

BEYOND BORDERS:

# Navigating Germany

Dear Clients and Partners,

we are pleased to bring you the latest edition of our **Beyond Borders: Navigating Germany Newsletter**, designed to keep you well-informed about significant developments and strategic considerations in the German landscape.

As your trusted advisors, we are committed to providing you with valuable insights that can help navigate the complexities of international business operations with relation to Germany. In this issue, we focus on several key topics that are particularly relevant for companies engaging with the German market.

Firstly, we delve into the nuances of **permanent establishment** risk in Germany an essential consideration for any business activity within the region and very often neglected and not on the radar – especially by small and medium sized businesses. We also provide an update on important changes to the deadlines and requirements for submitting **transfer pricing** documentation in Germany, a crucial compliance matter for multinational entities, which becomes increasingly an important part of tax audits in Germany. Additionally, we are honored to include a **guest article** by Dr. Philipp Schultes from the law firm Zirngibl discussing the specifics of **M&A activities** in Germany, highlighting legal nuances of inbound transactions.

We trust that the information provided in this newsletter will be beneficial to you and support your business endeavors.

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CONTENT

## PERMANENT ESTABLISHMENT RISK IN GERMANY – A RISK FOR MANY COMPANIES DOING BUSINESS IN GERMANY

Constituting a permanent establishment for tax purposes in Germany often entails considerable tax risks, as permanent establishments are often not recognized and / or properly registered too late or not at all. In addition to a permanent establishment created by a fixed place of business in Germany, especially construction and installation projects in Germany as well as permanent representatives can lead to a German permanent establishment from a tax perspective.

Appropriate internal guidelines and raising awareness among the relevant employees are essential in a company that operates beyond the borders of the relevant country. This risk is not only present for large global organizations, but also for small and medium sized companies which conduct cross-border business.

### 1. CONSTITUTION OF A PERMANENT ESTABLISHMENT IN GERMANY

In general, a permanent establishment for tax purposes in Germany is constituted by the existence of a fixed place of business or facility (e.g. branch offices, warehouse, place of management) in Germany, through which the activities of a foreign company are carried out in full or in part in a sustained manner.

In addition to the mostly relatively clear and definable general principles, a permanent establishment for tax purposes in Germany can also be constituted in the following cases without the existence of a fixed place of business:

- **Building sites or constructions or installation projects**  
Activities in respect of building sites or constructions or installation projects carried out in Germany can constitute a permanent establishment for tax purposes if they are carried out over a certain period of time. German tax law considers a duration of more than 6 months to be harmful - double taxation agreements concluded by Germany usually provide for 12 months and only sometimes 3 or 6 months.

#### **Practical note:**

*When determining the relevant time period, it may happen that the activity times of subcontractors are also included. Interruptions (e.g. due to weather or strikes) or remedial work can also result in the project duration being exceeded unplanned. Furthermore, different projects for the same customer may also be added together if there is a certain connection.*



- **Permanent representative**

A so-called representative permanent establishment in Germany with a permanent representative can be established by the fact that a person in Germany conducts the business of a foreign company for the foreign company on a sustained manner and is subject to its instructions.

#### **Practical note:**

*Representative permanent establishments can be constituted in particular by sales employees. If these employees work in Germany, it is therefore essential that they are made aware of this issue.*

Appropriate internal guidelines and raising awareness among the relevant employees are essential in a company that operates beyond the borders of the relevant country. This risk is not only present for large global organizations, but also for small and medium sized companies which conduct cross-border business.

### 2. CONSEQUENCES OF CONSTITUTING A PERMANENT ESTABLISHMENT IN GERMANY

A German permanent establishment for tax purposes is not an independent legal entity such as a German subsidiary but forms a legal entity with its foreign head office. For tax purposes, however, a permanent establishment is assumed to be independent and therefore has **limited tax liability in Germany**. The corresponding profits of the permanent establishment are taxable in Germany.

