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Transfer Pricing 2024

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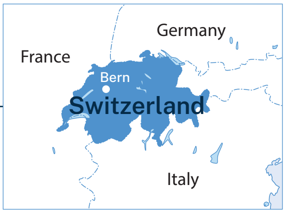
Switzerland: Law & Practice and Trends & Developments

René Matteotti, Monika Bieri, Daniel Schönenberger, Caterina Colling-Russo and Christian Attenhofer
Tax Partner AG

SWITZERLAND



Law and Practice

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Contents

1. Rules Governing Transfer Pricing p.6
1.1 Statutes and Regulations p.6
1.2 Current Regime and Recent Changes p.9

2. Definition of Control/Related Parties p.10
2.1 Application of Transfer Pricing Rules p.10

3. Methods and Method Selection and Application p.10
3.1 Transfer Pricing Methods p.10
3.2 Unspecified Methods p.10
3.3 Hierarchy of Methods p.10
3.4 Ranges and Statistical Measures p.11
3.5 Comparability Adjustments p.11

4. Intangibles p.11
4.1 Notable Rules p.11
4.2 Hard-to-Value Intangibles p.11
4.3 Cost Sharing/Cost Contribution Arrangements p.12

5. Affirmative Adjustments p.12
5.1 Rules on Affirmative Transfer Pricing Adjustments p.12

6. Cross-Border Information Sharing p.12
6.1 Sharing Taxpayer Information p.12

7. Advance Pricing Agreements (APAs) p.13
7.1 Programmes Allowing for Rulings Regarding Transfer Pricing p.13
7.2 Administration of Programmes p.14
7.3 Co-ordination Between the APA Process and Mutual Agreement Procedures p.14
7.4 Limits on Taxpayers/Transactions Eligible for an APA p.14
7.5 APA Application Deadlines p.14
7.6 APA User Fees p.14
7.7 Duration of APA Cover p.14
7.8 Retroactive Effect for APAs p.15

8. Penalties and Documentation p.15
8.1 Transfer Pricing Penalties and Defences p.15
8.2 Taxpayer Obligations Under the OECD Transfer Pricing Guidelines p.17

9. Alignment With OECD Transfer Pricing Guidelines p.17
9.1 Alignment and Differences p.17
9.2 Arm's Length Principle p.17
9.3 Impact of the Base Erosion and Profit Shifting (BEPS) Project p.18
9.4 Impact of BEPS 2.0 p.18
9.5 Entities Bearing the Risk of Another Entity's Operations p.19

10. Relevance of the United Nations Practical Manual on Transfer Pricing p.20
10.1 Impact of UN Practical Manual on Transfer Pricing p.20

11. Safe Harbours or Other Unique Rules p.20
11.1 Transfer Pricing Safe Harbours p.20
11.2 Rules on Savings Arising From Operating in the Jurisdiction p.20
11.3 Unique Transfer Pricing Rules or Practices p.20

12. Co-ordination With Customs Valuation p.21
12.1 Co-ordination Requirements Between Transfer Pricing and Customs Valuation p.21

13. Controversy Process p.21
13.1 Options and Requirements in Transfer Pricing Controversies p.21

14. Judicial Precedent p.22
14.1 Judicial Precedent on Transfer Pricing p.22
14.2 Significant Court Rulings p.22

15. Foreign Payment Restrictions p.25
15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions p.25
15.2 Restrictions on Outbound Payments Relating to Controlled Transactions p.25
15.3 Effects of Other Countries' Legal Restrictions p.26

16. Transparency and Confidentiality p.26
16.1 Publication of Information on APAs or Transfer Pricing Audit Outcomes p.26
16.2 Use of "Secret Comparables" p.26

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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 11 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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1. Rules Governing Transfer Pricing

1.1 Statutes and Regulations

Preliminary Remarks

First of all, it should be noted, that Switzerland has no specific codified transfer pricing law. Consequently, there are no specific regulations regarding determination and documentation of transfer prices, neither at the federal level nor at the cantonal level. The arm's length principle is, nevertheless, recognised and substantiated by the practice of the Federal Tax Administration (FTA) and case law. In addition, Switzerland has accepted the initial version and all updates of the OECD Transfer Pricing Guidelines (TPG) without reservation, including the latest update in 2023. Thus, there is full consensus in Swiss tax law practice that the OECD TPG are an important – although not binding – interpretative tool for the application of the arm's length principle in Swiss tax law. The importance of the OECD TPG has been further underlined by the recently published paper of the Swiss tax authorities, namely the SSK (*Schweizerische Steuerkonferenz*) and the FTA regarding transfer pricing, as this paper strongly refers to and basically summaries the OECD TPG. Further the FTA recently published a Q&A on specific transfer pricing topics.

Mainly, transfer pricing issues arise in Switzerland in connection with federal and cantonal corporate income tax and federal withholding tax. However, transfer pricing issues might also arise in connection with VAT – eg, in the event of retrospective transfer pricing adjustments and VAT impact at the level of the foreign related party. While, in the area of corporate income tax, the federal government (limited to a supervisory role) and the cantons have parallel competence, the federal government has the exclusive competence to levy withholding tax, stamp duties and VAT. With regards to withholding tax, in 2019 the FTA established a competence centre for transfer pricing. It is therefore no surprise that, in practice, for withholding tax purposes, transfer prices are increasingly being critically scrutinised during tax audits. This concerns, in particular, the relocation of functions abroad and controlled transactions between Swiss companies and related companies domiciled in tax havens or low-tax countries. In General, Swiss withholding tax implications may be a substantial concern as a result of a transfer pricing adjustment done in tax audits.

