimum wage), guarantee risk |

| | | | |
|---|---|---|---|
| **Sales and marketing** | Storage, advertising, sales and marketing, financing, transport, payment of customs duties, assembly, technical support, customer service, pricing, control and management of risks | Distribution rights, trademark rights, customer base, vehicles, storage equipment | Sales-related risks (changing tastes among customers, economic downturns), opportunities for net profit from trading and sales activities, market price risks, risks of insolvency, exchange rate risk, transportation risks, storage risks |
| **Business administration** | Management, coordination, strategy development, controlling, financing, accounting, recruiting, training of employees, control and management of risks | Special software, know-how, real estate, buildings | Business risks, liquidity risks |
| **Financing** | Lending operations, discounting, guarantee operations, custody of crypto assets, factoring, leasing, control and management of risks | Assets pledged as collateral, know-how | Exchange rate risk, maturity transformation risk, liquidity risk, debtor risk |
| **Insurance** | Insurance against risks, identification, control and management of risks | - | Risk transfer, insurance-related risk |

42 The records must allow a competent third party to understand, within a reasonable period of time, the fundamentals of how value is generated within the group (cf. paragraph 1.51 of the OECD Transfer Pricing Guidelines 2017) or within the unified business (point 30), as well as to understand the business model and the function and risk profiles of the parties to the transaction. Only then is it possible to evaluate whether the transfer prices are appropriate.

43 The business relations that are transacted with the individual related parties must be presented in an overview with regard to their type and the amount of the remuneration (transaction overview). In the case of loan relationships, the amount of the loan (principal) must also be recorded. It is generally necessary to submit the underlying contracts for evaluation purposes.

1.3.2.2. Documentation of commensurateness

44 In addition, records must be produced on the appropriateness of the transfer prices (documentation of commensurateness, cf. section 1 (3) and section 4 of the Ordinance

on the Documentation of Profit Allocations). These refer to the fundamental economic and legal aspects which show that the taxpayer followed the arm's length principle.

The documentation of commensurateness must demonstrate that the taxpayer is making a serious effort to follow the arm's length principle for the purposes of income assessment for taxation. The records must reflect the considerations that have been made in this regard and must ensure that a competent third party is able to understand these considerations within a reasonable period of time.

45 To this end, the taxpayer must justify the suitability of the transfer pricing method that has actually been used or of the hypothetical arm's length test, and the appropriateness of the prices or the results that are used as a basis for tax purposes (section 4 (1) no 4 (d) of the Ordinance on the Documentation of Profit Allocations). Taxpayers are therefore obliged to record why they consider the transfer pricing method that they have used in the respective case to be the most suitable method, or why the hypothetical arm's length test must be used. Taxpayers are not obliged to validate their results using other methods.

46 The revenue authorities themselves choose the correct transfer pricing method, namely the method that proves to be the most suitable. If the revenue authority uses in its assessment a different method than the taxpayer, this can only lead to an adjustment being made if the results of the alternative method are more probable. Taxpayers must submit the information that is required in this respect to the revenue authorities. If, for example, uncertainties about the comparability of data cannot be eliminated during the course of a field audit, the revenue authority may for its part carry out validation calculations in order to assess whether the taxpayer's results are to be recognised or discarded. The permissibility and necessity of investigating, substantiating and validating the results of one method by using a different method also arise from established case-law (Federal Fiscal Court judgment of 17 October 2001, I R 103/00, Federal Tax Gazette 2004 II p. 171; Federal Fiscal Court judgment of 6 April 2005, I R 22/04, Federal Tax Gazette 2007 II p. 658).

47 If the hypothetical arm's length test is used, then, due to the importance of the underlying assumptions and valuation parameters, a proper assessment of the valuation is only possible if all the underlying assumptions that were relevant when creating the valuation model are presented in detail, and the basis for selecting the valuation parameters is described. It must be explained why these assumptions and valuation parameters are appropriate for the specific transaction. In addition, sensitivity analyses should be used to provide information on how the calculated value of the subject of the valuation changes if alternative assumptions and parameters are

chosen for the model (see also paragraph 6.160 of the OECD Transfer Pricing Guidelines 2017).

