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Transfer Pricing 2022

Switzerland: Law & Practice
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Switzerland: Trends & Developments
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SWITZERLAND

Law and Practice

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1. RULES GOVERNING TRANSFER PRICING

1.1 Statutes and Regulations

Preliminary Remarks

In Switzerland, transfer pricing issues arise mainly in connection with federal and cantonal corporate income taxes and federal withholding tax. With respect to corporate income tax, it should be noted that cantons have the authority not only to assess the cantonal and municipal but also the federal corporate income tax. This means that the cantons can issue advance rulings (so-called tax rulings), in particular with regard to federal income taxes. However, the Federal Tax Administration (FTA) still exercises an important supervisory function over the cantons and can also intervene in individual cases. In practice, the FTA is becoming increasingly involved in discussions, especially in large transfer pricing cases.

While in the area of corporate income tax there is a parallel competence of the federal government and the cantons, the federal government has the exclusive competence to levy withholding tax, stamp duties and value added tax. In the area of withholding tax, the FTA established a competence centre for transfer pricing in 2019. It is, hence, no surprise that in practice it can already be seen that, for withholding tax purposes, transfer prices are increasingly being critically scrutinised during tax audits. This applies, in particular, in connection with the relocation of functions abroad and in the case of controlled transactions between Swiss companies and related companies domiciled in tax havens or low-tax countries.

As far as legislation in the field of transfer pricing is concerned, it should be noted that there are no specific regulations on the determination and documentation of transfer prices, neither at the federal level nor at the cantonal level.

One major reason for the lack of specific transfer pricing rules is that Switzerland has comparatively low corporate income tax rates and there has generally been little incentive for Swiss-based companies to shift profits abroad. A second reason is that Switzerland, as a member state of the Organisation for Economic Co-operation and Development (OECD), adheres to the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD's TPG). Switzerland has accepted the initial version and all updates of the OECD's TPG without reservation, including the latest update in 2022. Thus, there is full consensus in Swiss tax law practice that the OECD's TPG are an important interpretative tool for the application of the at arm's-length principle in Swiss tax law.

In exercising its supervisory role over the cantonal tax administrations, the FTA instructed the cantonal tax administrations in 1997 and 2004 with a circular letter to directly apply the OECD's TPG. The Federal Supreme Court (FSC) tends to apply a static approach regarding the version of the OECD's TPG. Hence, the arm's-length principle and the methods to determine the transfer prices will be assessed according to the OECD's TPG as they were published at the time the transaction in question was settled.

Statutes

Overview

Even though transfer pricing issues arise primarily regarding corporate income and withholding tax, stamp duties and VAT must always be analysed as well in a comprehensive transfer pricing advice.

Corporate income tax

From a corporate income tax perspective, the following two scenarios must be distinguished:

- controlled transactions between the corporation and its shareholders; and

- controlled transactions between other related parties.

The latter includes, in particular, transactions between group companies that are under the same management and control. In both situations, the arm's-length principle is to be applied.

Under Swiss law, a tax authority may make an adjustment only if the following three conditions are met:

- the company received evidently no adequate compensation for its services or deliveries;
- the compensation in question was in favour of the shareholder or a related party and would not have been provided to unrelated parties at the same conditions; and
- the evident discrepancy between the service or delivery and the compensation was recognisable for the company or the persons representing the company.

The first two conditions concern the question of whether the agreed transfer prices fall within the range of prices that independent third parties would have agreed on for the services or goods received. The third condition, however, is a Swiss peculiarity: the tax authority may only make an adjustment if the violation of the at arm's-length principle is obvious and thus recognisable for the management or the board of directors. This has to be determined on the basis of the concrete facts and circumstances of the case at hand.

If profits are shifted from the subsidiary to the parent company due to an obvious violation of the arm's-length principle in the aforementioned sense, a deemed dividend is to be assumed and the tax authority is entitled to adjust the profit of the subsidiary. In addition, income is attributed to the shareholder to the extent of the deemed dividend. If, on the other hand, the violation of the arm's-length principle leads to an increase of income at the level of the subsidiary, there is a so-called informal capital contribution. The tax treatment of such an informal capital contribution at the level of the shareholder and the beneficiary company depends on the facts and circumstances of the case.

If the contracting parties of a transaction violating the arm's-length principle are sister companies, the so-called modified triangle theory applies. In a first step, the profit of the company that has distributed a deemed divided is adjusted. In a second step, the benefit is attributed to the shareholder, which in turn makes a hidden capital contribution to the beneficiary sister company.

Withholding tax

Hidden profit distributions described above, which result from a violation of the arm's-length principle, regularly also trigger withholding tax consequences for the distributing company.

Under Swiss law, withholding tax of 35% must be passed on to the recipient of the deemed dividend. The taxable company must therefore, in principle, reclaim the withholding tax from the beneficiary company. Unlike in the case of corporate income tax, it is not the triangular theory that applies, but the direct beneficiary theory. In the case of payments to sister companies, this means that the reimbursement must be requested by the benefiting sister company. If it is not possible to pass on the withholding tax, the deemed dividend is grossed up and the beneficiary is deemed to have effectively received only 65% of the deemed dividend. The corporation that provided the deemed dividend is therefore liable for the payment of the remaining 35%. This gross-up results in an effective withholding tax rate of 53.8% of the tax adjustment. Currently, there are political discussions to also apply the triangular theory for withholding

tax purposes, which is normally applied by other states (see the **Switzerland Trends & Developments article**).

Foreign beneficiaries may request a full or partial refund of the withholding tax based on the applicable double taxation agreement (DTA). However, the application of the direct beneficiary theory regularly limits the treaty relief in cases where the direct beneficiary is not the direct shareholder. If specific conditions are met, the law entitles companies to fulfil the withholding tax liability by notification instead of paying the tax. In practice, however, the application of the notification procedure in the case of deemed dividends is granted only very reluctantly. In the case of a deemed dividend to a sister company, no notification is possible. If the notification procedure is not possible, not only the full withholding tax but also an interest on late payment of 5% per annum will be due.

Stamp tax duty

In the case of stamp duties, the arm's-length principle is only applied in certain cases. In principle, as in the case of withholding tax, the direct beneficiary theory also applies to the stamp duty, which means that only hidden capital contributions made directly by shareholders to the corporation are subject to the 1% stamp duty. In particular, this has the consequence that contributions to sister companies do not trigger stamp duty. Also, no stamp duty is triggered for so-called benefits periodically granted to the subsidiary, as is the case, for example, if the shareholder charges an interest rate that is too low according to the arm's-length principle for the loan granted to the subsidiary.

Value added tax

The Federal VAT Act, in contrast to the above-mentioned legislation, explicitly states that transactions between related parties have to be at arm's length. For VAT purposes, a related party is to be assumed if a shareholder holds at least 20% of the nominal share capital or an equivalent participation, or in the case of foundations and associations with which there is a particularly close economic, contractual or personal relationship.

Regarding the determination of the arm's-length transfer prices for VAT purposes, it can generally be referred to the principles applicable for corporate income tax. Though, according to administrative practice in specific cases, the arm's-length price can be calculated on a lump-sum basis. If, for example, a holding company does not have its own personnel to effectively manage the holding company and that management is carried out by personnel of its subsidiaries, the at arm's-length remuneration can be set at 2 or 3‰ of the average total assets held by the holding company.

Administrative Guidelines

As already set out, the FTA instructed the cantonal tax administrations by a circular letter of 1997, which was renewed in 2004, to directly apply the OECD's TPG. The circular explicitly states that the mark-ups for service companies must be determined in accordance with the arm's-length principle; ie, for each individual case on the basis of comparable uncontrolled transactions and with reference to the range of appropriate margins.

The most relevant administrative guidelines in Switzerland in the area of transfer pricing can be seen in the circulars published by the FTA providing safe harbour rules for thin capitalisation and for intra-group interest rates (see **11.1 Transfer Pricing Safe Harbours**) where the arm's-length principle is not adhered to.

1.2 Current Regime and Recent Changes

Overview

As Switzerland adheres to the OECD's TPG and has not established specific transfer pricing rules, the current regime and its development are, in general, reflected by the OECD's TPG. However, the arm's-length principle was already acknowledged before the first OECD's TPG were published. Hence, in the matter of Bellatrix SA, the FSC confirmed in 1981 that for withholding tax purposes, the arm's-length principle is applicable with regard to transactions concerning the company's shareholders.