OECD TPG

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

Statutes

Corporate income tax

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

- controlled transactions between a company and its shareholders; and
- controlled transactions between a company and related parties, other than its shareholders.

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 has to be applied.

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

- the company has evidently received 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 or margins that independent third parties would have agreed on for the respective intercompany transaction (services, goods, licensing, financing). The third condition, however, is a Swiss peculiarity: the tax authority may only make an adjustment if the violation of the 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, 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 triangular 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. Political discussions on also applying the triangular theory for withholding tax purposes are currently put on hold.

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 the case of deemed dividends, however, the application of the notification procedure is granted only very reluctantly. The notification procedure is not applicable in the case of deemed dividends to sister companies. If the notification procedure is not available, not only the full withholding tax but also an interest on late payment of 5% per annum will be due.

Stamp tax duty

Regarding 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, where 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 (VAT)

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. However, 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 arm's length remuneration can be set at 2% or 3% of the average total assets held by the holding company.

Furthermore, it should be noted that in relation to VAT, the FTA, according to case law and in contrast to corporate income tax, can challenge the prices determined between related parties without first having to prove that the agreed remuneration violates the arm's length principle and that such a violation was obvious (see above comments on corporate income tax). If the FTA does not agree with the prices set by the taxpayer and the self-declaration respectively, the taxpayer has to prove that the prices nonetheless comply with the arm's length principle and are determined by using the appropriate transfer pricing method. Concerning the selection of the method, the FSC noted in a ruling concerning VAT that the selection of the method 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. It goes without saying that the challenging the selected method and the proving of obvious incorrectness or arbitrariness requires solid transfer pricing documentation, which is – however – not required by law.

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 TPG. The circular explicitly states that the profit margins for service companies must be determined in accordance with the arm's length principle – i.e, 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 TPG and has not established specific transfer pricing rules, the current regime and its development are, in general, reflected in the OECD TPG. However, the arm's length principle was already acknowledged before the first OECD TPG were published. Namely, 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.

Recent Changes

Prior to the progression of the BEPS project, core transfer pricing issues were seldom touched on by the tax administrations. However, transfer pricing issues increasingly form part of routine audits today. Hence, taxpayers are more often confronted with detailed questions regarding transfer pricing matters (eg, requests regarding detailed transfer pricing documentation and explanations concerning comparables). Switzerland itself also seems to be increasingly confronted with requests for administrative assistance in transfer pricing cases.

In international cases, the main focus is on the transfer of functions, the transfer or licensing of intellectual property rights, financial transactions, corporate management services and asset management services. Another main focus lies on transactions with foreign companies in low-tax jurisdictions Recently, the OECD TPG were also referred to in a purely national, inter-cantonal FSC case where one company was domiciled in a high-tax and one in a low-tax canton. In another purely domestic FSC case the OECD TPG were cited by the court in connection with the inter-cantonal value attribution of an intangible.

2. Definition of Control/Related Parties

2.1 Application of Transfer Pricing Rules

Swiss tax law – except VAT-legislation (see more in **1.1 Statutes and Regulations**) – 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, where 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 whether 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 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. Nevertheless, as Switzerland adheres to the OECD TPG, all the usual transfer pricing methods are admissible (“most appropriate method” approach). 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 TPG, and these 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 TPG specify, it should be explained why the methods described by the TPG themselves are not considered appropriate for the case at hand.

3.3 Hierarchy of Methods

As Switzerland in general follows the OECD TPG, the hierarchy of the transfer pricing methods as stipulated in the OECD TPG is also applicable in Switzerland. However, in individual decisions, the FSC has held that there is no fixed hierarchy of methods, meaning that the most appropriate method should be used according to the case at hand. In other rulings the FSC has held that the hierarchy of methods as stipulated in the OECD TPG should in fact be followed. In a recent decision by the Swiss Federal Administrative Court it was ruled that the FTA has to respect the hierarchy of methods according to the OECD’s TPG.

In practice, 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 the case of comparability. However, the transactional net margin method (TNMM) is the most commonly used method in Switzerland for determining transfer prices for services (corporate services, contract manufacturing services, contract R&D services), and routine distribution, whereas the CUP method is the most commonly used method for intangible property licensing and financing.

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

It is sometimes difficult, however, to assess whether an update of the OECD TPG can be considered merely a more detailed explanation of the existing principles or an actual change in the guiding principles. If the former is the case, a dynamic approach to the application of the TPG 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, in particular because the comparables in a benchmark study are usually not perfect.

For 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 comparability adjustments. However, the OECD 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 TPG are to be consulted regarding transfer pricing of intangibles.

4.2 Hard-to-Value Intangibles

Officially, Switzerland did not adopt the hard-to-value intangibles (HTVI) approach as defined in Chapter VI of the OECD TPG as this approach 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.

However, in general, due to the adherence to the OECD TPG, the OECD's approach regarding HTVI should be applicable in Switzerland.

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 ex post show that the value of the intangible is, in fact, higher. In this case, the ex post data would not qualify as new facts or evidence, and thus prohibit the final tax assessment from being reopened and changed.