48 The documentation of commensurateness must relate to the taxpayer's agreement with the related party that was actually concluded and carried out. If, for example, the taxpayer based the taxation on a different price than the one that was agreed under civil law, then the records must show the transfer price that was used for taxation purposes. If the taxpayer has concluded contracts but has not performed these contracts in accordance with what was agreed, then the records must relate to the actual circumstances and hence the business relation that was actually performed.

49 The relevant point in time with regard to the arm's length test is generally the time when the contract was concluded, not the time when it was fulfilled (Federal Fiscal Court judgment of 9 March 1983, I R 182/78, Federal Tax Gazette II p. 744). For this reason, the records must be based on the circumstances at the time when the transaction was agreed. Taxpayers may use as a basis external comparability data that has subsequently become known, to the extent that this data relates to the time when the transaction was agreed. Hence the decisive factor remains the circumstances at the time when the transaction was agreed. Accordingly, the information given regarding the time when the transfer price was determined should enable the revenue administration to carry out a better assessment of the temporal distance that applied when the business relations that were actually carried out were checked in terms of compliance with the arm's length principle.

50 Documentation of commensurateness that draws on planning calculations must, as far as possible, be based on comparables data such as arm's-length profit mark-ups or the normal return on capital under market conditions. The underlying planning assumptions must be individually justified on the basis of experience from previous periods and on the basis of commercial projections that are economically well-founded and cautious (Federal Fiscal Court judgment of 17 February 1993, I R 3/92, Federal Tax Gazette II p. 457). Taxpayers must carry out comparisons between the projected figures and the actual figures on a regular basis, in order to be able to react in good time to changes in business performance. Measures that are adopted in response must be recorded and justified. If the developments that have actually happened deviate significantly from the projections that had been prepared, the taxpayer must record the deviations and show that these deviations were due to unexpected circumstances (e.g. extraordinary costs, economic crises, natural disasters) that the taxpayer could not have taken into account in their cautious commercial projections.

51 The documents that are relevant for taxation purposes and the financial statements of all participants, including single-entity financial statements that are suitable for consolidation (known as financial statements II (*Handelsbilanzen II*)), must be submitted so that the appropriateness check can be carried out.

52 Transfer pricing guidelines used by the taxpayer and by the group to which the taxpayer belongs form part of the records (section 2 (3) sentence 5 of the Ordinance on the Documentation of Profit Allocations). Corresponding requirements apply to these transfer pricing guidelines. If taxpayers deviate from the transfer pricing guidelines in a specific case, they must justify the deviation, record the reasons relating to the respective transaction, and show that the divergent price determination is appropriate.

53 If information from databases is used, then a precondition for a check by the revenue authorities is that the search process carried out in the database must be understandable and verifiable, within the scope of what is possible technically. It must be made possible for the revenue authorities to independently carry out alternative calculations based on the data used by the taxpayer and to be able to establish whether the taxpayer took into account all the relevant information using a range of appropriate search criteria. Given that the results obtained by merely carrying out a database screening are generally not sufficient for checking the comparability of facts and circumstances and hence checking the documentation of commensurateness, additional search steps and selection processes must be recorded and documented accordingly (cf. section 4 (3) of the Ordinance on the Documentation of Profit Allocations). The data produced and collated by the taxpayer for this purpose must be made available to the revenue authority in electronic form within the scope of section 147 (5) and (6) of the Fiscal Code.

1.3.3. Master file (section 90 (3) sentences 3 to 4 of the Fiscal Code)

54 Pursuant to section 90 (3) sentence 3 of the Fiscal Code, taxpayers must under certain conditions produce documentation known as a “master file” for a company as part of the transfer pricing documentation. This provision implements the recommendations of the OECD/G20 final report of 5 October 2015 on Action 13 of the BEPS project in German law. The contents of this final report were incorporated into Chapter V and Annex I to Chapter V of the OECD Transfer Pricing Guidelines 2017. The objective and purpose of the master file are to give revenue authorities an overview of the nature of the multinational group’s global business operations and of the system that it uses to determine transfer prices.