Depending on the double taxation agreement and the respective local tax regulations, the permanent establishment profits taxed in Germany may be exempt from taxation abroad or the German tax will be offset against the local tax abroad.



*For a more detailed overview of the risk associated with a PE in Germany see our SuP OnePager*



In addition to the limited tax liability, also the following tax obligations apply if a permanent establishment in Germany is constituted:

- Trade tax liability
- Obligation to notify the municipality / the tax office
- Duty to keep accounts
- Transfer Pricing documentation requirements
- Payroll and potential sales tax obligations

### 3. RISK MITIGATION IN RELATION TO PERMANENT ESTABLISHMENTS FROM A TAX PERSPECTIVE IN GERMANY

To successfully mitigate any risk in relation to permanent establishments from a tax perspective in Germany, we recommend:

- A detailed examination of the individual case, if possible before implementation
- The corresponding development, implementation and enforcement of internal guidelines and the training of sales staff and employees in the human resources department
- A thorough analysis between establishing a local legal entity in Germany and a permanent establishment for tax purposes.

### ABOUT GERMANY

As one of the strongest economies in the world, situated in a unique location in the heart of Europe, Germany is a great place to do business in. A highly skilled available workforce, a political stable environment along with the availability of both, large multinational corporations as well as small and medium sized businesses are further reasons to conduct business in Germany.

In addition to certain cultural and language barriers, Germany is characterized by a very complex system of regulations and tax rules. If you are thinking about doing business in Germany, Schlecht & Partner can help you navigate through these challenges and help you focus on the core part of your business ensuring your business success in Germany.



<https://taxadvisorgermany.com>



### IMPORTANT CHANGES OF THE DEADLINE FOR THE SUBMISSION OF TRANSFER PRICING DOCUMENTATION AND ITS SCOPE IN GERMANY

With the implementation of the so-called DAC-7 Directive into German law and the corresponding amendments to Section 90 of the German Fiscal Code, the deadline for submission of a transfer pricing documentation will be significantly shortened in the future. Moreover, the documentation will need to be submitted in full.

Since transfer pricing is regularly and increasingly a part of tax audits in Germany, please find below general explanations on the topic of transfer pricing in Germany, details on the future tightened regulations regarding the deadline and scope of transfer pricing documentation, as well as our recommendations for properly preparing for future tax audits.

#### 1. BACKGROUND

Generally, a transfer price is the price that a related company or a legally dependent party charges another party of the same company for a product, an intermediate product, or a service. In cross-border situations, transfer prices must be set as if they had been agreed upon by independent third parties under the same or similar conditions (so-called arm's length principle).

The cross-border service relationships that are relevant in the area of transfer pricing include, for example, the following transactions:

- Sale of goods/merchandise
- Contract manufacturing
- Licenses
- Loans
- Services (e.g., management or administrative services)
- Employee secondments
- Restructurings

In the area of transfer pricing, it is essential on the one hand to **set prices in accordance with the arm's length principle**. On the other hand, the **documentation of transfer prices** is an extremely important component, as it serves as proof of arm's length conformity in a tax audit, and some countries also require the maintenance of annually updated transfer pricing documentation.

## 2. CHANGES WITH RESPECT TO TRANSFER PRICING DOCUMENTATION IN GERMANY

With the implementation of the so-called DAC-7 Directive into German law and the corresponding amendments to Section 90 of the German Fiscal Code, the deadline for the submission of a transfer pricing documentation in Germany **will be significantly shortened in the future**.

Starting from 2025, for all business transactions, the deadline will be only 30 days from the date of the audit order or any time upon separate request. Furthermore, the documentation will need to be submitted in full.

These are the specific changes:

- Previously, the taxpayer was obliged to present the transfer pricing documentation upon request, which, however, in practice, usually occurred during the conduct of a tax audit.
- In the future, the documentation can be explicitly requested at any time.
- Furthermore, in the event of a tax audit, the documentation will have to be presented in the future without a separate request.
- The deadline begins with the request or the notification of the audit order and will be only 30 days in the future. This represents a halving of the current 60-day submission deadline.
- Another tightening is the fact that the documentation will have to be submitted in full in the future. This full submission requirement also includes transactions with low volumes and minor changes that are qualified as extraordinary business transactions.