4.3 Cost Sharing/Cost Contribution Arrangements

Switzerland recognises cost contribution arrangements and applies the OECD 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. Generally, 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 if specific rules of the tax law require an adjustment.

However, as long as the tax return has 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, a balance sheet adjustment is only permissible if it violates commercial law. Hence, if a transfer pricing issue arises once the tax return has been filed, an adjustment, in principle, will only be allowed if the original transfer prices also violate commercial law.

However, as long as the adjustment increases the taxable profit, the tax administrations are likely to accept such adjustments, even if the original transfer prices were in line with the accounting principles as set forth in the 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 by law make the respective adjustments.

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

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 for exchange of 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.

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.

Practice shows that foreign tax authorities are increasingly submitting requests for administrative assistance to Switzerland when auditing transfer prices, thereby requesting very comprehensive information and data. In this context, the Federal Tax Court (FTC) has – correctly in itself – decided that requested information for the verification of transfer prices must be exchanged. In doing so, the FTC referred in particular to the explanations of the OECD TPG in Chapter V regarding documentation (in the 2010 version). At the same time, the FTC stated that the OECD TPG are not binding for the court and merely represent an interpretative instrument. This means in the context of international exchange of information in tax matters that the provision of administrative assistance is not limited to the information required to apply a specific transfer pricing method. It is sufficient that there is merely a reasonable connection between the information requested and the facts described in the request for administrative assistance. As a result, the administrative assistance provided by Switzerland in transfer pricing cases can be very comprehensive and information is also transmitted that would not be required for the application of the methods defined in the OECD TPG.

Spontaneous Exchange of Information on Specific Tax Rulings

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 (CbCR)

As of 1 January 2017, Switzerland also signed the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (MCAA CbCR). However, the MCAA CbCR will not be applicable between Switzerland and another state until the other state has also included Switzerland on its list.

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.

With respect to corporate income tax, cantons have the authority not only to assess cantonal and municipal taxes but also federal corporate income taxes. This means that the cantons can issue advance (tax) rulings not only regarding cantonal and municipal taxes but also regarding federal income taxes. However, the FTA still exercises an important supervisory function over

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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.

It should be noted that it is important to provide the competent tax administration with comprehensive documentation to keep the tax administration updated regarding the underlying facts of the unilateral transfer pricing ruling at all times, as the tax administration could challenge the validity of the ruling if the relevant facts have not been fully disclosed or new developments not communicated. Once a ruling has been granted, the facts on which it is based must be continuously monitored and changes must be identified, analysed and, if necessary, reported to the tax authorities.

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 APAs.

7.2 Administration of Programmes

With regard to bilateral 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 procedures (MAPs), co-ordination between APA procedures and MAPs 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.

7.6 APA User Fees

Under current practice, APA procedures are free of charge. However, the implementation costs in connection with a mutual agreement can in individual cases be charged to the taxpayer (Article 23, Federal Law on the Implementation of International Agreements in the Tax Field).

7.7 Duration of APA Cover

In practice, an APA will cover three to five years. However, Switzerland does not have specific time limitations that 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 administrative-economical reasoning and the uncertainty concerning future developments of the transactions that are the subject of the APA.

7.8 Retroactive Effect for APAs

Basically, unilateral rulings cannot have retroactive effect, as ruling requests can only be accepted if they concern future affairs.

However, as bilateral 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 by Swiss domestic law. In practice, Switzerland seeks to limit the retroactive effect of APAs to five years. The limiting factor in practice is often the legislation in the country of the counterparty, as only certain foreign tax authorities allow a rollback period.

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.

As a general rule, tax adjustments to values that are determined on a discretionary basis – as is the case with transfer pricing – have no criminal consequences. This principle only applies, though, to the extent that the provisions of commercial law have not been violated and the relevant transactions have been presented correctly in accordance with commercial law. However, violations of the arm's length principle can, under certain circumstances, still be qualified as unlawful tax evasion (or tax fraud) and as such be subject to penalties. This is the case if basic principles of transfer pricing have been grossly neglected and, thus, the violation of the arm's length principle is not only recognisable by the company or the persons in charge, respectively, but downright obvious. In such cases, it can be assumed that the transfer prices were deliberately set in violation of the arm's length principle. Furthermore, ignoring an earlier correction by the tax authorities could also give rise to a violation of the arm's length principle that could lead to prosecution. This would be the case, for example, if the tax authority had rightly objected to an assessment in previous tax periods and the taxpayer deliberately stuck to the original estimate or approach, respectively, without disclosing it to the tax authority.

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. In the case of corporate income tax, the penalties are determined based on the unlawfully evaded tax amount, whereas – if the respective year has already been finally assessed – the potential penalty ranges from one third of the evaded tax to three times that amount. In general, the fine is equal to the amount of the evaded tax. Mitigating circumstances, such as full co-operation, are taken into account when determining the fine for tax evasion – as shown by the only tax evasion case in the context of transfer pricing decided by the FSC to date. In this case, the evasion fine was set at 75% of the evaded tax due to full co-operation.

If the tax has not yet been definitively assessed, there may a case of attempted tax evasion, which reduces the penalty by one third. It is important to note that for the purposes of corporate income tax the fine is imposed on the company. Regarding withholding tax and VAT, however, the fine is directly imposed on the person(s) responsible for the violation. At least in these cases, the fine is not determined based on the amount of tax evaded, but according to a fixed fine range.