55 The following conditions apply when determining if a master file needs to be produced:

a. The company (enterprise) is part of a multinational group.
b. The term “enterprise” (*Unternehmen*) as used in this provision refers to businesses that generate income from commercial operations pursuant to section 15 (1) sentence 1 (1) of the Income Tax Act (*Einkommensteuergesetz*).
c. The company’s revenue amounted to at least €100 million in the preceding fiscal year. The term “revenue” (*Umsatz*) is based on section 277 (1) of the Commercial Code (*Handelsgesetzbuch*). What is relevant in this respect are the company’s non-consolidated domestic and foreign revenues with regard to third parties and related parties as defined in section 1 (2) of the External Tax Relations Act. Internal revenues between the company and its permanent establishments must not be included. When determining whether the revenue limit of €100 million has been exceeded, the size of foreign revenues as a proportion of total revenue is irrelevant. A master file must also be prepared even if the foreign revenues only represent a negligible share of the relevant total revenue.

56 The scope of the master file is set out in section 5 (1) sentence 1 of the Ordinance on the Documentation of Profit Allocations and in the Annex to section 5 of this Ordinance. The Annex lists the individual records and documents that must be presented. This is an exhaustive list; section 90 (3) sentence 10 of the Fiscal Code (point 66) and section 2 (5) of the Ordinance on the Documentation of Profit Allocations must nevertheless be observed.

57 Pursuant to section 5 (2) of the Ordinance on the Documentation of Profit Allocations, it should be possible for the taxpayer to achieve the objective of the master file using a reasonable amount of resources (principle of proportionality). The nature of the master file as an overview should be preserved. Hence documents that are required as part of the master file, but which the revenue authorities already have at their disposal, do not need to be submitted again by the taxpayer (e.g. the consolidated financial statement); a corresponding reference in the master file is sufficient.

58 The discretional leeway granted in sentence 2 of the Annex to section 5 of the Ordinance on the Documentation of Profit Allocations with regard to the interpretation of imprecise legal terms contained in the Annex should be based on the recommendations of the OECD/G20 final report on Action 13 of the BEPS project and on Chapter V of the OECD Transfer Pricing Guidelines 2017. This ensures that the master file is implemented in a uniform way worldwide.

59 The master file pursuant to section 90 (3) sentence 3 of the Fiscal Code supplements, in terms of content, the country-specific company-related transfer pricing documentation (local file) pursuant to section 90 (3) sentences 1 and 2 of the Fiscal Code. However, a separate report or report section must be produced for the master file pursuant to section 90 (3) sentence 3 of the Fiscal Code which, if necessary, can make reference to the country-specific company-related transfer pricing documentation (local file) and any documents that have already been provided to the revenue authorities.

60 If the record-keeping obligation pursuant to section 90 (3) sentence 3 of the Fiscal Code is not complied with, then coercive measures (section 328 of the Fiscal Code) or a fine for delay (section 146 (2b) of the Fiscal Code) may be applied.

1.3.4. Requesting of documents (section 90 (3) sentences 5 to 6 of the Fiscal Code, section 2 (6) of the Ordinance on the Documentation of Profit Allocations)

61 Pursuant to section 90 (3) sentence 5 of the Fiscal Code in conjunction with section 2 (6) of the Ordinance on the Documentation of Profit Allocations, revenue authorities may decide at their own discretion whether and when they request the submission of records. In general, documents should only be requested for the purpose of conducting a field audit. In justified individual cases, the records may also be requested outside the scope of a field audit. For example, the carrying out of a mutual agreement procedure may provide a reason to request the submission of records as referred to in section 90 (3) sentence 5 of the Fiscal Code, even outside the scope of a field audit.

62 For the purpose of expediting a possible mutual agreement procedure, the taxpayer may already inform in advance the authority that is responsible in this respect that an income adjustment was carried out at a related party or a permanent establishment in a foreign country. This authority is then responsible for suggesting that the taxpayer submit all the required documents (section 90 (2) of the Fiscal Code) and prepare records pursuant to section 90 (3) of the Fiscal Code even outside the scope of a field audit.

