

Ordinance governing the application of the arm's length principle in accordance with section 1 (1) of the External Tax Relations Act in cases of cross-border relocations of business functions (Business Function Relocation Ordinance (*Funktionsverlagerungsverordnung – FVerIV*))¹

Business Function Relocation Ordinance

Latest version of the complete text as of 31/07/2017

Ordinance governing the application of the arm's length principle in accordance with section 1 (1) of the External Tax Relations Act in cases of cross-border relocations of business functions (Business Function Relocation Ordinance (*Funktionsverlagerungsverordnung – FVerIV*))

As at: Last amended by Article 24 of the Act of 26/06/2013 I 1809

Footnotes

(+++ Text reference from: 01/01/2008 +++)

(+++ For details relating to application please see sections 12 +++)

This Act amends the following laws

Provision	Amendment	Amended law	Applicable		
			from	to	Version
Section 13	Entry into force	FVerIV	01/01/2008		

Enacting Clause

On the basis of section 1 (3), thirteenth sentence, of the External Tax Relations Act (*Aussensteuergesetz*) of 8 September 1972 (Federal Law Gazette I, p. 1713), as inserted by Article 7 of the Act of 14 August 2007 (Federal Law Gazette I, p. 1912), the Federal Ministry of Finance orders as follows:

Part I – General rules

Section 1 – Definitions

(1) ¹A business function is a business activity consisting of an aggregate of similar operational tasks performed by certain offices or departments of an enterprise. ²It is an organic part of a company without constituting a partial entity for taxation purposes.

(2) ¹A relocation of business functions as contemplated by section 1 (3), ninth sentence, of the External Tax Relations Act, subject to the application of section 1 (6) and section 1 (7), shall apply where a company (the relocating enterprise) transfers economic assets or other benefits to another related entity (the accepting enterprise) as well as the related opportunities and risks or allows it to make use of such economic assets and other benefits so that the accepting enterprise can exercise a business function hitherto performed by the relocating enterprise, causing the exercise of the relevant business function by the relocating enterprise to be restricted. ²If the accepting enterprise only assumes the business function on a temporary basis, this may also constitute a relocation of business functions. ³Business transactions realised within five fiscal years shall be consolidated as a uniform relocation of business functions at the time at which the requirements of the first sentence above have been met in economic terms on account of their joint realisation.

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

(3) A transfer package as contemplated by section 1 (3), ninth sentence, of the External Tax Relations Act consists of a business function and of the opportunities and risks associated with it, along with the economic assets and benefits transferred by the relocating enterprise to the accepting enterprise together with the business function (or allowing it to use the assets and benefits), and the services rendered in this context.

(4) Profit potential as contemplated by section 1 (3), sixth sentence, of the External Tax Relations Act shall be net after-tax profits expected to be generated by the relocated business function from time to time (present value) which a prudent and conscientious business manager within the meaning of section 1 (1), third sentence, of the External Tax Relations Act would not dispense with gratuitously from the perspective of the relocating enterprise and for which such a business manager from the perspective of the accepting enterprise would be prepared to pay consideration.

(5) Intangible assets and benefits shall, in cases of business function relocations, be significant within the meaning of the External Tax Relations Act, section 1 (3), tenth sentence, first alternative, if they are required for the relocated business function and their arm's length transaction price amounts to a total of more than 25 per cent of the sum total of individual prices of all economic assets and benefits of the transfer package and if this is plausible, taking into account the consequences of the business function relocation as documented in the records made pursuant to section 3 (2), second sentence.

(6) ¹An operation shall not be deemed a business function relocation within the meaning of subsection (2) above, if, in spite of the remaining requirements of subsection (2), first sentence, above, having been met, within a period of five years after the business function was assumed by the related entity, the exercise of the relevant business function is not restricted by the enterprise first mentioned in subsection (2), first sentence, above (duplication of business functions). ²If, within this period, there is such a restriction, then at the time at which such restriction occurs, on the whole a uniform business function relocation shall be deemed to exist, unless the taxable person can furnish evidence to show that there is no direct economic link between this restriction and the duplication of business functions.

(7) ¹Equally, if only economic assets are sold, or allowed to be used, or if only services are rendered – unless these transactions are part of a business function relocation – an operation shall not be deemed a business function relocation as contemplated by subsection (2), above. ²The same shall apply where personnel is posted for assignments if this is not accompanied by a business function, or if the process would not have been considered a sale or acquisition of a business function between third parties independent from one another.