Documentation Obligations

Swiss tax laws – apart from the Federal Act on the international automatic exchange of country-by-country reports of multinational groups – 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. In particular, taxpayers are obliged to provide the tax authorities with any information on transactions between associated companies upon request. 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. In addition, it should be noted, that with regard to MAPs and APAs, the master and local file as well as any other relevant information for the resolution usually have to be presented by the taxpayer.

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. Regarding 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).

Back Taxes

It is worthwhile noting that criminally relevant violations of the arm's length principle may also trigger back taxes. This is the case if the tax administration becomes aware of new facts or pieces of evidence that have not been disclosed to the tax administration with the tax return or during the ordinary tax assessment procedure. In order to levy back taxes the tax administration can reopen tax assessments as far back as for the last ten fiscal years.

8.2 Taxpayer Obligations Under the OECD Transfer Pricing Guidelines

Concerning transfer pricing documentation, Switzerland legally only requires preparing a CbCR. There is no legal 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 (or similar documentation) at hand. In practice, tax authorities increasingly expect local files (at last broadly in line with the OECD TPG) for Swiss companies to be prepared by taxpayers in the event of a tax audit.

9. Alignment With OECD Transfer Pricing Guidelines

9.1 Alignment and Differences

Though the OECD TPG are not implemented into domestic law, the administrative practice has declared the OECD TPG as applicable. The importance of the OECD TPG for administrative practice is underpinned by the paper on transfer pricing recently published by the FTA, which makes strong reference to the OECD TPG.

Nonetheless, a caveat is made 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 arm's length principle as defined and agreed upon in the OECD TPG (see **11.1 Transfer Pricing Safe Harbours**).

There is a long tradition in Swiss tax law of applying the formulary apportionment method for 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

Besides the above-mentioned exceptions, 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%. To determine the qualifying income, a top-down approach is used. Thereby, income from routine activities and trade marks is to be excluded, thus being 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. For 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 (only available in the canton of Zurich). 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, to 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 and corporations.

Pillar One

Regarding Pillar One, Switzerland advocates that the interests of small, economically strong countries be taken into account in the implementation. Although in principle Pillar One works in both directions, Switzerland exports much more than it imports, as it creates attractive location conditions for a wide range of industries while is itself a small but nevertheless important consumer market.

Pillar Two

On 18 June 2023, the Swiss electorate voted on the implementation of the OECD/G20 minimum taxation (and the creation of the constitutional basis for the introduction of Pillar One), with the proposal being approved by 78.5%. The referendum was necessary as the introduction of the OECD/G20 minimum taxation required an amendment to the Federal Constitution. This was because the OECD/G20 minimum taxation would have contradicted the constitutional principle of equal treatment of taxpayers. With the approval of the constitutional amendment, which came into force on 1 January 2024, the Federal Council enacted the ordinance on minimum taxation at federal level on the same day. At the same time, some cantons also decided to increase tax rates for companies.

It should be noted, however, that the minimum taxation in Switzerland is currently limited to the national supplementary tax (Qualified Domestic Minimum Top-up Tax, QDMTT). The Federal Council has refrained from applying the international supplementary tax rules (Income Inclusion Rule, IIR and Undertaxed Profit Rule, UTPR), which are provided for in the ordinance, for the time being. The partial introduction of the minimum taxation results in a tax increase for Swiss corporate groups and in particular US corporate groups with directly held Swiss constituent entities, provided the GloBE effective tax rate ETR in Switzerland is below 15% (and no corresponding substance-based income exclusion applies). However, there will generally be no additional tax burden for corporate groups from countries that introduce an IIR from 1 January 2024.

The reasoning of the Federal Council for this partial introduction of the minimum taxation is the aim of preventing the erosion of the Swiss tax base in favour of other countries. In contrast, an IIR would currently lead to the capture of under-taxed tax substrate from abroad, with negative effects on Switzerland's attractiveness as a business location. As things stand at present, it is expected that Switzerland will apply all measures, including the UTPR, from 2025 if at least the EU member states have introduced the UPTR by this point, which is to be expected based on the current legal situation.

It is obvious, that Pillar Two (as well as Pillar One) poses major challenges for Switzerland. Low taxes, clearly a locational advantage for Switzerland, will lose importance. 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 quite high labour costs by international standards.

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 measures to maintain and even improve their attractiveness. In this context, the instrument of the Qualified Refundable Tax Credit (QRTC) will play an important role.

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

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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 were 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 to thin capitalisation and to interest rates that are regularly used by corporate taxpayers (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 amount (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 by performing and providing 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 TPG on this issue. However, Switzerland does not provide notable location savings in the sense of the OECD 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 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 8.1%, 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 bodies. 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.

Regarding customs duty, no adjustment is generally required as the customs duty itself is based on weight and not on monetary value. It is to be noted that Switzerland has abolished levying customs duty on industry products as of 1 January 2024.

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. For the transfer pricing controversy process, whether a cantonal tax administration or the FTA raised the issue of transfer pricing has to be differentiated. While the cantonal tax administrations raise this issue in the context of corporate income tax, the FTA may also challenge transfer pricing with regard to withholding tax, stamp duty or VAT.