Nevertheless, it has to be noted that in recent years Switzerland applied a rather pragmatic approach with regard to the application of the arm's-length principle. For instance, the FTA published in 2001 the so-called 50-50 practice, according to which, foreign-controlled trading companies that were predominantly active abroad could set off 50% of their gross earnings as commissions or provisions to related or third parties. This practice was abolished in mid-2005.

Until recently, the FTA also maintained a practice for Swiss finance branches and principal companies. According to these practices, part of the earnings of the Swiss companies was not taxed. In the case of Swiss finance branches, Swiss permanent establishments of foreign companies, a notional interest was calculated on the capital made available to the branch, which reduced the taxable profit in Switzerland. With regard to principal companies, the practice of the FTA allowed the partial apportionment of the earnings abroad, thus exempting part of the net profit from taxation. In the course of the comprehensive corporate tax reform, these practices have been abolished as of the beginning of 2019.

Recent Changes

Until recently, core transfer pricing issues were only seldomly touched by the tax administrations. Not least due to the BEPS project, transfer pricing issues increasingly form part of routine audits. Hence, in recent years, taxpayers have been more often confronted with detailed questions regarding transfer pricing matters (eg, requests regarding detailed transfer pricing documentation and explanations concerning comparables). In international cases, the main focus is on the transfer of functions, the transfer of intellectual property rights, financial transactions and asset management services. Transactions with foreign companies in low-tax jurisdictions, in particular, attract the tax authorities' attention.

Switzerland seems to be increasingly confronted with requests for administrative assistance in transfer pricing cases. Most recently, the OECD's TPG were also referred to in a purely national, intercantonal Federal Court Case where one company was domiciled in a high and one in a low tax canton (see more in **14.2 Significant Court Rulings**).

2. DEFINITION OF CONTROL/RELATED PARTIES

2.1 Application of Transfer Pricing Rules

Swiss tax law does not include an explicit definition of the terms "associated enterprises", "related parties" or "controlled transactions".

According to the FSC, for income tax purposes, related parties are to be considered as entities with close commercial or personal relationships, whereas any close relationship between the parties involved in the transaction is enough. According to the Swiss understanding of the term "related parties", direct or indirect control

(participation in management or capital) in itself is not decisive. The crucial question is if the tested transaction was conducted under the given conditions only as a consequence of the associated relationship. In practice, some cantonal tax administrations tend to apply the definition of "associated entities" set forth by the OECD. Furthermore, according to the FSC, "associated enterprises" or "related parties" can be assumed if the conditions agreed upon by the involved parties apparently do not meet the at arm's-length standard.

3. METHODS AND METHOD SELECTION AND APPLICATION

3.1 Transfer Pricing Methods

Swiss domestic tax laws or practices do not provide specific transfer pricing methods. But as Switzerland adheres to the OECD's TPG, all the usual transfer pricing methods are admissible. However, according to the FTA circular of 2004, the cost plus method is, in general, not to be seen as an appropriate method for financial services or management functions.

3.2 Unspecified Methods

As Switzerland adheres to the OECD's TPG and the Guidelines do not exclude the use of unspecified methods, such methods can indeed be applied.

However, if an unspecified method is intended to be applied, as the Guidelines specify, it should be explained why the methods described by the Guidelines themselves are not considered appropriate for the case at hand.

3.3 Hierarchy of Methods

In accordance with the OECD's TPG, Switzerland does not have a specific hierarchy of the methods described in the Guidelines. The most appropriate method should be used. However, the three traditional methods – ie, the comparable uncontrolled price (CUP) method, the resale price method and the cost plus method – are still preferred by the tax administrations. Furthermore, the CUP method enjoys preference over the other two traditional methods. In practice, however, the transactional net margin method is the most commonly used method in Switzerland to determine transfer prices.

The hierarchy of transfer pricing methods as stipulated in the older versions of the OECD's TPG can still be of relevance. This is due to a static approach to the application of the Guidelines that means that the version of the Guidelines in effect at the time the transaction was settled is applied (see **1.1 Statutes and Regulations**).

It is sometimes difficult, though, to assess whether an update of the OECD's TPG can be considered merely a more detailed explanation of the existing principles or a change in the guiding principles. If this is the case, a dynamic approach to the application of the Guidelines is permissible as well.

3.4 Ranges and Statistical Measures

The use of statistical tools that consider central tendency, such as the interquartile range or other percentiles, is not required. However, in practice, such tools are usually used to narrow the range.

With regard to the determination of adequate transfer prices, the tax authorities generally consider the interquartile range as the arm's-length remuneration.

3.5 Comparability Adjustments

Swiss domestic tax laws do not provide specific guidance on comparable adjustments. However, the OECD's TPG on how and when to apply comparability adjustments are applicable.

4. INTANGIBLES

4.1 Notable Rules

Swiss domestic tax laws do not provide specific guidance on the pricing of controlled transactions involving intangibles. Rather, the OECD's TPG are to be consulted regarding transfer pricing of intangibles.

4.2 Hard-to-Value Intangibles

In general, due to the adherence to the OECD's TPG, the OECD's approach regarding hard-to-value intangibles is considered by the tax authorities to be applicable in Switzerland as well.

However, there is controversy as to whether this approach is, in fact, applicable, since it seems to collide with long-standing case law and the tax laws themselves. In particular, the question is whether ex post data can influence open or final tax assessments.

Open Tax Assessments

If a tax assessment is not yet final, a transfer pricing adjustment requires, inter alia, an obvious mismatch between the value of the transferred intangible and the compensation received, and that this mismatch was recognisable for the persons in charge (see **1.1 Statutes and Regulations**). This mismatch is evaluated ex ante, namely at the time the transaction was settled.

The hard-to-value intangibles (HTVI) approach, however, assesses the conditions of the transaction ex post and does not provide an answer to whether a potential mismatch was ex ante already obvious and, thus, recognisable. Hence, the HTVI approach – as mentioned above – does not seem to fit into pre-existing domestic law and the respective case law. So far, however, there is no precedent on this issue.

Final Tax Assessments

If a tax assessment is already final and legally binding, an adjustment is generally only possible if the tax administration becomes aware of new facts or evidence. As long as the taxpayer provided the tax administration with appropriate and correct transfer pricing documentation during the assessment relating to the ex ante valuation of the intangible in question, the administration is not entitled to come back to its own evaluation should it ex post turn out that the value of the intangible is, in fact, higher. In this case, the ex post data would not qualify as new fact or evidence, allowing the final tax assessment to be reopened and changed.

4.3 Cost Sharing/Cost Contribution Arrangements

Switzerland recognises cost contribution arrangements and applies the OECD's TPG correspondingly. However, Switzerland does not have special rules that apply to such arrangements.

5. AFFIRMATIVE ADJUSTMENTS

5.1 Rules on Affirmative Transfer Pricing Adjustments

Switzerland does not have specific rules regarding affirmative transfer pricing adjustments. In general, pursuant to Swiss tax law, the financial statements prepared in accordance with commercial law are, in principle, binding for tax purposes. The tax administrations can only deviate from the financial statements in order to determine the taxable base if the statements violate accounting principles as set forth in the federal Code of Obligations or specific rules of the tax law require an adjustment.

However, as long as the tax return had not yet been filed by the taxpayer, the balance sheet

can, in accordance with the Code of Obligations, be adjusted without further restrictions. Once the tax return has been filed, however, according to case law, a balance sheet adjustment is only permissible if it violates commercial law. If a transfer pricing issue arises later that makes a proactive adjustment of the balance sheet necessary, an adjustment, in principle, will only be allowed if the original transfer prices also violate commercial law.

But as long as the adjustment increases the taxable profit, the tax administrations are nonetheless likely to accept such adjustments, even if the original transfer prices were in line with the accounting principles as set forth in the federal Code of Obligations. This is due to the fact that if a transaction is not conducted according to the arm's-length principle, the tax administration can make the respective adjustments (see Article 58 paragraph 1 of the Federal Act on Direct Federal Taxation, and Article 24 paragraph 1 of the Federal Act on the Harmonisation of Direct Taxes).

Neither transfer pricing-specific returns nor related-party disclosures along with the corporate income tax return are required to be filed.

