

Major trends in transfer pricing audits

When determining how to set the “arm’s length” prices in intragroup transactions, multinational companies (“MNEs”) will refer to the OECD Transfer Pricing Guidelines (“OECD TPG”) for the interpretation of the arm’s length principle. The OECD TPG have substantially been revised in recent years. We have analysed these international transfer pricing developments in various publications. Please refer to the list of publications below and to our website www.taxpartner.ch.

The OECD TPG now require taxpayers to explain their transfer pricing approach in more detail. Having access to more information, tax authorities are now in a better position to challenge the taxpayer and have a different view as to which group entities profits – derived from a particular intragroup transaction – should be attributed to and, therefore, in which jurisdictions these profits should be taxed. It is not surprising that – as a result of these OECD developments – both foreign and Swiss tax authorities have increased their audit focus on transfer pricing.

What are the main audit topics? Our observations:

- Tax authorities now consider the process of value creation within an MNE in more detail. In assessing which group entity contributes to value creation, their focus is on the role of key critical decision-makers responsible for important business decisions related to that particular transaction.
- MNEs often (i) have management teams spread across various jurisdictions having regional or even global P&L or functional responsibilities, (ii) have highly integrated transactions, or (iii) operate through a structure of foreign branches. They now face the daunting task of explaining their complex integrated global processes of value creation and decision

making, as well as the transfer pricing between group entities.

- MNEs with Swiss trading or principal structure operating a centralised business model, on the other hand, are challenged by the tax authorities who question whether the key critical decision-makers are indeed located in Switzerland.
- Asset management companies performing asset management activities are increasingly subject to challenges of tax authorities who argue that the allocation of income to off-shore entities is not justified.
- These taxpayers must be ready to (i) outline the key value drivers, (ii) identify the critical decision-makers involved in managing these core business activities, and (iii) specify from which location these activities are performed.
- Within an MNE, many group entities will have a role in Developing, Enhancing, Maintaining, Protection and Exploiting (DEMPE) the valuable group intangibles (such as patent, process know-how, trademarks and tradenames). We observe that tax authorities often challenge royalty-bearing intragroup licenses for the use of an intellectual property. The taxpayer must be ready to explain in detail which DEMPE functions are performed by the licensor and licensee and why a royalty-bearing intragroup license for the use of that intellectual property is justified. In addition, they must be able to provide a solid economic analysis documenting the pricing (royalty rate).
- MNEs adjust their operating models regularly, for example, when introducing an online sales platform to meet increasing online demand, or when implementing a global ERP platform allowing MNEs to automate processes leading to changes on how business processes can be managed. In tax audits, tax authorities focus on these business restructurings as they may lead to shifting taxable profits.

Our take

- Being aware of the major transfer pricing audit trends allows taxpayers to anticipate possible transfer pricing risks areas and develop transfer risk mitigation strategies. In the first instance when developing a transfer pricing approach, and in the second instance when preparing OECD conform transfer pricing documentation as a first line of defence of the implemented transfer pricing policy.

- Questions in tax audits often exceed the level of details provided in the transfer pricing documentation. Therefore, MNEs are advised to prepare their tax audit defence carefully in order to be ready to explain their business model in the context of the intragroup transactions under audit in a clear and consistent way.

Publications

1. **Transfer Pricing Switzerland – Trends and Developments**

Prof Dr René Matteotti and Hendrik Blankenstein analyse the current transfer pricing trends and developments in Switzerland in the recently published Transfer Pricing 2021 by Chambers and Partners

Link online: <https://taxpartner.ch/app/uploads/2021/05/Blankenstein-Matteotti-Trends-and-Developments-Switzerland-Transfer-Pricing-2021-Global-Practice-Guide-1st-Edition.pdf>