As will be shown, taxpayers may challenge the results of a tax assessment or of 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

Transfer pricing adjustments affecting corporate income tax have to be discussed with the cantonal tax administrations, as they are the competent authorities to assess and levy corporate income tax at cantonal and federal level. If a tax administration has already issued an assessment or a decision, a formal 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 decision can be appealed before court, again within a 30-day deadline. Generally, each canton provides two judicial instances; though, typically, smaller cantons only establish 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

TPG as soft law. Issues concerning the facts will only be dealt with if the facts were arbitrarily established. In the context of transfer pricing, it is worth noting that the choice of the transfer pricing method and its correct application is a question of law, whereas the result is considered a factual question. Hence, regarding the determination of the arm's length remuneration, the FSC can only intervene if the remuneration appears arbitrary.

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, with interest. However, the FSC clarified that the tax administration is 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 and VAT

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

As such a decision affects taxes being levied by a federal administrative authority, the appeal has to be lodged with the Swiss Federal Administrative Court (FAC)– within 30 days. This court's decision can then – again within 30 days – be appealed with the FSC.

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 as well as the FAC have recently issued important decisions that raise key issues in the field of transfer pricing. Furthermore, it can be observed that cantonal courts are also scrutinising transfer pricing in more detail and increasingly refer to the OECD TPG.

14.2 Significant Court Rulings

FAC Decision A-4976/2022 of 4 September 2023

Although this case was not decided by the FSC, the ruling of the FAC nevertheless contains interesting and important considerations with respect to the selection and application of transfer pricing methods; especially concerning financial service transactions. The case at hand concerned Company A ("A AG") – an asset manager operating in Switzerland. A AG had outsourced part of its activities to two companies domiciled abroad, Company B ("B Ltd.", domiciled in Hong Kong) and Company C ("C AG", most likely domiciled in Germany). These companies were each owned by different shareholders, with individual I holding a direct or indirect stake in all companies to varying degrees. In addition, his two sons held substantial shares in A AG and one of these sons also held a substantial share in C AG.

With regard to the services provided by B Ltd. and C AG, the FTA was of the opinion that the services had been provided at an excessive price and made adjustments for the 2015 and 2016 tax periods. With regard to the services provided by C AG, which essentially related to the creation of model portfolios, the FTA justified its assumption of an obvious mismatch on the fact that two employees of A AG also worked for C AG, whereby they had an hourly rate of CHF60 at A AG and C AG charged CHF300 per hour for the creation of the model portfolios. The FTA concluded that the hourly rate charged by C AG was obviously too high and not in line with the arm's length principle. It reached the same conclusion with regard to B Ltd., which provided services to A AG for "non-discretionary investment advisory" and "Asia market news". To the extent that the dealing at arm's length principle was violated, the FTA assumed a deemed dividend and levied WHT of 35%.

With regard to the assumption of a deemed dividend by the FTA, the FAC first pointed out that the tax administration has to prove the existence of an obvious mismatch between the service rendered and its consideration. Once this proof has been provided, the person concerned has the opportunity to provide evidence to the contrary. With regard to the assumption of an obvious mismatch, the FAC further stated that such a mismatch could only be assumed if the actually agreed prices lay outside the benchmark range for arm's length conditions. For the determination of the benchmark, the FAC acknowledged that the hierarchy of methods according to the OECD TPG has to be respected. Thus, firstly, an effective comparison has to be sought. Only if there is no effective comparison should the applicability of the various transactional standard methods be assessed, whereas the CUP has priority. With regard to the application of the cost plus method (CPM), the FAC stated that the relevant cost base included all direct and indirect costs.

Against this background, the FAC held that the FTA's approach had violated the methodological hierarchy according to the OECD by relying exclusively on the CPM. In addition, the FTA only considered the labour costs and did not take into account any other direct or indirect costs to determine the relevant cost base. In the opinion of the FAC, the FTA wrongly relied on the CPM and also applied it incorrectly. As a result, it referred the case back to the FTA for reassessment.

This ruling is part of a series of more recent rulings that heavily refer to the OECD TPG and make extensive statements on transfer pricing methodology. For example, in a case that has not yet been legally decided, the competent court of first instance dealt in detail with the question of the lege artis performance of a benchmark analysis. This development is to be welcomed, as the systematic application of the OECD TPG creates legal certainty and prevents seemingly arbitrary assessments by the administration.

FSC Decision 9C_686/2022 of 14 March 2023

In this decision the FSC dealt with the question of whether a real estate management fee of 20% on the gross rental income charged by a fund to one of its special purpose vehicles was, in fact, at arm's length. In the case at hand, a foreign pension fund invested – inter alia – indirectly into Swiss real estate via Company A ("A GmbH"), which was held by foreign companies without notable substance. The fund management was provided by a foreign asset manager H. For its services asset manager H charged a fee of 1.25% based on the assets under management to the fund which in turn charged 20% on the gross rental income generated by the real estate held by A GmbH to A GmbH itself (the allocation of the fee was based on the real estate assets managed by the fund).