6. CROSS-BORDER INFORMATION SHARING

6.1 Sharing Taxpayer Information

Exchange of Information on Request

In 2009, Switzerland committed to the internationally agreed standard regarding the exchange of information on request. By doing so, Switzerland renewed most of its more than 100 DTAs.

Moreover, in 2016, Switzerland ratified the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, extending the network of jurisdictions to exchange information even further. Switzerland has implemented the legal basis for exchange of information on request with around 140 jurisdictions. In addition, Switzerland has signed ten tax information exchange agreements.

Practice shows that foreign tax authorities are increasingly submitting requests for administrative assistance to Switzerland when auditing transfer prices. Under current law, administrative assistance may only be provided if the requesting state demonstrates in its request that the information requested is foreseeably relevant and confirms that it will treat the requested information confidentially. Administrative assistance may be refused if the information is to be used for taxation contrary to the DTA or if the requested information could not be obtained by the Swiss tax authorities under domestic tax procedural law.

Spontaneous Exchange of Information on Specific Tax Rulings

In December 2015, the Swiss Parliament approved the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters (MAC). The MAC entered into force for Switzerland as of 1 January 2017 and laid the legal foundation concerning the automatic, as well as the spontaneous, exchange of information. According to the minimum standard defined in Action 5 of the BEPS project it is incumbent on states to spontaneously exchange information on tax rulings in cross-border situations.

Switzerland has implemented the spontaneous exchange of information on tax rulings into domestic law as of 1 January 2017. In particular, it has also committed to the spontaneous exchange of unilateral rulings on transfer pricing and permanent establishments with the state of the direct parent, the state of the group top company and, if available, the state of the counterparty of the transaction.

Automatic Exchange of Information on Country-by-Country Reports (CbCRs)

In 2016, Switzerland also signed the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports, which entered into force on 1 January 2017.

Apart from voluntary CbCRs, the first reports had to be prepared for 2018 and information was first exchanged in 2020 with around 60 states. These countries include all the EU states, but also emerging economies such as Indonesia and Brazil, as well as developing countries such as Pakistan and Kazakhstan. Switzerland does not exchange CbCRs with the USA.

7. ADVANCE PRICING AGREEMENTS (APAS)

7.1 Programmes Allowing for Rulings Regarding Transfer Pricing

Unilateral Rulings

Switzerland has a long-standing practice regarding the issuance of unilateral rulings. This practice also includes the issuance of unilateral transfer pricing rulings. These rulings may be subject to the spontaneous exchange of information (see also **6.1 Sharing Taxpayer Information**).

Advance Pricing Agreements

In Switzerland, advance pricing agreements (APAs) are available. APAs have become a favoured option for Swiss-based international groups with complex or high-volume transactions. In practice, the procedure starts with a presentation of the facts and a formal request to the State Secretariat for International Finance (*Staatssekretariat für internationale Finanzfragen*, or SIF), the competent authority in Switzerland.

In 2020, 85 APA proceedings were opened and 55 of the 304 pending APA proceedings have been closed. The SIF has published guidance on mutual agreement procedures (MAPs) and APAs.

7.2 Administration of Programmes

With regard to bi- and multilateral APA procedures, the competent authority in Switzerland is the SIF.

Concerning unilateral transfer pricing rulings for corporate income tax purposes, the cantonal tax administrations and the FTA will be the competent authorities.

7.3 Co-ordination between the APA Process and Mutual Agreement Procedures

Since the SIF is also the competent authority for mutual agreement, co-ordination between a MAP and APA procedures is ensured.

7.4 Limits on Taxpayers/Transactions Eligible for an APA

In principle, the APA programme is open for all taxpayers that engage in cross-border intra-group transactions.

7.5 APA Application Deadlines

The application for an APA procedure can be filed at any given time, including after an audit.

7.6 APA User Fees

Under current practice, APA procedures and MAPs are free of charge. This may change in the future.

7.7 Duration of APA Cover

In practice, an APA will cover three to five years. However, Switzerland does not have specific time limitations an APA may or may not cover. Rather, the time period to be covered by an APA has to be decided depending on the characteristics of the case at hand and is subject to negotiations. Hence, the duration is typically a trade-off between an administrative-economical

reasoning and the uncertainty concerning future developments of the affairs that are the subject of the APA.

7.8 Retroactive Effect for APAs

Unilateral rulings cannot have retroactive effect, as according to domestic law, ruling requests can only be accepted if they concern future affairs.

However, as bi- and multilateral APAs are based on the MAP provision of the respective tax treaty, the aforementioned restriction does not apply. Hence, APAs can, depending on the involved countries, have retroactive effect. However, the retroactive reach is limited to ten years due to Swiss domestic law. In practice, Switzerland seeks to limit the retroactive effect of APAs to five years.

8. PENALTIES AND DOCUMENTATION

8.1 Transfer Pricing Penalties and Defences

Transfer Pricing Penalties

Switzerland does not impose penalties that apply specifically in the transfer pricing context, except for violations of the CbCR requirements.

In cases of unlawful tax evasion or tax fraud, penalties can nevertheless also be imposed concerning transfer pricing issues. This is, in particular, true for cases where basic principles of transfer pricing were grossly neglected and, thus, the violation of the arm's-length principle was not only recognisable for the company or the persons in charge respectively but downright obvious.

In the case of tax evasion or tax fraud, penalties may be imposed for all taxes involved. For instance, a transfer price-induced adjustment by the tax administration concerning corporate income tax may trigger respective consequences regarding withholding tax or VAT. Hence, in practice, it seems advisable to seek an amicable solution with the tax administration as the tax administration would then refrain from initiating criminal proceedings. Whether this approach is actually appropriate requires a careful consideration and assessment of the facts and circumstances of the individual case.

Documentation Obligations

Swiss tax laws do not define specific documentation requirements with respect to transfer pricing. However, taxpayers must provide all documents necessary in order to enable the tax administration to conduct a proper assessment of the taxable base. This legal obligation is based on the principle that the taxpayer and the tax administration jointly determine the relevant facts to ensure a complete and correct assessment as far as corporate income tax is concerned. As a consequence, despite the lack of specific documentation rules, taxpayers are strongly advised to have full and state-of-the-art transfer pricing documentation at hand that can, if requested by the tax administration, be disclosed. This also includes intercompany agreements with respect to the controlled transactions. Such documentation will also be helpful in the defence of potential tax evasion charges. Such documentation should also include sound and updated benchmarking studies.

If no appropriate transfer pricing documentation can be presented and the taxable base subsequently cannot be properly determined, the tax administration might need to estimate the transfer prices. Even though that estimate has to be dutiful and based on experience, such estimates are rarely in favour of the taxpayer. Although such an estimate is not to be considered as a penalty, it still has to be taken into consideration as a potential negative impact. The reason for

that is that the courts will reject such an estimate only if the taxpayer can demonstrate that the transfer prices set by the tax administration are obviously flawed or arbitrary.

Penalty Relief

Federal and cantonal Swiss tax laws provide for a one-time voluntary disclosure, which leads to a complete penalty relief if specific statutory conditions are met. Outside the voluntary disclosure procedures, penalties charged are lower in the case of ordinary negligence and higher in the case of gross negligence. Collaboration with the tax administration in the course of a tax criminal investigation will usually result in a lower penalty. With regard to the question of culpability, the importance of state-of-the-art transfer pricing documentation should be emphasised. If a company does have such documentation, it will be difficult for the tax administrations to substantiate culpability. However, as indicated above, many disputes can be prevented or settled by negotiations with the tax authorities during a tax assessment or tax audit process (by filing formal complaints).

8.2 Taxpayer Obligations under the OECD Transfer Pricing Guidelines

Concerning transfer pricing documentation, Switzerland only adopted the minimum standard. Hence, taxpayers are only required to prepare CbCRs, without having the obligation to prepare a master or local file.

However, in view of a potential challenge of the transfer prices by the tax authorities, it is nonetheless advisable to have master and local files at hand, especially in cases where documentation requirements exist with foreign group companies rendering or receiving intercompany services.

9. ALIGNMENT WITH OECD TRANSFER PRICING GUIDELINES

9.1 Alignment and Differences

Though the Guidelines are not implemented into domestic law, the administrative practice declared the Guidelines as applicable.

