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New Financing Rules for Corporate Groups – Significant Conflict Potential in Tax Audit

Dear Sir or Madam,

Recently, new legal provisions governing cross-border group financing under Sections 1 (3d) and (3e) of the German Foreign Tax Act („Außensteuergesetz", AStG) came into effect. According to reports, the tax authorities interpret the statutory application rules in such a way that agreements concluded before 2024 do not benefit from grandfathering protection but are instead subject to a one-year transitional period. This means that the new prowvisions will apply to expenses arising from financing agreements concluded on or after January 1, 2024, and to those from existing agreements starting January 1, 2025.

Section 1 (3d) AStG governs the extent to which remuneration (e.g., interest) paid to foreign group lenders is deductible as a business expense for tax purposes. The borrower must demonstrate that:

- they could meet the debt service obligations from the outset,
- the financing received was economically necessary, and
- it was used for the intended business purpose.

Notwithstanding the above, deductibility is denied to the extent that the interest rate exceeds the refinancing rate at which the company, based on the group's credit rating, could have secured financing from unrelated third parties. However, it may be proven on a case-by-case basis that a standalone credit rating derived from the group's credit rating aligns with the arm's length principle (escape clause).

Furthermore, Section 1 (3e) AStG classifies group financing entities as routine entities by default. A rebuttal is possible, for instance, through a detailed functional and risk analysis.

In mid-August, the tax authorities clarified their interpretation of the new provisions through a draft revision of Chapter J, „Financial Relations," in the Administrative Principles on Transfer Pricing („Verwaltungsgrundgesätze Verrechnungspreise"). However, ambiguities remain. Unfortunately, it is expected that the final version will also lead to increased advisory requirements.

The new provisions carry significant conflict potential in tax audits. We strongly recommend a comprehensive review of all relevant financing arrangements and are available to assist with the necessary documentation.

Please feel free to contact us for further assistance.

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