1.3.5 Period for submission and extension (section 90 (3) sentences 7 and 9 of the Fiscal Code)

63 The period for submission begins with the notification of the requirement, not with the beginning of the audit at the taxpayer’s company. The revenue authority may then also

request the submission of the documents within this period even if the field audit is delayed upon application by the taxpayer.

64 It is the taxpayer's responsibility to take the necessary precautions so that they are able to comply with the submission deadline. The revenue authority assumes that taxpayers collect the data and facts that are essential for determining transfer prices on a regular and timely basis and keep them available in an appropriate and orderly manner.

65 If, in an individual case, it becomes apparent that the taxpayer is having significant difficulties in their efforts to prepare to comply with the record-keeping obligations, this can be discussed in advance with the revenue authority responsible for the field audit. This does not imply any recognition of the transfer prices used by the taxpayer.

1.3.6. Submission of additional records upon request (section 90 (3) sentence 10 of the Fiscal Code)

66 Pursuant to section 90 (3) sentence 10 of the Fiscal Code, revenue authorities may request that taxpayers supplement the submitted records by providing additional or more detailed documents within an appropriate period of time. Submitting additional records is in particular necessary if the revenue authority believes there are grounds for additional follow-up questions on the basis of the records already submitted.

## 2. Estimating tax bases; penalties (section 162 of the Fiscal Code)

### *2.1 General*

67 The cooperation obligations set out in section 90 (1) to (3) sentences 1 and 2 and section 200 of the Fiscal Code are deemed to be breached in particular if participants fail to disclose to the revenue authority facts that lie exclusively or predominantly within their sphere of knowledge. In such cases, the revenue authority is authorised to estimate the tax base. Persons who corrupt evidence should not derive any advantage from their behaviour (Federal Fiscal Court judgment of 15 February 1989, X R 16/86, Federal Tax Gazette II p. 462).

68 In principle, the burden of proof for facts that give rise to or increase a tax claim lies with the revenue authority. The question of the burden of proof arises in cases where the circumstances that are relevant for a decision cannot be fully clarified, even after all available and reasonable investigation avenues have been exhausted. The taxpayer and the revenue authority share responsibility for the full clarification of the

circumstances; consequently, in cases where a taxpayer breaches general or specific cooperation, information or documentation obligations, the revenue authority's obligation to investigate is reduced accordingly. The criteria for and the extent of this reduction of the obligation to clarify the circumstances and the standard of proof cannot be specified generally, but can only be determined on a case-by-case basis. In particular, if taxpayers breach cooperation obligations that relate to facts or evidence falling under their sole responsibility, revenue authorities may draw conclusions from this behaviour that are to the taxpayers' disadvantage. In this context, the idea of "proximity to the evidence" is especially important: The taxpayer's responsibility to clarify the circumstances of the case increases in line with the amount of facts and evidence belonging to the sphere of information or activities that is controlled by the taxpayer (Federal Fiscal Court judgment of 15 February 1989, X R 16/86, Federal Tax Gazette II p. 462). Nevertheless, the revenue authority must clarify the circumstances in these cases too, insofar as this is reasonable.

69 If the breach of cooperation obligations affects multiple elements of an income adjustment provision, the standard of proof is reduced for each affected element of the adjustment provision.

70 The basis of the estimate is an act of evaluative deduction (Federal Fiscal Court judgment of 26 February 2002, X R 59/98, Federal Tax Gazette II p. 450) involving making assumptions about circumstances that are as close as possible to reality. The result of the estimate should be as close as possible to the actual circumstances (Federal Fiscal Court judgment of 13 March 1999, V R 78/98, BFHE 188 p. 160). The estimates thus obtained must be coherent, reasonable and economically feasible (Federal Fiscal Court judgment of 20 March 2017, X R 11/16, Federal Tax Gazette II p. 992). Any imprecisions resulting from the estimate are resolved to the taxpayer's detriment.

71 To verify the transfer price actually agreed and as a basis for the estimate pursuant to section 162 (1) of the Fiscal Code, the arm's length price may, in specific individual cases, be determined with the help of a suitable transfer pricing method, in a way that achieves the greatest possible probability of correctness (Federal Fiscal Court judgment of 17 October 2001, I R 103/00, Federal Tax Gazette II 2004 p. 171).