Nonetheless, differences exist regarding the application of thin capitalisation rules and the determination of intra-group interest rates for loan receivables and loan payables both in Swiss francs and in foreign currencies. In this regard, the FTA annually publishes safe haven interest rates that deviate from the at arm's-length principle as defined and agreed upon in the OECD's TPG.

There is a long tradition in Swiss tax law of applying the formulary apportionment method regarding the profit allocation between the Swiss head office of an enterprise and its foreign permanent establishments. However, Switzerland now follows the OECD authorised approach for the attribution of profits of permanent establishments (AOA). The FSC has, in its ruling in the matter of Swiss International Airlines, even shown sympathy for the application of the AOA also in domestic matters, but ultimately left the question open. In this respect, it should be noted that Switzerland has numerous DTAs in force that are still based on the OECD Model Convention, where the application of the formulary apportionment method for the allocation of profits to permanent establishments was considered permissible. However, Switzerland tends to follow the AOA even if a tax treaty has not yet been updated regarding the new Article 7.

9.2 Arm's-Length Principle

Deviations from the arm's-length principle can be seen in the implementation of the patent box and the notional interest deduction, which were

introduced in connection with the corporate tax reform that came into force on 1 January 2020.

In line with BEPS Action 5, cantons are allowed to exempt income from patents and similar rights from taxation up to 90%. The top-down approach is used to determine qualifying income. Thereby, income from routine activities and trade marks is to be excluded. These are subject to ordinary taxation. According to the FTA, it is not necessary to determine the income for routine activities and brand use by means of transfer pricing studies. Instead, for reasons of practicability, the law provides for fixed margins. With regard to the income of routine functions, a mark-up of cost plus 6% is defined, and concerning the income of trade marks, as a rule of thumb, 1% of the turnover of the patent box is regarded as appropriate. However, the right to prove higher or lower income from trade marks based on the arm's-length principle is reserved.

The law also provides for simplifications in connection with the notional interest deduction. The special feature of the Swiss notional interest deduction is that it is only possible on the so-called security equity. For this purpose, core and security equity must be determined in a first step. The law does not require the preparation of a transfer pricing study for this purpose.

For reasons of practicability, the regulation rather provides for equity backing rates for the individual assets, following the circular on thin capitalisation and its inversed maximum safe haven debt capacity rates (for example, for intercompany loans, a minimum equity rate of 15% is required). If these rates are exceeded, there is security capital on which an imputed equity interest deduction can be claimed. In general, this interest is also not determined on the basis of the arm's-length principle. Rather, the law provides for the interest rate for ten-year federal bonds. However, to the extent the security capital is attributable to receivables from related parties, an interest rate corresponding to the arm's-length principle may be applied.

9.3 Impact of the Base Erosion and Profit Shifting (BEPS) Project

In general, the BEPS project had a major impact on the Swiss tax law landscape. Based on BEPS Action 5, Switzerland agreed to spontaneously exchange certain tax rulings, and based on BEPS Action 13, the exchange of country-by-country reports (see **6.1 Sharing Taxpayer Information**).

Moreover, Switzerland abolished the administrative practices on Swiss finance branches and principal companies (see **1.2 Current Regime and Recent Changes**). The BEPS project raised the awareness of transfer pricing considerably, prompting the tax administrations – at cantonal and federal level – to address this issue more frequently and persistently (see **1.2 Current Regime and Recent Changes**).

9.4 Impact of BEPS 2.0

Switzerland is in favour of long-term, broad-based multilateral solutions instead of a multitude of confusing national measures. Thus, in principle, Switzerland supports the parameters of the discussed rules regarding the international profit reallocation of large multinational entities (MNEs) according to Pillar One as well as the minimum taxation global anti-base erosion (GloBE) rules according to Pillar Two, in order to restore legal certainty for countries as well as corporations.

Pillar One

Regarding Pillar One, Switzerland advocates that the interests of small, economically strong countries be taken into account in the implementation. Although Pillar One works in both directions in principle, in practice Switzerland exports much more than it imports, because Switzerland creates attractive location conditions for a wide

range of industries while it is itself a small but nevertheless an important consumer market.

Pillar Two

Pillar Two, as well as Pillar One, poses major challenges for Switzerland. Low taxes, clearly a locational advantage for Switzerland, will lose importance. The Swiss Federal Council plans to implement the rules and ensure minimum taxation in accordance with Pillar Two with a "qualified domestic minimum top-up tax", which will compensate for the difference between any lower taxation and the minimum tax of 15% for MNEs that fall into the scope of Pillar Two. For all other companies, nothing will change. This approach protects companies from additional taxes abroad and brings legal certainty. The implementation secures additional tax revenues for Switzerland that would otherwise flow abroad. Any additional revenue shall be used to increase the attractiveness of Switzerland as a business location.

Pillar Two will lead to a different treatment of affected and non-affected companies. Therefore, it is planned to amend the Constitution to give the Swiss Confederation the authority to implement the Pillar Two GloBE rules. In order to achieve an entry into force on 1 January 2024, a temporary ordinance is to be enacted, which is to be replaced by a federal law passed by Parliament as soon as there is sufficient clarity regarding the application of the international rules.

The financial impact for Switzerland cannot be reliably estimated. The available data is limited and individual reform elements cannot be quantified. Initial rough estimates indicate short-term additional revenues of CHF1–2.5 billion. The additional revenues of the cantons increase the volume of the National Fiscal Equalisation Scheme.

It is clear that BEPS 2.0 is a major development in the international tax landscape and poses a great challenge, particularly for Switzerland. However, the liberal economic system – in particular, the liberal labour law – good infrastructure, the first-class education system and the comparatively moderate corporate tax burden are reasons why Switzerland is, and will continue to be, a popular location for group headquarters and entrepreneurial activities that yield high residual profits, despite internationally rather high labour costs.

Even though the effective Swiss tax burden may increase for multinational companies that fall under the Pillar Two regime, their higher tax costs may be offset by other benefits: the cantons are analysing how to use the expected additional tax revenues from the additional qualified domestic top-up tax, and it can be expected that they will take non-fiscal measures (eg, reducing the rates of higher individual income tax brackets, granting social security credits or R&D benefits) to maintain and even improve their attractiveness. Given this situation, there will also be a significant tax rate differential between Switzerland and many other jurisdictions after Pillar Two, so foreign tax authorities are expected to continue to be increasingly interested in intra-group transactions with Swiss companies.

9.5 Entities Bearing the Risk of Another Entity's Operations

From a contract and commercial law perspective, a group can freely allocate risks and functions to be assumed between its entities. With a view to the acceptance of such an allocation, the FSC held, in favour of the taxpayers, that the tax administration must recognise the contractual distribution of functions and risks undertaken by group entities, if these were not merely sham structures.

However, as the tax administrations are also following a substance-over-form approach in the area of transfer pricing, the splitting up of the assumption of risks and functions is increasingly questioned by the tax authorities. In particular, the tax administrations will evaluate whether the personnel of a risk-bearing entity was effectively able to manage and control the assumed risks.

10. RELEVANCE OF THE UNITED NATIONS PRACTICAL MANUAL ON TRANSFER PRICING

10.1 Impact of UN Practical Manual on Transfer Pricing

The UN Practical Manual on Transfer Pricing is of only minor importance in Swiss transfer pricing practice.

11. SAFE HARBOURS OR OTHER UNIQUE RULES

11.1 Transfer Pricing Safe Harbours

There are safe harbour rules that apply on thin capitalisation and on interest rates that are regularly used by corporate tax payers (see **9.1 Alignment and Differences**).

Thin Capitalisation

The FTA published thin capitalisation rules in its Circular Letter No 6 (6 June 1997). In this circular, the maximum debt is determined according to maximum debt capacity ratios that apply for each asset category. No interest expense can be made on debt that surpasses this maximum debt calculated (to be considered as constructive dividend distribution). Special safe haven rules might apply on the level of the Swiss cantons (eg, a maximum debt ratio of 6/7 in the canton of Zug).

Interest Rates

Furthermore, the FTA annually publishes circular letters providing inbound and outbound safe harbour interest rates on long-term intercompany loan receivables and payables.

The FTA, in principle, allows taxpayers to deviate from the conditions set out in the above-mentioned circular letters if the taxpayer can prove that the applied interest rate is at arm's length. The taxpayer has the burden of proof to establish that the applied interest rate is at arm's length. The taxpayer preferably does that through performing a detailed transfer pricing analysis.