2. **Transfer Pricing Switzerland – Law and Practice**

Prof Dr René Matteotti, Hendrik Blankenstein, Monika Bieri and Christian Horni outline the transfer pricing law and practice in Switzerland in the recently published Transfer Pricing 2021 Practice Guide by Chambers and Partners. Link online: <https://taxpartner.ch/app/uploads/2021/05/Blankenstein-Matteotti-Bieri-Horni-Law-and-Practice-Switzerland-Transfer-Pricing-2021-Global-Practice-Guide-1st-Edition.pdf>

3. **Considering TP implications beyond the pandemic**

Hendrik Blankenstein and Caterina Colling-Russo evaluate the transfer pricing challenges that the COVID-19 pandemic has brought for multinational enterprises.

Link online: https://taxpartner.ch/app/uploads/2021/03/Blankenstein-Colling-Russo_Considering-TP-implications-beyond-the-pandemic_ITR-Transfer-Pricing-Focus.pdf

4. **Strengthening legal certainty and transparency in the mutual agreement procedure in Switzerland**

Prof Dr René Matteotti and Monika Bieri illuminate the draft law of the Federal Act on the Implementation of International Tax Agreements which attempts to regulate the domestic procedural issues regarding MAPs.

Link online: https://taxpartner.ch/app/uploads/2020/09/Matteotti_Bieri_Strengthening-legal-certainty-and-transparency-in-the-mutual-agreement-procedure-in-Switzerland_2021-Tax-Controversy-Leaders-Guide-1.pdf

5. **Locating intangibles in a post-reform Switzerland: Tax incentives and transfer pricing consistency**

Switzerland's much-anticipated tax reform introduces a number of measures which will ensure that it remains an attractive location for innovative businesses. Hendrik Blankenstein, Caterina Colling-Russo and Oliver Jäggi examine the pull of these new tax incentives also from a transfer pricing perspective.

Link online: https://taxpartner.ch/app/uploads/2020/05/Blankenstein_Colling-Russo_Jaeggi_Locating-intangibles-in-a-post-reform-Switzerland1.pdf
6. **OECD's guidance on financial transactions: Evaluating intercompany loans in Switzerland**

Hendrik Blankenstein, Caterina Colling-Russo and Tom Lawson discuss how the OECD's new guidance on financial transactions will impact the characterization and pricing of intercompany loans for multinational enterprises in Switzerland.

Link online: https://taxpartner.ch/app/uploads/2020/05/Blankenstein_Colling-Russo_Lawson_Evaluating-inter-company-loans-in-Switzerland1.pdf
7. **OECD's guidance on financial transactions**

Stephan Pfenninger and Hendrik Blankenstein in the following discuss the recently published OECD Transfer Pricing Guidance on Financial Transactions (OECD) and evaluate the transfer pricing impact on shareholder loans to fund real estate ventures in Switzerland. The OECD report covers the transfer pricing aspects of various intercompany finance transactions, such as loans, financial guarantees, cash-pooling, hedging and captive insurance companies. The OECD now provides detailed guidance supporting taxpayers as well as tax authorities in analysing shareholder loans and in determining arms' length interest rates.

Link online: <https://taxpartner.ch/en/oecd-s-guidance-on-financial-transactions/>
8. **Swiss tax audits pivot to intellectual property**

As Switzerland passes wide-scale tax reform, local tax authorities are increasingly focusing on intangibles and intellectual property (IP) audits as part of a two-pronged approach in tackling tax evasion. Caterina Colling-Russo and Prof Dr René Matteotti discuss the focus.

Link online: https://taxpartner.ch/app/uploads/2020/05/Matteotti_Colling-Russo_Swiss-tax-audits-pivot-to-IP_ITR_March-2019.pdf
9. **Intangibles in a post-BEPS world**

The framework for analysing intercompany transactions involving intangibles is examined

by Hendrik Blankenstein and Caterina Colling-Russo.

Link online: https://taxpartner.ch/app/uploads/2020/05/1_new_intangibles_in_a_post_beps_world1.pdf

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