The FTA contested that the fee should be calculated on an arm's length basis and was of the opinion, that – according to practice applicable for pure real estate companies – only 5% calculated on the gross rental income generated by the real estate held by A GmbH (equal to CHF200,000) would qualify as a commercially justified administration fee. In addition, the FTA argued that the fee paid by the fund to asset manager H also covered services in favour of other real estate held by the fund outside of Switzerland. Accordingly, the FTA held that A GmbH could only be charged for services that could directly be attributed to the activities of A GmbH. Thus, the amount exceeding the 5% threshold was qualified by the FTA as deemed dividend and as such subject to 35% WHT. According to the FAC, the significant discrepancy indicated that A GmbH provided a benefit without a corresponding equivalent consideration. It was questionable, for instance, whether a single piece of real estate, of whose rental income 80% was attributable to a single tenant, required specific management services at all. Furthermore, the lack of a contract between asset manager H and A GmbH showed that the service had its legal basis in the shareholding relationship and had an unusual character. The mere listing of the services allegedly provided or invoiced was not sufficient evidence.

Against the FTA's position, A GmbH argued that it was to be regarded as an economic unit with the fund and, thus, not as a pure real estate company. As a consequence, the 5% limit could not be applied since this limitation only applies for pure real estate companies. Furthermore, A GmbH argued that there was neither a mismatch between the management fee and the services consumed by A GmbH nor would an eventual mismatch have been recognisable for the management of A GmbH. This was due to the fact that asset manager H was an independent third party and the remuneration of asset manager H was, by definition, at arm's length. The lack of a contract between asset manager H and A GmbH was justified by considerations of practicability.

The FSC essentially supported the arguments of the FTA and the FAC. However, the FSC amended the findings of fact in line with the statement that A GmbH had conceded in the proceedings before the FTA that the services provided by asset manager H in the area of investment advice were marginal. The services were essentially limited to the real estate management of the property held by A GmbH – ie, so-called facility services. For such services, compensation of only 2–6% of the annual gross rental income can be considered as customary and, thus, at arm's length. Against this background, the 5% fee according to FTA practice is not objectionable.

This ruling, although it may well be correct in its result, gives rise to the following issues: As shown, the FTA's practice provides for a 5% fee for administrative costs. However, this percentage should be limited to the purely technical administration costs and not also include asset management. In addition, the 5% fee should be interpreted as a safe haven rule, which means that proof of remuneration in line with third-party comparisons should always be reserved, provided, however, that the services in question can be documented. However, practice shows that the tax authorities tend to use the 5% rule as an at arm's length benchmark, which is certainly not in line with the OECD TPG.

FSC Decision 2C_907/2022 of 16 December 2022

In this case, a Swiss entity with domicile in Geneva ("A SA") held a subsidiary in Gibraltar, which, in turn, held directly and indirectly 79.53% of Company D with domicile in the British Virgin Islands (BVI). A SA was active in the business of asset and fund management and was, as far as was evident, operationally run by individual B, the sole shareholder of A SA. For the sake of completeness, it is worth mentioning that the name of the shareholder and A SA can be tracked down using the information in the anonymised decision and that the person concerned was also mentioned in the Panama Papers.

Company D, for which B served as a director, owned shares in various companies, whereas the assets were managed by B who received a salary from A SA of around CHF700,000 per year. A SA, however, did not charge Company D for the services of B. Further, Company D had no employees or any other physical substance. In light of these facts, the tax administration of the Canton of Geneva was of the opinion that A SA should have been compensated by Company D at arm's length and added 79.53% of Company D's earnings to the earnings of Company A. This offset was challenged by A SA, which ultimately brought the case to the FSC.

The FSC ruled, inter alia, that the approach taken by the tax administration of Geneva was not in line with the arm's length principle. According to the FSC, the tax administration should have analysed the value of the services rendered by B to Company D and set the respective service fee accordingly. However, the FSC nevertheless confirmed the offset of 79.53% arguing that the established structure was abusive and served only the purpose of avoiding taxes. According to the FSC it would have been much more logical if the funds were managed directly by A SA. Following this line of argument, the earnings of Company D were added to the earnings of A SA to the extent of 79.53%.

This case shows that the law provides tax administrations with different means to prevent undue profit shifting to offshore jurisdictions. The FSC, however, upholds that corrections based on transfer pricing principles have to be justified according to best practice. Simple lump-sum offsets are therefore inadmissible from the perspective of transfer pricing. In specific cases, however, this does not protect the taxpayer from corresponding offsets.

15. Foreign Payment Restrictions

15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions

Switzerland does not have any specific rules or even restrictions regarding uncontrolled outbound transactions.

15.2 Restrictions on Outbound Payments Relating to Controlled Transactions

Switzerland does not have any specific rules or even restrictions regarding 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 regarding 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 be incurred.

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. Thus, results from APAs and transfer pricing audits are not published.

However, it is to be noted that court rulings (excluding the reasoning) are made publicly available at the court for 30 days, whereby the names are generally not redacted. The FAC, as an exception, also redacts the names during the temporary public disclosure. After the public disclosure, rulings are published online with the names redacted. Despite the redactions, it cannot be excluded that from the other pieces of information of the decision, the party concerned can be identified. Outside of the administrative procedure, tax secrecy is therefore not guaranteed.

16.2 Use of "Secret Comparables"

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

Trends and Developments

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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 11 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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SWITZERLAND TRENDS AND DEVELOPMENTS

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More Guidance and Increased Focus on Transfer Pricing

Traditionally, transfer pricing has played a modest role in Switzerland; influenced by the country's historically low corporate income tax rates and the favourable tax regimes available. However, a noticeable shift has taken place in recent times. In the opening two months of 2024, two additional guidance documents have been issued.