## 3. APPLICATION PERIOD OF THE CHANGES

The new regulations regarding the submission of transfer pricing documentation in Germany apply to taxes that are incurred after December 31, 2024, and to taxes incurred before this date if a tax audit is ordered after December 31, 2024.

### RECOMMENDED ACTIONS

Based on the above-mentioned tightening of deadlines and scope if you have cross-border intercompany transactions with Germany, we **strongly recommend putting the issue of transfer pricing documentation on the agenda in 2024** in order to be appropriately prepared.

The new, stricter deadline makes it practically impossible to start preparing transfer pricing documentation only after an audit order has been issued or a request is received – therefore, in our opinion, it is essential to be prepared in advance.

On a positive note, this provides an excellent opportunity to review and proactively plan the transfer pricing strategy within your company.

Should you need support in this area, we are happy to assist. In addition to planning transfer pricing strategies and documenting transfer prices, we are also happy to review your existing transfer pricing documentation – please feel free to contact us.

## GUEST ARTICLE

### M&A SPECIFICS IN GERMANY FOR INBOUND TRANSACTIONS: AN OUTTAKE ON LEGAL NUANCES

In the complex landscape of M&A transactions, the German legal system brings specific (formal) elements that practitioners may not encounter in other jurisdictions. Our M&A practice frequently advises on complex inbound M&A transactions, taking into account the particularities of German law. The unique legal aspects of these transactions often require comprehensive negotiations and detailed preparatory work prior to the closing of a transaction. In the following overview, we will take a closer look at three selected topics that frequently arise in connection with inbound transactions.



## 1. REQUIREMENTS FOR NOTARIZATION AND REGISTRATION

One of the more challenging (formal) aspects of conducting M&A transactions in Germany regularly involves the notarization of share purchase agreements and the need to register the transaction in the German Commercial Register. In particular, the transfer of shares in a GmbH (limited liability company), as well as agreements obligating a shareholder to transfer such shares, require notarization under German law. This notarial formality is crucial to ensure the validity and enforceability of the transaction. If the transaction involves foreign entities, the notary and registry court must verify the existence of these entities and the authority of their representatives. If relevant documents from the foreign company's commercial register are not available, additional certificates may have to be prepared. In addition, documents such as foreign registry extracts and certifications often require notarization as well as an apostille to ensure their acceptance by German authorities. To avoid transaction delays, it is imperative that these evidentiary requirements be identified and satisfied well in advance of the transaction.

## 2. EARN-OUT-CLAUSES

An earn-out clause can generally be defined as a contractual provision pursuant to which a buyer in a transaction undertakes to pay an additional purchase price to the seller if the target achieves certain agreed (financial) milestones within a specified period after the closing date. Especially in the context of inbound transactions, German M&A lawyers encounter nowadays more often than in the past earn-out clauses in share purchase agreements. This is primarily due to the current economic situation in Germany, where uncertainties and market fluctuations encourage parties to use earn-out mechanisms to bridge valuation gaps between buyers and sellers.

Earn-out clauses play a key role in transactions, providing a flexible pricing mechanism that adjusts based on the post-transaction performance of the target company. These clauses help resolve valuation discrepancies resulting from uncertain future earnings and differing expectations between buyer and seller. By tying additional payments to specific financial or operational targets, earn-outs align the interests of both parties and mitigate risks such as overpayment and post-sale underperformance.

They also bridge valuation gaps and facilitate agreements when initial price negotiations are far apart. Particularly valuable in unstable economic conditions or in deals involving start-ups, volatile industries or new products, earn-outs reduce the risk of overpayment by providing staggered payments and easing financial pressure. Sellers benefit by potentially securing the full value of the business if performance targets are met.



