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By PwC Deutschland | 02 December 2025

Constitutional Court: No general requirement for written agreements in arm's length transactions

In a ruling from May 2025, the Federal Constitutional Court decided that the lack of a written contract between related German companies is not sufficient ground for refusing the deduction of business expenses. Rather, an overall assessment must be made to determine whether the agreement actually took place, even if made verbally or implied.

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Background

The appellant (GmbH & Co. KG) trades in beech sawn timber worldwide and acts as the strategic leader within the group. In 2005, the appellant planned and built a sawmill for its sister partnership. No written agreement was concluded in this connection. Due to poor planning and defects and deficiencies in the construction of the sawmill additional costs of around EUR 4.1 million were incurred. As a result, an agreement for compensation of the damage was concluded in 2009 whereby the appellant agreed to pay the sister partnership EUR 4 million. The appellant claimed this payment as business expense in its 2008 income tax and trade tax returns. The business expense was taken into account in the tax assessment notices as declared.

Following an external audit, the tax office refused the deduction of business expenses for lack of written contract as regards the scope of work and services for the planning and construction of the sawmill. The action before the Thuringian Tax Court was also not successful and the appeal rejected as unfounded. The tax court was of the opinion that the damage payments were not deductible as operating expenses. Because there was no prior written agreement regarding both the construction of the sawmill and the contract manufacturing relationship the transaction was not in line with the arm's length principle.

Decision

The Federal Constitutional Court agreed with the appellant and reversed the decision of the Thuringian Finance Court. According to the Federal Constitutional Court, the Thuringian Finance Court had misinterpreted the arm's length principle by treating the written form as an independent criterion. As a result, it failed to consider all circumstances as a whole, in particular the actual economic functions and the distribution of risk.

The lack of written form cannot exclude the arm's length nature of an agreement as such even if contracts between third parties are usually concluded in writing. Such separation of individual pieces of evidence would be in breach of the principle of equal treatment under Article 3(1) of the German Basic Law.

As a result, the Federal Constitutional Court overturned the ruling of the Thuringian Tax Court and referred the case back to the latter.

Note: The decision strengthens the recognition of common contractual practice even without written agreements for domestic matters as well as for German transfer pricing practice.**It is only relevant for strictly domestic German situations and cross-border situations without treaty protection.**

Source:

Federal Constitutional Court, decision of 27 May 2025 (case ref. 2 BvR 172/24).

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Keywords

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