The first was guidance issued by the Swiss Tax Conference together with the Swiss Federal Tax Administration (SFTA), and the second, on 23 February 2024, saw the SFTA introducing a new publication of its transfer pricing practice, presented in the form of a Q&A.

This article highlights the key aspects of each of these guidance papers and discuss the expected impact they might have, as well as other recent regulatory developments in and key decisions in the Swiss transfer pricing space.

Guidance Issued by the Swiss Tax Conference and the Swiss Federal Tax Authority

On 23 January 2024, the Swiss Tax Conference, an organisation of the cantonal tax administrations, together with the SFTA, published a comprehensive paper on transfer pricing for the dossier "Tax Information" on the Swiss tax system. This publication, which mainly refers to the OECD TP Guidelines for Multinational Enterprises and Tax Administrations (the "OECD TP Guidelines"), makes it clear that transfer pricing is becoming increasingly important in Switzerland.

Despite the fact that this publication is not legally binding in Switzerland, the guidelines contained therein are important in interpreting the arm's length principle and stress the interpretation of the OECD TP Guidelines as soft law in Switzerland. In essence, the paper discusses the comparability analysis, the method selection, intangibles, services and financial transactions, without covering cost contribution arrangement and transfer pricing aspects of business restructurings.

The publication, with respect to administrative approaches to avoiding and resolving transfer pricing disputes, recommends filing simultaneous transfer pricing ruling requests with both cantonal and federal tax authorities due to the potential impacts on income tax and withholding tax. The paper briefly touches upon the process of primary, corresponding and secondary adjustments.

While confirming the three-tiered documentation approach, the paper clarifies that in Switzerland,

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the only mandatory transfer pricing documentation is the country-by-country report (if the relevant group turnover threshold of CHF900 million is surpassed).

Swiss law does not specify other particular requirements; however, taxpayers must provide relevant information upon request under the existing collaboration obligation. This implies a recommendation for Swiss companies involved in cross-border intercompany transactions to proactively prepare comprehensive supporting transfer pricing documentation, to document the process of ensuring the arm's length nature of these transactions.

Q&A Section Published by the SFTA

On 23 February 2024, the SFTA also published a Q&A list (in German and French) on a new separate website, shedding light on its transfer pricing practice. In this Q&A, the SFTA clarifies 41 questions in relation to transfer prices, always with reference to the OECD TP Guidelines. It is the first time that the SFTA has published its practice on selected transfer pricing issues.

Normally, administrative tax practice is published in the form of circulars in which it is also indicated to which taxes the particular circular applies. It is not made clear in the Q&A whether the practice disused in it only applies to federal direct tax and Swiss withholding tax or also to stamp duties and/or VAT.

Further, the Q&A only applies to international transactions. Considering the increased number of inter-cantonal transfer pricing cases (please note that the effective tax rates in Switzerland range from around 11% to 21%), it would have been welcomed if these answers had been declared applicable also to intra-national constellations.

Cost-plus method

For example, the Q&A answers the question on the composition of the cost base for the cost-plus method calculation. The answer, referring to the OECD TP Guidelines, points out the distinction that needs to be made between operating costs (ie, expenses that a company regularly incurs to keep business processes and systems running and to provide services that generate value), and non-operating costs, such as taxes and financing costs.

Though the SFTA is referring to the cost-plus method for the purpose of a benchmark study, it actually means the application of the transactional net margin method (TNMM), using the profit level indicator mark-up on total operating costs.

Financing costs (at least for typical service companies and non-capital-intensive (routine) production companies) are also not usually incurred during actual operating activities and do not generate added value. Thus, as non-operating costs do not contribute to a company's "value added", they are generally not included in the cost base.

This is a welcome clarification by the SFTA as there were disputes with the cantonal tax authorities that wanted to have these costs included (in all circumstances). However, it still needs to be seen whether the cantonal tax authorities will apply these guidelines.

In addition, the questionnaire comments on the treatment of pass-through costs, as well as the mark-up for low value-adding services, both in line with the OECD TP Guidelines.

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Withholding tax in the case of primary, corresponding and secondary adjustments

Further, the questionnaire also provides answers as to when Swiss withholding tax is triggered in the case of primary adjustments, profit repatriations and secondary adjustments.

The SFTA stresses that primary and corresponding adjustments typically relate to income tax. If such primary adjustment results in a profit repatriation, these are not considered to be deemed dividends and are not subject to withholding tax if they are carried out in accordance with the result of a mutual agreement procedure or a unilateral agreement. In the absence of a mutual agreement procedure or a Swiss internal agreement, withholding tax is levied on payments made for the purpose of repatriation.

If, for example, a primary adjustment made by a cantonal tax administration is confirmed in whole or in part in the mutual agreement procedure, the question of the secondary adjustment arises – ie, the levying of withholding tax by the SFTA on the amount of the primary adjustment confirmed in the mutual agreement procedure. In this respect, the SFTA differentiates between no withholding tax if there is a respective agreement in the mutual agreement or withholding tax (especially in cases of evident profit shifts). If addressed in the agreement, the repatriation of profits must take place within 60 days of the mutual agreement's conclusion.

Financing transactions

Surprisingly, out of the 41 questions, 20 relate to financing transactions. This shows the importance of financing transactions in general and the clear need for the tax authorities to provide clarification to taxpayers. Considering that the chapter on financing transactions is only part of the OECD TP Guidelines as of the 2022 update, it is unclear whether these answers are also valid for the years before. Below, several interesting questions that are raised and answered in this area are explored.