72 Database analyses are a permissible estimating method for the purposes of section 162 of the Fiscal Code. Comparable enterprises are to be determined individually. In this respect, estimates must be internally consistent overall.

73 The submission of usable records does not rule out income adjustments. The revenue authority may request further information and documents in addition to such records (section 88 of the Fiscal Code) and carry out validations using other methods. In this context, the revenue authority may, in line with point 49, also base its validation on external comparability data that has subsequently become known. Usable records are merely the starting point for the audit. Therefore, the submission of usable records does not preclude the revenue authority from being authorised to estimate the tax base pursuant to section 162 (1) and (2) of the Fiscal Code. Shortcomings in the taxpayer's justification of the appropriateness of the income are not sufficient grounds for an income adjustment. Rather, the prerequisite for an income adjustment is that the transfer prices applied by the taxpayer are highly unlikely to be in line with the arm's length principle and that the transfer price calculated by the revenue authority is at least more plausible.

74 The revenue administration of the state that has proposed the primary adjustment bears the burden of proof in the mutual agreement procedure (see paragraph 4.17 of the OECD Transfer Pricing Guidelines 2017).

### *2.2 Estimates pursuant to section 162 (1) of the Fiscal Code*

75 An estimate is not wrongful merely because it does not correspond to the actual circumstances. Deviations from the actual circumstances are unavoidable, since the real situation is not fully known. An estimate is wrongful only if the estimating framework, which is delimited by the revenue authority's knowledge of the case, is exceeded. If the revenue authority knowingly and deliberately makes an estimate that is to the taxpayer's disadvantage (punitive estimate), this may render the estimate notice void (Federal Fiscal Court judgment of 1 October 1992, IV R 34/90, Federal Tax Gazette 1993 II p. 259; Federal Fiscal Court judgment of 20 December 2000, I R 50/00, Federal Tax Gazette 2001 II p. 381).

### *2.3 Estimates pursuant to section 162 (2) of the Fiscal Code*

76 If the tax bases have to be estimated for reasons falling under the taxpayer's responsibility, e.g. if the taxpayer has breached cooperation obligations pursuant to section 90 (2) of the Fiscal Code, any uncertainties are resolved to the taxpayer's detriment (reduced standard of proof). In the case of serious breaches on the part of the taxpayer which necessitate significant adjustments compared with the information provided in the tax return, the revenue authority is generally entitled and obliged to determine the tax base according to the circumstances that are most unfavourable for the taxpayer while still being feasible (Federal Fiscal Court judgment of

9 March 1967, IV 184/63, Federal Tax Gazette II p. 349). In these cases, too, punitive estimates are not permissible.

77 In transfer pricing cases, an estimate pursuant to section 162 (2) of the Fiscal Code is intended to result in the taxation of the profits that would have been obtained if transfer prices based on the arm's length principle had been applied. The requirements placed on the evidence to be furnished by the revenue authority must not be excessive (Federal Fiscal Court judgment of 23 June 1993, I R 72/92, Federal Tax Gazette II p. 801).

78 If the prerequisites for an estimate pursuant to section 162 (2) of the Fiscal Code are met, the tax bases may be estimated using methods and data that would not constitute sufficient evidence for an income adjustment in circumstances other than such estimates (e.g. standard rate comparison, industry averages).

79 The right to estimate the tax base is not conditional on the revenue authority's having previously taken recourse to international legal and administrative assistance.

### *2.4 Estimates pursuant to section 162 (3) of the Fiscal Code and penalty pursuant to section 162 (4) of the Fiscal Code*

80 If a taxpayer breaches the record-keeping obligations pursuant to section 90 (3) of the Fiscal Code by

a. failing to submit records or submitting records that are essentially of no use, despite a request from the revenue authority or
b. having failed to compile usable records on exceptional transactions in a timely manner (section 3 of the Ordinance on the Documentation of Profit Allocations),

it is rebuttably presumed, pursuant to section 162 (3) sentence 1 of the Fiscal Code, that the taxpayer's income from business relations as defined in section 1 (4) of the External Tax Relations Act was reduced in a way that is not in line with the arm's length principle. In such cases, the taxpayer bears the burden of proving that no income reduction has taken place.