Footnotes

Section 1 (4): In the version of Article 24 of the Act of 26/06/2013, Federal Law Gazette I, p. 1809 with effect as of 01/01/2013

Section 2 – Applying the rules to the transfer package

(1) ¹In cases of business function relocations where the determination of prices for the transfer package as a whole can be effected on the basis of values for comparison purposes with limited or unlimited comparability, priority shall be given to the application of section 1 (3), first to fourth sentences, of the External Tax Relations Act. ²If not, the price determination for the transfer package shall be made in accordance with the hypothetical arm's length principle in accordance with section 1 (3), fifth and sixth sentences, of the External Tax Relations Act. ³Section 1 (3), tenth sentence, first alternative, of the External Tax Relations Act shall remain unaffected by the above.

(2) ¹If the accepting enterprise exercises the relocating business function exclusively in relation to the relocating enterprise and if the remuneration payable for exercising the business function and for rendering the relevant services shall be determined according to the cost plus method, it shall be assumed that the passage of the transfer package will result in no material intangible assets and benefits being transferred, so that section 1 (3), tenth sentence, first alternative, of the External Tax Relations Act shall be applicable. ²If an accepting enterprise as contemplated by sentence 1, above, independently performs the services previously rendered exclusively to the relocating enterprise, either wholly or in part, to other enterprises at prices that exceed the remuneration received in accordance with the cost plus method, or which are to be valued at a higher level in accordance with the arm's length principle, then remuneration in accordance with section 3 shall be charged for the economic assets and benefits made available the first time the service previously performed gratuitously by the relocating company is rendered to the other companies; the relevant economic assets and benefits shall be deemed a transfer package to the extent that the other

requirements applicable in this regard have been met.

(3) ¹ In those cases which, in accordance with section 1 (3), tenth sentence, second alternative of the External Tax Relations Act, require the recognition of transfer pricing for a business function relocation on the basis of the sum total of transfer prices for the individual economic assets and benefits concerned, then both the arm's length range and the value of the transfer package as a whole shall be determined in accordance with section 1 (3), seventh and ninth sentences, of the External Tax Relations Act. ²The sum total of individual transfer prices for economic assets and benefits to be recorded in full shall only be recognised if they are within the arm's length range and the taxable person can provide plausible evidence that this is in conformity with the arm's length principle.

Part 2 – Value of transfer package and recognition of transfer prices in respect of its component parts

Section 3 – Value of the transfer package

(1) If, in cases of section 2 (1), second sentence, the value of a transfer package attributable to the relocating company is to be determined as a whole, in accordance with the arm's length principle as contemplated by section 1 (1) of the External Tax Relations Act, from the perspective of the parties concerned, this value shall correspond to the profits that can be expected by exercising the business function at the time of relocation and are attributable to the business function (profit potential).

(2) ¹The respective profit potential shall be determined, taking into account all circumstances of each specific case on the basis of a functional analysis before and after the business function has been relocated, including actual scope for action available, and including location-based advantages or disadvantages, and synergy effects. ²The starting point for calculation purposes shall be the records used as the basis for the corporate decision to perform a business function relocation. ³For purposes of calculating the respective profit potential and the arm's length range (section 7), the relevant profit expectations of the enterprises involved on a scale corresponding to section 1 (1), third sentence, of the External Tax Relations Act, appropriate capitalisation interest rates (section 5) and a capitalisation period depending on the circumstances of the business function being exercised (section 6) shall be used as a basis.

Footnotes

Section 3 (2), third sentence: In the version of Article 24 of the Act of 26/06/2013, Federal Law Gazette I, p. 1809 with effect as of 01/01/2013

Section 4 – Component parts of the transfer package

(1) If different arrangements are made for individual parts of the transfer package, or if such arrangements are to be assumed in accordance with the arm's length principle, then transfer prices shall be applied to all parts of the transfer package which correspond to the total value thereof in accordance with section 3 (1).

(2) In the event of any doubts as to whether a transfer or grant of use is to be assumed regarding the transfer package or individual parts thereof, it shall be assumed, upon application by the taxpayer, that the use thereof has been surrendered.

(3) In cases of section 1 (6), in which it emerges subsequently that a business function relocation has taken place, the transfer prices for business transactions that have led to the business function relocation occurring shall be fixed in accordance with the arm's length principle in such a manner that, together with the transfer prices originally determined, they correspond to the value of the transfer package as a whole, determined in accordance with section 3 (1).

Section 5 – Capitalisation interest rate

¹To determine the appropriate capitalisation interest rate in each case, taking into account the tax burden, the interest rate for a risk-free investment shall be assumed, on which a surcharge shall be imposed that is adequate for the business function and risk in question. ²The lifetime of the comparable risk-free investment shall depend on how long the business function assumed is foreseeably to be exercised. ³The surcharge shall be measured in such a manner as to reflect the usual entrepreneurial risk assessment in comparable cases, both for the receiving and for the relocating enterprise.