11.2 Rules on Savings Arising from Operating in the Jurisdiction

Switzerland does not have any specific rules relating to location savings and relies on the OECD's TPG on this issue. However, Switzerland does not provide notable location savings in the sense of the OECD's TPG as production and labour costs are comparatively high.

11.3 Unique Transfer Pricing Rules or Practices

Switzerland does not have unique transfer pricing rules and, in principle, adheres to the OECD's TPG.

12. CO-ORDINATION WITH CUSTOMS VALUATION

12.1 Co-ordination Requirements between Transfer Pricing and Customs Valuation

Switzerland levies VAT on imported goods (import tax) of 7.7%, where the tax is assessed on the respective consideration. The import tax is levied by the Federal Customs Administration, which acts, like the FTA, as an independent administrative body of the federal government.

Despite the fact that the FTA and the Federal Customs Administration act independently, the administrations are entitled and encouraged to exchange relevant information between themselves and with other interested administrative branches. The information exchange has massively increased within the past couple of years, which is mostly due to improved electronic systems, allowing a comprehensive and steady data flow. Hence, transfer pricing adjustments should always be considered for import tax purposes, as well. With regard to customs duty, no adjustment is generally required as the customs duty itself is based on weight and not on monetary value.

13. CONTROVERSY PROCESS

13.1 Options and Requirements in Transfer Pricing Controversies

General

Transfer pricing issues can generally be raised by the tax administration in the course of ordinary tax assessments or in the course of audits. With regard to the transfer pricing controversy process, it has to be differentiated whether a cantonal tax administration or the FTA raised the issue of transfer pricing. While the cantonal tax administrations raise this issue in the context of corporate income tax, the FTA may challenge transfer pricing also with regard to withholding tax, stamp duty or VAT.

As will be shown, taxpayers may challenge the results of a tax assessment or from an audit in an administrative objection proceeding before bringing the case to court. As regards the selection of the courts, the taxpayer does not have options since the competent courts are determined by law.

Corporate Income Tax

Since the cantonal tax administrations are the competent authorities to assess and levy corporate income tax at cantonal and federal level, transfer pricing adjustments affecting corporate income tax have to be discussed with these cantonal tax administrations. If the tax administration has already issued an assessment or a decision, an objection can be lodged with the tax administration itself within 30 days. The tax administration will then have to evaluate the material objections and render a new decision.

The tax administration's second decisions can be appealed before court, again within a 30-day deadline. Generally, each canton provides two judicial instances, whereas, typically, smaller cantons only established one judicial instance. Once the highest cantonal court has rendered its decision, an appeal with the FSC can be lodged, also within 30 days. In contrast to the cantonal instances, the FSC will only deal with questions concerning the correct application of the law, which includes the application of the OECD's TPG. Issues concerning the facts will only be dealt with if the facts were arbitrarily established.

The disputed tax needs to be paid irrespective of the fact of appealing a decision or moving the case forward into court. If the appeal/objection is successful, the tax already paid will be paid back. However, in ruling 5A_41/2018, the FSC clarified that the tax administration is nevertheless not entitled to enforce the disputed tax amount as long as the controversy has not been decided with legal effect. Nevertheless, the tax authority may request a freezing order at any time, even before the tax amount has been legally determined, if the taxpayer is not domiciled in Switzerland or payment of the tax owed by them appears to be at risk. The freezing order is immediately enforceable and has the same effects in the debt collection proceedings as an enforceable court judgment.

Withholding Tax, Stamp Duty, VAT

In contrast to the cantonal tax administrations, the FTA can also raise transfer pricing issues in connection with withholding tax, stamp duty and VAT. As at the cantonal level, the taxpayer can object against a negative decision of the FTA before appealing to the court.

As such a decision affects taxes being levied at federal level, the appeal has to be lodged with the Swiss Federal Administrative Court within 30 days. This court's decision can then be appealed with the FSC.

The disputed tax needs to be paid irrespective of the fact of appealing a decision or moving the case forward into court. If the appeal/objection is successful, the tax already paid will be paid back. However, in ruling 5A_41/2018, the FSC clarified that the tax administration is nevertheless not entitled to enforce the disputed tax amount as long as the controversy has not been decided with legal effect. Nevertheless, the tax authority may request a freezing order at any time, even before the tax amount has been legally determined, if the taxpayer is not domiciled in Switzerland or payment of the tax owed by them appears to be at risk. The freezing order is immediately enforceable and has the same effects in the debt collection proceedings as an enforceable court judgment.

14. JUDICIAL PRECEDENT

14.1 Judicial Precedent on Transfer Pricing

Due to Switzerland's practice of issuing transfer pricing rulings and its APA programme, disputes on core transfer pricing issues that have to be settled by courts are relatively rare. Nevertheless, the FSC has issued important decisions that raise key issues in the field of transfer pricing. It is already evident that transfer pricing will play an important role in case law in the future.

Important cases have been decided in connection with IP transactions, group financing (in particular, cash pools), contract manufacturers and asset management services. In some cases, the rulings deal with transactions involving companies resident in low-tax jurisdictions. In addition, there are various administrative assistance cases arising from transfer pricing audits abroad.

14.2 Significant Court Rulings

Due to the significant number of rulings in the area of transfer pricing, a selection of the most important transfer pricing cases decided by the FSC in the past four years is presented below.

FSC Decision 2C_11/2018 of 10 December 2018

This decision marks a tipping point concerning the case law of the FSC. The subject of the case was a penalty that was imposed for unlawful tax evasion due to blatantly disregarding the principle of dealing at arm's length. Second, it has to be pointed out that this decision concerns payments to the Netherlands, whereas other cases usually concerned offshore tax havens.

The case at hand dealt with a Swiss company that is involved in the manufacturing and distribution of pharmaceutical and chemical products. The Swiss company was held by a Dutch parent that held another company in France. The R&D activities were delegated by the Dutch parent to its French subsidiary and compensated with cost plus 15%. In turn, the Swiss company had to pay a royalty to its Dutch parent of 2.5% of its turnover for using the R&D results.

The FSC ruled that the Dutch parent was a mere shell company as it had no substance (in 2006 and 2007, no employees were employed, and in 2010 and 2011, an average of only three employ-

ees were employed). Hence, the royalty agreement was disregarded. Instead, the R&D agreement between the Dutch parent and the French subsidiary was regarded as being directly concluded between the Swiss and French companies. The tax adjustment therefore amounted to the royalty payments minus the cost plus 15% remuneration, which equalled a yearly average adjustment of approximately CHF350,000. Whether the latter was in line with the OECD's TPG was not assessed by the FSC.

With regard to the imposed penalty, the Court ruled that it must have been recognisable to the persons in charge and that a royalty to the shell company that was not entitled to the fruits of the R&D activities could obviously not be considered as a commercially justified expense. Hence, an unlawful tax evasion was confirmed and 75% of the evaded tax was imposed as a penalty.

FSC Decision 2C_343/2019 of 27 September 2019

This decision concerns a Swiss company that offered administration and other services concerning trusts. For this purpose, it held, inter alia, an international business company in the Seychelles that handled the daily business of the administered trusts. The remuneration of the Seychelles company was defined in a service agreement. In the relevant years (2008–12), the Swiss company mainly reported losses. The tax administration argued that the remuneration for the Seychelles company was not at arm's length and determined the remuneration using the cost plus (5%) method.

According to long-standing case law, the tax administration has to prove that the company rendered a service for which it was not, or not adequately, reimbursed. The taxpayer then has to prove that the remuneration was, in fact, at arm's length. The burden of proof is thus reversed.

In the case at hand, the plaintiff was not able to provide proof regarding the payments to its subsidiary being conducted at arm's length. The plaintiff has limited itself to submitting price lists of competitors. However, it was not clear from these lists that the transactions in question were actually free-market transactions to which the intra-group transactions were comparable. Thus, due to the lack of adequate information, the CUP method could not be applied. In turn, the FSC confirmed the ruling of the lower instances that the Seychelles company only executed routine functions and did not assume any risk. The cost plus 5% remuneration was, hence, confirmed. However, in the years 2008 to 2010, only immaterial adjustments were made and consumed by the tax losses carried forward. In 2011 and 2012, adjustments were made in the amounts of approximately CHF125,000.