81 In cases where records on exceptional transactions were compiled in an untimely manner, their value as evidence must be considered, taking into account the fact of the delay (indication).

82 Records are essentially of no use if they do not make it possible for a competent third party to determine and assess, within a reasonable period of time, what circumstances the taxpayer has realised and whether the taxpayer followed the arm's length principle in the process. The question of usability therefore refers to both documentation of facts and commensurateness. The standards of proper accounting (cf. Application Ordinance for the Fiscal Code on section 158 of the Fiscal Code) apply accordingly. In particular, records are of no use if

a. there is no documentation of facts, or the documentation of facts describes the circumstances incorrectly (in conjunction with a significant impact on the function and risk profile, e.g. an entrepreneur is described as a "routine" company, description of the contractual situation instead of (different) actual facts),
b. there is no documentation of commensurateness, or the external data presented is not consistent with the function and risk profile,
c. the commensurateness analysis does not contain sufficient justification of the comparability of the external data used (e.g. arm's length prices or outside companies) (comparability analysis, paragraphs 3.1 et seqq. of the OECD Transfer Pricing Guidelines 2017), or
d. the application of the chosen transfer pricing method is not shown.

If the documentation of commensurateness is based on a small amount of external comparability data, this does not always mean that the records are essentially of no use. Generally, the decisive factor is not the quantity of the records presented, but their quality. If records are incomplete or incorrect on individual points, this alone does not usually render them essentially of no use.

83 A decision regarding the usability of specific records has no bearing on records pertaining to other audit subjects.

84 If the revenue authority determines that records are essentially of no use, it must inform the taxpayer immediately and give the taxpayer an opportunity to rectify this. Irrespective of this, the revenue authority must check on a case-by-case basis whether it is possible and reasonable to render the records usable without further involvement by the taxpayer, so as to avoid or minimise penalties (proportionality principle).

85 Pursuant to section 162 (3) and (4) of the Fiscal Code, the legal consequences of breaches of the record-keeping obligation set out in section 90 (3) sentences 1 and 2 of the Fiscal Code apply in a transaction-based way. This means that, if records on an exceptional transaction are not compiled on a timely basis, or if records on a transaction are not submitted or are not usable, no legal consequences arise in respect

of other transactions. The fact that it is generally permissible to combine transactions (section 3 of the Ordinance on the Documentation of Profit Allocations) must be taken into account. If the taxpayer fails to comply with a request by the revenue authority to submit additional records pursuant to section 90 (3) sentence 10 of the Fiscal Code (cf. point 66), or if the records then presented are essentially of no use, section 162 (3) and (4) of the Fiscal Code also apply in a transaction-based way. Section 162 (3) and (4) of the Fiscal Code do not apply to the record-keeping obligation pursuant to section 90 (3) sentence 3 of the Fiscal Code.

86 If an estimate pursuant to section 162 (3) sentence 2 of the Fiscal Code is necessary because the taxpayer has committed breaches as specified in section 162 (3) sentence 1 of the Fiscal Code, and if the revenue authority has determined an estimating framework, then the revenue authority may exhaust the scope of this framework to the taxpayer's detriment.

87 An estimate may be reviewed and corrected in a subsequent mutual agreement or arbitration procedure (EU). In this context, however, taxpayers are obliged to contribute to the procedure by disclosing their circumstances and by describing, and if necessary providing, documentary evidence.

88 Section 162 (3) and (4) of the Fiscal Code also apply if the taxpayer meets the requirements of section 6 of the Ordinance on the Documentation of Profit Allocations, but breaches the obligations arising therefrom.