In the context of inbound transactions, earn-out clauses are particularly important for foreign buyers who may not be very familiar with the German market. The parties can then use such clauses to create mutual trust.

However, earn-outs can lead to disputes over performance measures and add uncertainty to the final purchase price. Drafting, negotiating and monitoring earn-outs requires clear definitions of terms such as duration, calculation methods and performance metrics. In cross-border transactions, considerations of differing legal and accounting standards as well as currency fluctuations are critical. While earn-out clauses align interests and manage risks, they require careful management to effectively balance the benefits for both parties.

## 3. INVESTMENT SCREENING

The Federal Ministry of Economics and Labor (BMWK) may review the acquisition of a German company by a foreign buyer in order to avoid negative effects of foreign investments on public order or security of the Federal Republic of Germany. This always applies if the buyer is not from an EU member state or a member state of the European Free Trade Association (EFTA). In individual cases in the field of arms and defense technology, this also applies to buyers from EU Member States and EFTA Member States.

The jurisdiction of the BMWK also depends on the size of the share of voting rights to be acquired in the German company.

Depending on the activities of the target company, the acquisition may even have to be reported to the BMWK (this applies, for example, in the case of the acquisition of critical infrastructure operators; companies that develop industry-specific software for the operation of critical infrastructure; companies active in the field of telecommunications; companies that provide cloud computing services; companies active in the field of telematics infrastructure; companies in the media industry; companies that develop or manufacture certain medical products and equipment; companies that develop and manufacture critical technologies; etc.). In such cases, the acquisition may not be completed until the BMWK has approved the acquisition. However, even if the acquisition is not subject to mandatory notification, the BMWK may subsequently prohibit the acquisition.



In order to prevent such subsequent prohibition, it is possible to apply to the BMWK for a certificate of non-objection.

In the context of a transaction, the time required for the procedure after notification or application for a certificate of non-objection must be taken into account. The review of BMWK may take several months. Therefore, the parties should examine at an early stage whether an investment review procedure of BMWK has to be initiated and which measures are necessary or useful.

#### 4. CONCLUSION

In the complex field of M&A transactions, the particularities of German law present special challenges and opportunities not typically encountered in other jurisdictions. Given the complexity, it is imperative for the parties involved to seek specialized legal advice. This will ensure that all contractual nuances are carefully addressed and aligned with both German law and international standards, ultimately protecting the interests of all parties involved in the transaction.

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AUTHOR

#### OUR SERVICES TO HELP YOUR BUSINESS BE SUCCESSFUL IN GERMANY

Whether you are planning on establishing a business in Germany or you are already doing business in Germany, or you are an individual, owning e.g. real estate in Germany, we are happy to assist you in all tax, accounting, or finance matters.

We can provide detailed advice in respect of which business form is the right one for your specific case, setting up and registering the business, as well as assisting you with the ongoing tax compliance and accounting and audits.

As a founding member of the global network XLNC, we have proven relationships to lawyers, auditors and tax consultants in almost all relevant countries around the world. Due to our commitment and engagement within the network as well as our strong focus in the area of international tax law, we offer our clients solutions that go beyond borders.

Our clients therefore have the advantage that we assist in foreign issues and also offering coordination with our foreign based partners, keeping the focus on the core issues and also being dedicated to high-quality and cost-efficient advice.

#### OUR FIRM

Schlecht und Partner are experienced auditors, accountants and tax advisors. Our partnership relies on a long-term cooperation and a common understanding of the needs of a modern client service and project consulting.

We advise entrepreneurs, companies and individuals in all business and tax matters and conduct audits for medium-sized companies on a variety of occasions and issues. Based on our broad technical and industry expertise, we have a vast experience in SME consulting.

Schlecht und Partner bundles different specializations and forms a powerful team in complex consulting assignments. In addition, we draw on a network of law firms with different focal points.

Our law firm organization is characterized by a high degree of efficiency and digitization. This is proven not least by our award as a DATEV Digital Law Firm.