This case demonstrates that in the absence of transfer pricing analysis documenting the correct delineation and pricing of the intra-group transaction (as outlined in the OECD's TPG), the taxpayer is not in a strong position when facing the tax authorities.

FSC Decision 2C_1073/2018 of 20 December 2019

Contrary to the above-mentioned cases, this case dealt with an insufficient remuneration of the Swiss company, a bank. Said bank had a subsidiary in Guernsey that administered a number of umbrella funds and received a management fee of 1.5% of the net value of the assets under management and a performance fee of 10–20% of the funds' performance. Even though the Guernsey company was contractually obliged to administer the funds, these activities were delegated to third parties and to the Swiss parent. Whereas the third parties as well as the Swiss parent received an equal management fee (0.75%), only third parties were also entitled to a performance fee. The Swiss parent company

did not receive any retrocessions relating to the performance fees.

The tax administration claimed that 70% of the performance fees and a remuneration for other activities (eg, marketing and distribution) should have been awarded to the Swiss parent. In addition, the tax administration imposed a fine of 75% of the unlawfully evaded tax concerning the already definitive tax assessments (2001–07) and 50% concerning the open ones (2008–10). Unfortunately, the effective amounts were redacted by the competent courts.

The FSC confirmed the decision of the last cantonal court in the present matter and took into consideration that the Guernsey company received management and performance fees concerning the funds, the management of which it has delegated to third parties and its parent. Hence, it could have been assumed that the contractual conditions concerning the third-party services were, in fact, at arm's length, which, according to the FSC, should also have been applied in relation to the Swiss parent company.

FSC Decision 2C_153/2021 of 25 August 2021

This decision concerned a Swiss company (A AG) providing legal and tax advice as well as general fiduciary services that was domiciled in the Canton of Nidwalden, a canton with a low corporate income tax rate. The founder of the company incorporated in the same canton a second company (B AG) that concluded on the day of incorporation a management agreement with A AG, according to which B AG was obliged to acquire customers for A AG in the domestic market and abroad, to provide strategic management, to bear the entrepreneurial risk, to ensure that A AG has the necessary liquid funds, and to grant it a right to use the name and logo "A".

The compensation owed by A AG for these services was determined as follows: net income of A AG less a margin of 1.5% of the fee income (2012: CHF706,927, 2013: CHF 875,551). Soon after the incorporation of A AG, a branch office was opened in Zurich, with practically the entire staff working at the Zurich location, where a relatively high corporate income tax rate applies. Due to the management fee owed by A AG to B AG, the taxable profit, which was in part taxable in Zurich, could in effect be shifted to A AG. In contrast to B AG, the entire profit of B AG was taxable in Nidwalden.

In the course of a tax audit in the Canton of Zurich, the tax administration asked A AG to submit documentation showing that the management fee paid to B AG was commercially justified by reason and by amount. As A AG could not provide sufficient documentation regarding the management fee, the Zurich tax administration first denied the deductibility of the fee completely. After an objection, however, the tax administration accepted CHF200,000 as commercially justified. This amount was estimated within the course of a discretionary assessment, whereby the result of this assessment can only be examined by the courts in the case of obvious errors. Although it is unclear which method was applied to estimate the amount of CHF200,000, the FSC confirmed the estimate and did not see any obvious errors in the assessment.

The case at hand is an example of an undue profit shifting within the borders of Switzerland. Unfortunately, the transfer pricing method to come to the agreed fee was not discussed in the proceedings as a proper delineation of transaction, including functional analysis, was not performed. The same is to be noted with regard to a recent ruling of the Administrative Court of the Canton of Zurich (SB.2020.00011 of 29 September 2021). This case concerned the determination of the at arm's-length sales price

of IP rights. As in the case described above, the questions posed by the tax authorities could not be answered adequately. Hence, the tax authorities determined the sales price at their discretion. In this case, too, the court upheld the tax authority's estimate without discussing the method applied. These decisions illustrate the enormous importance of solid transfer pricing documentation. If no such documentation can be presented to the tax authorities, there is a risk of a discretionary assessment that can only be challenged under very restrictive conditions (see also **8.1 Transfer Pricing Penalties and Defences**).

FSC Decision 2C_27/2021 of 5 October 2021

In contrast to the decisions discussed above, the ruling to be outlined in the following deals with VAT. The case at hand concerns the determination of an at arm's-length intra-group lease for a hotel. In this case, A BV, domiciled in the Netherlands and a subsidiary of a Dutch foundation, owns together with another group company a hotel located in Switzerland. The hotel is operated by D AG, domiciled in Switzerland, a subsidiary of A BV. In the course of a VAT audit, the FTA reached the conclusion that the lease agreed upon between D AG and A BV was not determined at arm's length.

In its ruling, the FSC first expressly stated that the cost plus method, the CUP method and the resale price method were admissible for examining the conformity of third-party transactions. With regard to the selection of the method, the FSC stated that this is regarded as a legal question that the FSC is free to review. The result of the selected method, however, is regarded as a question of fact that can only be reviewed by the FSC for obvious incorrectness or arbitrariness. Furthermore, the FSC stated that in the case of related parties, the FTA can determine the remuneration of the services concerned – in particular, on the basis of the methods mentioned – and, if necessary, deviate from the taxpayer's self-declaration. It is, hence, not necessary for the FTA to prove that the valuation applied by the taxpayer is actually not at arm's length.

In the specific case, the FTA determined the lease using a variant of the cost plus method. In doing so, the FTA determined the costs by capitalising the investments made for the hotel property according to the construction cost calculation using the depreciation rates applicable for direct taxation and added the actual capital and maintenance costs. On this cost basis, the FTA applied a mark-up of 10%. In the appeal proceedings, this method was confirmed in principle, although the lower court reduced the depreciation rate used in the calculation of the cost basis from 4% to 3%.

In its ruling, the FSC confirmed that the FTA does not have to prove that the remuneration for services between related parties does not meet the arm's-length standard. Even though not expressly stated by the FSC, this does not mean that the FTA does not have to deal with the method used by the taxpayer if it wants to use a different method. As the FSC has stated, the choice of method is a question of law, which means that the highest court is free to assess whether the appropriate method was used. Furthermore, the FSC will also have to examine whether the chosen method was actually applied correctly. As a result, the FSC has a broad authority to review the method applied by the FTA, which is to be welcomed from the taxpayer's point of view.

15. FOREIGN PAYMENT RESTRICTIONS

15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions

Switzerland does not have any specific rules or even restrictions with regard to uncontrolled outbound transactions.

15.2 Restrictions on Outbound Payments Relating to Controlled Transactions

Switzerland does not have any specific rules or even restrictions with regard to controlled outbound transactions.

However, as for all transactions, the payments have to be commercially justified in order to be effectively deductible for corporate income tax purposes. Furthermore, according to the FSC, a "particularly qualified" duty to co-operate with the tax authorities in the case of cross-border legal relationships has to be taken into account. This increased duty especially applies to outbound payments to a non-DTA foreign country or to a DTA foreign country to the extent that the DTA does not yet meet the current OECD standard on information exchange. The reasoning is that the circumstances of the foreign recipient are beyond the control of the domestic tax authorities.

15.3 Effects of Other Countries' Legal Restrictions

Switzerland does not have specific rules with regard to the effects of other countries' legal restrictions. In the event that a foreign entity is affected by an adjustment of a payment to a Swiss entity due to such restrictions, a double taxation is most likely to incur.

However, Swiss tax authorities may prevent a double taxation with unilateral measures if they agree to the reason and extent of the correction. Otherwise, a MAP would need to be initiated if a double taxation agreement is applicable.

16. TRANSPARENCY AND CONFIDENTIALITY

16.1 Publication of Information on APAs or Transfer Pricing Audit Outcomes

In Switzerland, taxpayer information is kept strictly confidential, apart from cases of administrative assistance with contracting states.

Thus, results from APAs and transfer pricing audits are not published. Data regarding APAs is, however, collected for statistical purposes, with these statistics limited to the number of requested APAs, current APA proceedings and closed APA proceedings.

16.2 Use of "Secret Comparables"

In principle, Switzerland adheres to the OECD's TPG and follows the principle according to which the tax administration is prohibited from basing transfer pricing adjustments on secret comparables.

