

## **Final German Administrative Principles for the Profit Attribution to Permanent Establishments published**

The guidance provides the German tax authorities' opinion on the interpretation of the "Authorized OECD Approach – AOA" as outlined in Sec. 1 para. 5 German Foreign Tax Code and the Decree Law on the Attribution on Profits to Permanent Establishments.

In Germany, the Authorized OECD Approach ("AOA") was implemented in the domestic tax law by amending Sec. 1 Para. 5 German Foreign Tax Act with effect for fiscal years beginning after December 31, 2012. The AOA was introduced by the OECD in 2008 and treats permanent establishments for profit allocation purposes as if they were separate legal entities. Further guidance on the attribution of profits between a head office and a permanent establishment ("PE") was provided by the German Federal Ministry of Finance ("BMF") with the help of the Decree Law on the Attribution on Profits to PEs ("Decree Law") with effect for fiscal years beginning after December 31, 2014. After issuing a first draft in March 2016, on December 12, 2016 the BMF published the final version of the Administrative Principles for the Attribution of Profits to PEs ("Administrative Principles") which provides the German tax authorities' opinion on the interpretation of the AOA as outlined in Sec. 1 para. 5 German Foreign Tax Act and the Decree Law.

The profit attribution according to the AOA follows a two-step approach, i.e.

- the performance of a functional and risk analysis considering the significant people's functions, and
- a transfer pricing analysis applying the accepted transfer pricing methods with respect to actual and deemed ("dealings") transactions.

In addition, the Decree Law introduced the further requirement of the preparation of a so-called "auxiliary calculation". This auxiliary calculation means the practical implementation of the two-step approach as described above for tax purposes and serves as a basis for the preparation of the tax payer's income tax return.

With respect to Sec. 1 para. 5 German Foreign Tax Act and the Decree Law, within its 186 pages the Administrative Principles contain general explanations on the AOA as well as further guidance on the individual stipulations of the Decree Law which are concretized and supplemented with further description and examples. Moreover, the general applicability of Sec. 1 Para. 5 German Foreign Tax Act and the Decree Law are discussed.

In this respect, the Administrative Principles in particular reflects the following aspects:

- Identification of the significant people functions;
- Attribution of tangible and intangible assets, opportunities and risks, free capital, liabilities, business transactions;
- Identification of dealings;
- Preparation of the auxiliary calculation;
- Specific requirements for certain industries (e.g. construction and assembly, exploration, financing and insurance) and for dependent agent permanent establishments.

In comparison with the Decree Law the Administrative Principles provide further material clarifications, e.g. concerning:

- Relationship between Sec. 1 Para. 5 German Foreign Tax Act and other domestic rules;
- Relationship between Sec. 1 Para. 5 German Foreign Tax Act and the stipulations of the double tax treaties;
- Impact of Sec. 1 Para. 5 German Foreign Tax Act and the Decree Law on crediting

according to the double tax treaties;

- Impact of Sec. 1 Para. 5 German Foreign Tax Act and the Decree Law on German trade tax issues;
- Effectiveness of Sec. 1 Para. 5 German Foreign Tax Act and the Decree Law;
- Applicability of the existing Administrative Principles regarding PEs and the Administrative Principles regarding Free Capital.

In fact, the Administrative Principles provide further explanation and examples on the application of the AOA and thus, contribute to a higher level of legal certainty. However, it is expected that tax payers will have difficulties in the practical implementation of the AOA due to the fact that the Administrative Principles do not cover all issues and individual cases that may arise in tax payer's business reality.

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