89 In imposing and legally assessing the penalty, the following must be observed:

a. The penalty is an ancillary tax payment as defined in section 3 (4) of the Fiscal Code, which applies to income tax or corporation tax. It is not deductible (section 12 no 3 of the Income Tax Act and section 10 no 2 of the Corporation Tax Act).
b. The imposition of a penalty pursuant to section 162 (4) of the Fiscal Code does not preclude either the imposition of a late-filing penalty (section 152 of the Fiscal Code) or the implementation of criminal or administrative offence proceedings (sections 369 et seqq. of the Fiscal Code).
c. The penalty may be imposed against any person who is subject to section 90 (3) of the Fiscal Code and from whom the revenue authority has requested the submission of the records referred to in section 162 (4) sentence 1 of the Fiscal Code, but not twice in respect of the same matter, e.g. against a partnership and its shareholders if records on the same matter were requested from both the partnership and its

shareholders. In such cases, the two persons are joint and several debtors as set out in section 44 of the Fiscal Code.

d. The penalty must be imposed uniformly for each assessment period for which records were requested. For example, the request may cover records for the audit area selected by the revenue authority and ultimately records on an individual (e.g. exceptional) transaction. The fact that it is generally permissible to combine transactions (section 3 of the Ordinance on the Documentation of Profit Allocations) must be taken into account. The penalty may therefore be based on multiple breaches of obligations in parallel and, in each case, with respect to different requests from the revenue authority: the failure to submit records, the submission of records that are of no use, the late submission of usable records. The composition of the penalty must be set out in detail upon imposition. The exercise of discretion must be substantiated in each case. In particular, the taxpayer's degree of fault, the length of time by which the deadline has been missed, and especially the benefits derived by the taxpayer must be taken into account.

e. If a penalty was imposed pursuant to section 162 (4) sentences 1 and 2 of the Fiscal Code based on the fact that the taxpayer failed to submit records during a field audit, or submitted records that were essentially of no use, and on the fact that the income was increased based on a legitimate estimate pursuant to section 162 (3) of the Fiscal Code, the penalty may be adjusted within the framework of sections 130 et seqq. of the Fiscal Code if, in legal remedy proceedings, a mutual agreement procedure or an arbitration procedure (EU), the income in question is set at a lower amount than the amount determined based on the field audit. In such cases, an adjustment of the penalty (recalculation) is possible only if the taxpayer submits usable records. If usable records are subsequently submitted in the procedures specified above, the penalty itself must be recalculated due to late submission pursuant to section 162 (4) sentences 3 and 4 of the Fiscal Code if adjustments of the penalty are possible within the framework of sections 130 et seqq. of the Fiscal Code.

f. The penalty pursuant to section 162 (4) sentence 3 of the Fiscal Code due to late submission may be higher than the penalty pursuant to section 162 (4) sentence 1 of the Fiscal Code in the case of a failure to submit records or the submission of records that are essentially of no use.

90 Section 162 (4) sentences 1 to 3 of the Fiscal Code do not apply in cases where the failure to fulfil obligations pursuant to section 90 (3) of the Fiscal Code appears excusable or the degree of fault is negligible. For example, this may be the case if records are presented in German after expiry of the 60-day deadline because the revenue authority, after requesting the records, did not immediately take a decision about a taxpayer's application for permission to compile and submit the records in a

foreign language, or if *force majeure* made it impossible for a taxpayer to fulfil the obligations in time.

## 3. Repeal of administrative provisions

91 The Federal Ministry of Finance circular of 12 April 2005 (IV B 4 - S 1341 - 1/05; Federal Tax Gazette 2005 I p. 570) continues to apply to the extent that no issues pertaining to the application of sections 90 and 162 of the Fiscal Code are affected. This applies particularly with regard to the following sections:

a. 1 (Application *mutatis mutandis* of the Federal Ministry of Finance circular to permanent establishments),
b. 2 (Obligations of the revenue authorities),
c. 3.4.10.2 (Company characterisation and transfer pricing),
d. 3.4.10.3 (Transfer pricing methods),
e. 3.4.12.5 (Ranges and the narrowing thereof),
f. 3.4.12.7 (Comparability),
g. 3.4.12.8 (Retrospective pricing and price adjustments),
h. 3.4.12.9 (Multi-year analyses),
i. 5 (Adjustments and their tax treatment),
j. 6 (Processing of transfer pricing adjustments and mutual agreement or arbitration procedures) and
k. 7 (Repeal of administrative provisions).

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