Section 6 – Capitalisation period

If no reasons are credibly presented for a certain capitalisation period depending on the circumstances of the business function being exercised, or if such reasons are not evident, an unlimited capitalisation period shall be used as a basis.

Section 7 – Determining the arm's length range

(1) ¹For a relocating enterprise that can expect profits from the business function, the floor of the scope for negotiations (minimum price of the arm's length range) as contemplated by section 1 (3), sixth sentence, of the External Tax Relations Act shall be derived from the elimination or reduction of the profit potential plus any closure or discontinuation costs that may be involved. ²Any actual scope for action that the relocating enterprise would have as an enterprise independent of the accepting enterprise shall be taken into account without questioning the entrepreneurial decision-making powers of the relocating enterprise.

(2) In cases where the relocating enterprise is no longer in a position to exercise the business function itself with its own resources, for legal, factual or economic reasons, the minimum price shall be the liquidation value.

(3) ¹If an enterprise relocates a business function from which it can expect to make losses on a long-term basis, the scope of negotiations for the relocating enterprise shall be limited by the anticipated losses or possible closure or discontinuation costs involved; the decisive value shall be the lower amount in absolute terms. ²In such cases, in order to mitigate losses it may be considered appropriate behaviour of a prudent and conscientious business manager to arrange remuneration for the business function relocation that only covers the closure or discontinuation costs to a certain degree, or to make a compensation payment to the accepting enterprise for assuming the source of losses.

(4) ¹The profit potential of the accepting enterprise from the business function assumed shall generally represent the ceiling of the scope of negotiations (maximum price of the arm's length range). ²Any actual scope for action that the accepting enterprise would have as an enterprise independent of the relocating enterprise shall be taken into account without questioning the entrepreneurial decision-making powers of the accepting enterprise.

(5) In cases of subsections (2) and (3), above, too, in which the minimum price of the relocating enterprise amounts to zero or less, it shall be ascertained according to the arm's length principle whether an independent third party in accordance with section 1 (3) sentence 9, read in combination with section 1 (3), seventh sentence, of the External Tax Relations Act would be prepared to pay a price for assuming the business function.

Section 8 – Damages, indemnification and claims for compensation

¹Statutory or contractual claims for damages, indemnification and compensation as well as claims to which third parties independent of one another would be entitled if their scope of action was contractually or de facto precluded can be used as a basis for taxation of a business function relocation if the taxable person can furnish plausible evidence that such third parties would have acted in a comparable manner in similar circumstances. ²Furthermore, the taxable person shall furnish plausible evidence that no material intangible assets and benefits were transferred or made available for use, unless the transfer or grant of use is the necessary consequence of claims within the meaning of the first sentence.

Part 3 – Details in cases of subsequent adjustments

Section 9 – Adjustment rule relating to the taxable person

An adjustment rule of the taxable person that precludes subsequent adjustments as contemplated by section 1 (3) eleventh and twelfth sentences, of the External Tax Relations Act shall also apply where licence arrangements are made with a view to material intangible assets and benefits that render the licence fee payable dependent on revenue or profits of the licensee, or where revenue and profits are taken into account in fixing the extent of the licence fee.

Section 10 – Substantial deviation

¹In cases of section 1 (3), twelfth sentence, of the External Tax Relations Act, a substantial deviation shall be deemed to apply where the appropriate transfer price, taking account of the actual trend in profits, is beyond the original arm's length range. ²The new arm's length range shall be limited by the minimum price originally agreed and the newly determined maximum price of the accepting enterprise. ³A substantial deviation shall also be deemed to prevail if the newly determined maximum price is lower than the original minimum price of the relocating enterprise.

Section 11 – Appropriate adjustment

An adjustment within the meaning of section 1 (3), twelfth sentence, of the External Tax Relations Act shall be appropriate if, in cases of section 10, first sentence, it corresponds to the difference in amount between the original and the newly determined transfer price, or if, in cases of section 10, third sentence, to the difference in amount between the original transfer price and the average between the new maximum price of the accepting enterprise and the original minimum price of the relocating enterprise.

Part 4 – Final regulations

Section 12 – Application regulation

This Ordinance shall be applied for the first time for the 2008 assessment period.

Section 13 – Entry into force

This Decision shall take effect from 1 January 2008.

Final clause

The German Bundesrat has approved this Ordinance.