However, there is not sufficient publicly available information with respect to transactions between unrelated parties in Switzerland, nor is there a public registry where the financial data of Swiss companies can be consulted. The lack of sufficient publicly available data might, for tax administrations, trigger the need for the use of secret comparables, at least for audit purposes. However, in practice, the tax administrations generally accept the use of pan-European data and, thus, the problem of limited data can effectively be mitigated.

Although pan-European data that generally provides a sound base for benchmarking analysis can be used, it can be observed in practice that

tax administrations nevertheless try to stick to secret comparables. If this occurs, the tax administration needs to disclose the comparables to the taxpayer.

17. COVID-19

17.1 Impact of COVID-19 on Transfer Pricing

The authors expect that COVID-19 will have a notable effect on transfer pricing in Switzerland, certainly where principal or trading structures with the main risk-taking entity in Switzerland are faced with a substantial fall in their taxable profits in Switzerland. It is expected that the tax administrations will monitor transfer prices very closely, since the COVID-19 measures heavily rely on the state's finances, as, probably, in all countries around the world.

The safe haven interest rates and thin capitalisation rules have not been adapted in spite of the extraordinary financial effects of the COVID-19 crisis.

17.2 Government Response

Regarding the Swiss economy, a large-scale financing programme has been rolled out to support the liquidity needs of companies short of funds. As regards taxpayers, the response regarding the implications of the COVID-19 pandemic focused on securing the taxpayers' liquidity as far as possible.

Financing Programme

In record time, the Swiss government and the Swiss banks rolled out an emergency programme to provide bridge loans to companies against the risk of illiquidity due to the COVID-19 measures. Affected companies had the chance until 31 July 2020 to apply for a bridge loan, which were guaranteed by the Swiss federal government. Credits up to CHF500,000 are fully guaranteed and no interest is charged, whereas credits higher than CHF500,000 are only guaranteed to the extent of 85%.

In total, around 140,000 applications for bridge loans have been filed, with only around 1,000 applications for credits higher than CHF500,000. The total amount of the credits amounts to approximately CHF17 billion, of which around CHF5 billion has been repaid at the time of writing.

Taxpayers' Payment Obligations

Temporary waivers concerning federal and, in most cases, cantonal taxes were granted and payment deadlines were extended. Furthermore, with regard to VAT credits, quicker refunds were made. These measures correspond with the measures recommended by the OECD but were only in effect until 31 December 2020. No further facilitations are applicable.

17.3 Progress of Audits

Though the tax administrations were at times urged to reduce the physical presence of personnel in their offices and partially work from home, audits have not stalled but notably slowed down. Such audits have been performed electronically (desk reviews).

As practice has shown, tax audits have not been conducted in a harsher fashion than before the COVID-19 pandemic. On the contrary, tax administrations have demonstrated a higher willingness to reach amicable solutions.

Tax Partner AG is focused on Swiss and international tax law and is recognised as a leading independent tax boutique. With currently 15 partners and counsel and a total of approximately 50 tax experts consisting of attorneys, legal experts and economists, the firm advises multinational and national corporate clients as well as individuals in all tax areas. A central focus lies on tax controversy and dispute resolution, including transfer pricing issues. Tax Partner AG also provides support regarding transfer pricing studies and the preparation of transfer pricing documentation. Other key areas include M&A, restructuring, real estate transactions, financial products, VAT and customs. Tax Partner AG is independent and collaborates with various leading tax law firms globally. In 2005 the firm was a co-founder of Taxand, the world's largest independent organisation of highly qualified tax experts.

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Trends and Developments

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Introduction

On 20 January 2022, the Organisation for Economic Co-operation and Development (OECD) published an updated version of its Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD's TPG). This latest version consolidates the changes to the 2017 version into a single publication. The 2020 version now incorporates additional guidance on the transactional profit split method, hard-to-value intangibles, and financial transactions. The Swiss tax authorities use the OECD's TPG when examining intra-group transactions. Cross-border intra-group transactions with companies that are domiciled in tax havens or in countries with attractive tax regimes are particularly scrutinised.

The authors have observed that intra-group transactions within Switzerland are now also subject to transfer pricing reviews, particularly where entities are domiciled in cantons with a low tax rate and have minimal substance. One case decided by the Swiss Federal Supreme Court is illustrated below.

Switzerland has taken important steps to put in place strong dispute resolution mechanisms in order to counteract the threat of double taxation. In its international tax policy, it advocates the inclusion of arbitration clauses. In addition to that, the Swiss legislator is committed to strengthening the rights and obligations of the taxpayer with respect to mutual agreement procedures (MAPs). The enactment of the Federal Act on the Implementation of International Agreements (ITAIA) is an important improvement in that respect. The Act regulates the application and the conduct of MAPs, as well as the implementation of mutual agreement resolutions, into domestic law.

When transfer pricing corrections are made by Swiss tax authorities in an international context, Swiss dividend withholding tax can be substantial. A motion that intends to mitigate the withholding tax consequences in such cases is pending in the Swiss parliamentary approval process. If the motion is approved, which is not certain, this would mean another improvement to a taxpayer's legal certainty in Switzerland, as well as to the attractiveness of Switzerland as a business location.

Audit of Intra-group Services – Hospital Case

A recent Federal Supreme Court (FSC) ruling deals with intra-group transactions within Switzerland. This case concerned A AG, a private hospital, which has its registered office in the Canton of Basel-Landschaft (BL). It is the wholly owned subsidiary of C AG and sister company of B AG, both of which have their registered office in Canton V. B AG has no staff of its own (one board member worked for this company one or two days per year) and the profit tax rate in Canton V is lower than that in Canton BL. A AG obtained services from B AG, in particular for salary administration, patient and financial accounting, and statistics, as well as medication administration. B AG obtained these services from the independent E AG. B AG charged A AG. With this activity, B AG achieved a margin of 740% in 2014 and over 1,000% in 2015.

Due to the high margin of B AG, the tax administration of Canton BL assumed a hidden profit distribution of A AG to B AG. It considered the application of the cost plus method on the basis

of cost invoiced by E AG and with a cost mark-up of 10% to be the appropriate method. A AG, however, took the view that B AG's costs related to purchasing the services of E AG had no relation to the pricing of the rendered services and only the comparison with the pricing of comparable services between unrelated parties was relevant. It claimed the application of the comparable uncontrolled price method. For this purpose, A AG provided comparable service offers. These offers were obtained some years after the facts at issue here. These were to show that the prices paid by A AG to B AG were lower than in the comparable market. After the BL cantonal court confirmed the tax authority's position, A AG took the case to the FSC.

According to the FSC, in order to be able to make an internal price comparison, proof of comparable transactions of B AG with independent third parties would have been necessary. In the present case, however, there was no such proof of transactions with independent third parties, of the prices charged in this context and, above all, of the similarity of the services invoiced.

This case confirms that in the process of finding the appropriate transfer pricing method, the following steps in the transfer pricing analysis are relevant.

- Selecting the appropriate method for the delineated transaction. This process starts with a functional analysis in order to accurately delineate the transaction; ie, with determining which services transactions actually took place between A AG and B AG. In this case, A AG failed to introduce compelling arguments that B AG can be characterised as a service provider with respect to the service transactions for which it charged A AG. The tax authorities successfully argued that B AG's activities were rather limited and that the services rendered to A AG were actually the services procured from third parties. B AG was de facto to be characterised as an intermediary. Therefore, the transfer pricing method remunerating B AG through leaving a 10% gross margin expressed as a percentage over the procured costs was considered to be more aligned with the actual behaviour of the parties.
- The FSC also confirmed that the proof of comparable transactions brought by B AG was not sufficient. The offers were not comparable with the delineated controlled transaction. The FSC added that it was already questionable whether prices included in such offers (which did not result in transactions) were suitable for carrying out a price comparison. The OECD guidelines for a price comparison also stipulate that such a comparison is to be carried out on the basis of prices actually agreed. Moreover, the offers submitted in the present case did not relate to the period at issue here; they were obtained years later.
- The FSC also pointed out that the services provided to A AG are so-called low value-added services (as per the OECD's TPG in 2017) subject to a 5% profit mark-up. The characterisation of services as low value-adding services would have been relevant when this case would have been about determining the arm's-length net profit mark-up over B AG's services costs while rendering these services itself. The FSC's observations may not be that relevant in this case, as B AG did not render these services, since B AG actually procured these services at a market price from third parties.

