

Intra-Group Financing

Implications of the Growth Opportunities Act ("Wachstumschancengesetz")

New German tax law increases the scope of the required transfer pricing analysis for inbound financial transactions. This applies with immediate effect, i.e. from 1 January 2024 onwards. Most importantly, the group rating applies unless a deviation is substantiated, and the financial ability to service the debt needs to be proven.

What happened in the legislation process?

On 27 March 2024, the "Growth Opportunities Act" (German: "Wachstumschancengesetz") was promulgated in the Federal Law Gazette. In the Außensteuergesetz ("**Foreign Transactions Tax Law**"), the law now stipulates specific, novel rules for income corrections for financing transactions between related parties.

Which intra-group transactions are affected?

All cross-border intra-group **inbound** financial transactions, in particular loans. Also, group cash pools and inhouse banks are affected.

Key contents of the new TP regulations on intra-group financing

The legal principles on arm's length analyses in connection with intra-group financing will be extended to include provisions on the deductibility of interest expenses and the classification of routine financial services (new paragraphs 3d and 3e, respectively, in Section 1 Foreign Transactions Tax Law).

Deductibility of interest expenses

Interest expenses of a domestic taxpayer arising from a cross-border financial transaction are generally only tax deductible:

- if the domestic taxpayer demonstrates that he could have provided the debt service from the issue/renewal date ("**Debt Capacity Analysis**") and that the financing is commercially necessary as well as used for the purpose of the business ("**Business Purpose Test**"); and
- to the extent the applied interest rate is equal or below the interest rate that would be granted by an external third party based on the group credit rating. If it is proven in individual cases that a rating derived from the corporate group rating ("**Credit Rating Analysis**") corresponds to the arm's length principle, this must be taken into account when calculating the interest rate ("**Interest Rate Analysis**").

Routine financial services

The new law classifies a pure brokerage service or forwarding of a financing transaction as well as typical treasury functions (such as liquidity management) or activities as financing company as a low-function and low-risk service (which is to be rewarded with a routine compensation). An exemption for a non-routine compensation is possible if the taxpayer evidences a more complex profile for the financial service providing company based on a functional and risk analysis (which would conversely allow a non-routine reward).

Effective date

The new legislation is effective from 1 January 2024. Based on the wording of the new law it should be expected that the German tax authorities will apply the new legislation also to existing intercompany financial transactions (i.e. to those interceded prior to and still effective after 1 January 2024).

Practical implications

The law as well as the explanatory memorandum mention further specific views on the contents of such analysis.

German taxpayers need to comply with the above regulations and need to consider the above in performing the transfer pricing analysis for intra-group financial transactions as well as preparing robust transfer pricing documentation.



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