The SFTA publishes, on an annual basis, safe harbour interest rates applicable to shareholder and intercompany loans, denominated in Swiss francs and foreign currencies. If these rates are adhered to, no proof is required that the arm's length principle is met.

Nonetheless, according to case law, these safe harbour rates do not apply for short-term loans. However, these safe harbour rates are not binding for foreign tax authorities. Thus, a taxpayer may set interest rates that deviate from the safe harbour. As a consequence, the arm's length character of the transaction has to be demonstrated in a separate study. As part of the questionnaire, the SFTA clarifies the requirements for doing so.

With respect to the application of a credit rating, the SFTA outlines the importance of distinguishing between the credit rating of the borrower and the credit rating of the particular transaction and recommends using the credit rating of the particular transaction. If a credit rating from an independent rating agency is available for a borrower, this must be used. If such a rating is not available, an estimation/calculation of the rating must be made.

There are various approaches to this – eg, applying the methods defined and used by rating agencies or the use of financial software to calculate the rating using statistical models. It is recommended that one of the methods used by rating agencies is applied. However, the use of financial software is not ruled out, provided that the reliability of the results can be demonstrated.

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An internal credit rating performed by a bank may be accepted by the SFTA if it is proven that the same method is applied for interest rate setting (since banks apply different methods and standards owing to regulatory and industry-specific differences compared to rating agencies).

The SFTA also answers the question of when the rating of a group can be used for a borrower. The SFTA specifies in this respect that a company must be rated as if it were not part of a group (ie, on a standalone basis). However, any implicit support must be taken into account. In exceptional cases, the group credit rating can be used for the rating of a borrower. However, it must be demonstrated that this is the most reliable indicator taking into account all facts and circumstances. In particular, the creditworthiness indicators of the company must not differ from those of the group (eg, in the case of structures in which the group is held by a number of intermediate holding companies).

The SFTA confirms that it is not easy to find comparative values in Swiss francs and that comparative values in other currencies can also therefore be used. The SFTA recommends the use of comparative values in Euros in view of the proximity and economic interdependence between Switzerland and the EU. In this case, a reliable adjustment of the results is necessary to improve comparability. In practice, it is appropriate in most cases to make an adjustment corresponding to the difference between a swap interest rate in Swiss francs and a swap interest rate in euros for the same term.

Regarding reference rates, the SFTA mentions the importance of using a reference rate that is equivalent to those used in practice by banking institutions as a substitute for LIBOR. These rates are determined according to new market standards set by stock exchange institutions or central banks that administer them. For the Swiss franc, this is SARON (Swiss Average Rate Overnight). LIBOR can have different maturities (eg, one day, one week, three months), while the alternative interest rate chosen is a daily rate. For this reason, a method to derive a longer-term interest rate from this daily rate should be taken into account. The appropriate method for intercompany loans in Swiss francs is the "last recent" option and the use of the SARON Compound Rate

Tax authorities are dedicating increased human resources to transfer pricing

There is already an increased focus of transfer pricing in Swiss tax audits. This tendency is also supported by the increased human resources dedicated to transfer pricing topics with the SFTA, which also supports the cantonal tax authorities in treating transfer pricing cases. Together with the published practices it is assumed that the Swiss tax authorities will handle transfer pricing matters more professionally in line with the OECD TP Guidelines.

Recent landmark decision

Swiss courts are judging more and more transfer pricing cases. This is clear evidence that the tax administrations are increasingly scrutinising transfer pricing.

It can be further seen that the cantonal courts now examine the cases at hand in much more technical detail. The Cantonal Tax Appeals Court in Zurich, for example, recently analysed which interest rate is at arm's length for intercompany loans that qualify as Additional Tier 1 Capital for Basel III purposes. In that decision, the court also discussed in detail the nature of the Swiss safe harbour interest rates and stated that they are not applicable to such loans but that an

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individual approach is required, referring to the principles stipulated in the OECD TP Guidelines.

In its decision, the court analysed the benchmarking study that had been performed in depth and rejected the comparables that were chosen. The court even added additional (local) comparables that were in the public domain and used regression analysis to derive the arm's length interest rate. In the end, the court supported the appeal filed by the tax payer.

Conclusions

The issuance of these new Swiss transfer pricing guidelines is expected to lead to an increased focus on transfer pricing in Switzerland. Also, the new transfer pricing publications issued by the SFTA provide for more transparency on Swiss transfer pricing practice, even if these publications do not yet cover all aspects of transfer pricing (eg, business restructuring).

Swiss tax authorities have increased human resources dedicated to transfer pricing topics with the SFTA, which also support the cantonal tax authorities in treating transfer pricing cases and tax audits.

Pragmatic approaches, such as simply cost-based methods, will often no longer be possible, and the principles of the OECD TP Guidelines are expected to be established in Switzerland. Even though there is no transfer pricing documentation obligation in Switzerland, an increased need for professional benchmarking and documentation is anticipated. This proactive approach is essential to effectively defend, and align with, the OECD TP Guidelines, demonstrating the arm's length nature of intercompany transactions. In tax audits, the federal and cantonal tax authorities increasingly expect transfer pricing documentation in line with the OECD TP Guidelines from the taxpayer.

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