Federal Act on the Implementation of International Tax Agreements

In 2021, the Swiss Parliament discussed the ITAIA, regulating the application and the conduct of MAPs, as well as the implementation of mutual agreement resolution into domestic law. On 1

January 2022, the ITAIA entered into force and is also mutatis mutandis applicable for advance pricing agreements (APAs). In view of the importance of MAPs and APAs, it was somewhat surprising that important procedural issues such as the rights and obligations of the taxpayer, time limits and the implementation of mutual agreements were not legally standardised in Switzerland. The new rules in the ITAIA are, thus, highly welcome and improve the legal certainty for taxpayers facing the need to request and conduct a MAP. In the following, some particularities shall be outlined.

Particularities regarding the request for a MAP

The competent authority responsible for MAPs is the State Secretariat for International Financial Matters (*Staatssekretariat für internationale Finanzfragen*, or SIF), whereas the cantonal tax administrations are responsible for the implementation of mutual agreements. Before the ITAIA entered into force, various cantons were of the opinion that taxpayers should be excluded from utilising a MAP if a potential international double taxation was already recognisable to the taxpayer in the assessment procedure. In such cases, the taxpayer – according to various tax administrations – should have raised the issue of a potential international double taxation in the ordinary assessment procedure. However, the ITAIA does – rightly so – not include such a limitation; hence, in such cases, MAPs remain available to the taxpayers. As mentioned, a MAP is to be requested with the SIF, which assesses whether the preconditions are met. Should the SIF reject a request, the taxpayer may lodge an appeal with the Federal Administrative Court.

In respect of timing, it should be noted that a MAP must be requested no later than ten years after the final assessment. There were controversial discussions regarding the deadline. Business associations called for a complete waiver of the time limit. The tax authorities, on the other hand, argued for a shortening of the deadline. Ultimately, the initially proposed deadline of ten years was upheld.

Particularities in the conduct of a MAP

If the preconditions are met and the double taxation cannot be eliminated with a unilateral measure, a MAP will be conducted. Once a MAP has been initiated, the taxpayer will no longer be a party of the proceedings and, thus, will – in principle – not have access to the files. However, the taxpayer can – contrary to the rules in many other jurisdictions – obtain information on the status of the proceedings from the SIF and provide further comments and documents to the competent authority on their own initiative. Just as the taxpayers are informed on the status of a MAP, the federal and cantonal tax administrations will be informed and given the opportunity to comment.

As mentioned, the SIF might also resolve the issue concerned with a unilateral adjustment without having to initiate a MAP. While such an approach is limited to clear-cut cases, it nevertheless is highly welcome as this provides an efficient way of resolving matters of international double taxation and may quickly bring legal certainty for affected taxpayers.

Particularities concerning the implementation of a mutual agreement

Mutual agreements have to be implemented by the competent tax authorities ex officio. If a taxpayer is already finally assessed, the assessing tax authority has to issue a so-called implementation order, which is a new legal instrument. Under the former law, mutual agreement solutions always had to be implemented by way of revision, even though the legal basis was not entirely sound.

Contributed by: *René Matteotti and Hendrik Blankenstein,* ***Tax Partner AG***

Swiss Dividend Withholding Tax Consequences of Transfer

If the intra-group transactions are considered to have resulted in too low income or too high costs, the missing income and/or excessive expense may qualify as deemed dividends for Swiss dividend withholding tax purposes. The amount of the deemed dividend is subject to 35% dividend withholding tax. Under Swiss withholding tax practice, such dividend is deemed to flow to the direct beneficiaries, which are the counterparties in the particular intra-group transactions (the so-called direct beneficiary theory). A deemed dividend is therefore not automatically considered to be a dividend to the shareholders. Therefore, the reduction of dividend withholding tax to 0% or 5%, which is generally available under double taxation treaties to the parent companies, often does not apply and corrections by Swiss tax authorities can result in substantial non-recoverable dividend withholding tax costs.

By applying the direct beneficiary theory for withholding tax purposes, Switzerland is not internationally aligned, as most jurisdictions consider dividends that are deemed to be the result of not at arm's-length transfer pricing to be a dividend to the shareholder (the so-called triangular theory) and hence generally allow the taxpayers to benefit from lower dividend withholding tax rates on such deemed dividends. In order to align the Swiss practice in such cases with internationally common rules and to alleviate the tax consequences of deemed dividends, a motion for a legislative change was submitted to Parliament, according to which the triangular theory should be applied consistently and thus also to the withholding tax. In December 2021, the Swiss Council of States approved the motion and it is now pending in the Swiss National Council. If the motion is adopted, the change would improve legal certainty and the attractiveness of Switzerland as a business location.

Outlook

The trend is clear: transfer pricing issues will keep on gaining importance in Switzerland in the coming years and challenge the taxpayers as well as the tax administrations.

The implementation of a global minimum tax and a domestic qualified top-up tax will give rise to new challenges related to the interplay between transfer pricing and the minimum taxation global anti-base erosion (GloBE) rules.

Substantial uncertain transfer pricing-related tax positions generally exist in MNEs. They may be a result of extraordinary events (such as particular tax positions with respect to COVID-19 losses and/or one-time business restructurings) but mostly they are in respect of their recurrent cross-border intra-group transactions. These recurrent transactions are often an important driver for the distribution of revenues, costs and profits over the group entities in the various jurisdictions. Hence, these transactions are often scrutinised in tax audits.

The following two problem areas are likely to be of primary concern:

First, the tax charge in a multinational entity's (MNE's) financial accounts – based on international accounting standards – includes various components; namely, current and deferred tax expenses and an amount to provide for uncertain tax positions. However, the amount that covers the uncertain tax positions is specifically excluded for the computation of the adjusted covered taxes under the GloBE rules. It is therefore important to consider this fact in analysing the possible impact of the GloBE rules.

Second, if – in a multiple year tax audit in a particular jurisdiction – cross-border intra-group prices are reassessed, it may trigger additional current tax expenses in the year that the prima-

ry adjustment in that jurisdiction will be recognised. That is generally three to five years after the original transactions took place. Since it involves multiple years, the amounts are often substantial.

The counterparty(ies) in the other jurisdiction(s) may also be implied and the disputed position may be resolved; for example, another three years after the primary adjustment (such as through the recognition of a corresponding tax relief through corresponding adjustments).

In the counterparties' financial accounts, the decrease of the tax charge will be recognised; however, without the recognition of a corresponding decrease of financial income. Without such corresponding adjustment to the income or loss in the financial statements, the decrease in the tax charge could cause a substantial reduction in the GloBE effective tax rate. That rate could even fall under the 15%, which then would trigger the levy of a top-up tax and lead to GloBE double taxation. That impact is, in particular, relevant in Switzerland, where the jurisdictional blended tax rates going forward will likely be 15% or just exceeding that level.

This issue now seems to be anticipated in the commentary to the GloBE rules. It is mentioned that when transfer prices of the counterparties are different due to unilateral measures (eg, domestic legislation, unilateral APAs, or, in the above-mentioned example, in tax audits), then the GloBE income or loss should be adjusted where necessary to prevent double taxation or double non-taxation. In situations where the tax authorities do not agree on the transfer pricing adjustment (whether, or to what extent, such adjustment is needed), the authors expect the GloBE Implementation Framework to include further considerations as to the appropriate adjustments to GloBE income and remedies to avoid GloBE double taxation.

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Tax Partner AG is focused on Swiss and international tax law and is recognised as a leading independent tax boutique. With currently 15 partners and counsel and a total of approximately 50 tax experts consisting of attorneys, legal experts and economists, the firm advises multinational and national corporate clients as well as individuals in all tax areas. A central focus lies on tax controversy and dispute resolution, including transfer pricing issues. Tax Partner AG also provides support regarding transfer pricing studies and the preparation of transfer pricing documentation. Other key areas include M&A, restructuring, real estate transactions, financial products, VAT and customs. Tax Partner AG is independent and collaborates with various leading tax law firms globally. In 2005 the firm was a co-founder of Taxand, the world's largest independent organisation of highly qualified tax experts.

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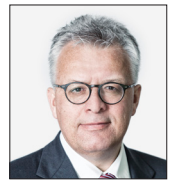

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