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Worldwide Transfer Pricing Update

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Content

- Swiss transfer pricing legislation and withholding tax legislation
- Adjustment procedures
- Advance pricing arrangements

Swiss transfer pricing legislation

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Swiss transfer pricing legislation

- No domestic transfer pricing legislation implemented → General rules apply
- Commercial law (Art. 678 of the Swiss Code of Obligations):
  - Shareholders as well as persons close to them, who have unjustifiably and in bad faith received shares of profits are obligated to return them.
- Federal direct tax law (Art. 58 of the federal tax law)
  - Taxable net profit consists also of undeclared profit distributions and financial contributions to third parties which are not commercially justified.
- Circular letters issued by federal tax administration:
  - FTA Circular 4 of 19 March 2004, taxation of service companies
  - FTA Circular 9 of 22 June 2005, commercially justified expenses
  - FTA Circular 1997, thin capitalization; and
  - FTA Circular Letter, interest rates (revised annually)
- OECD Transfer Pricing Guidelines

Legal basis

- Basic idea: Hidden profit distributions as circumstances which entitle tax authorities to adjust taxable profits

- Federal Supreme Court: Hidden profit distribution if
    - Company grants monetary benefit without receiving adequate consideration in return;
    - Benefit is granted to a shareholder or an affiliated party; and
    - Benefit would not have been granted to an independent third parties in comparable circumstances.

- In this context, the federal courts often refers to the arm's length principle (OECD Guidelines)

OECD Guidelines

- Tax authorities follow the OECD Guidelines
- Guidelines are very important in practice
- Courts refer to the OECD Guidelines when applying the arm's length principle
- However: Guidelines do not have the status of law

Transfer pricing approach of tax authorities in practice

- As no specific rules exist:→ pragmatic approach to all primary issues related to transfer pricing
  - Selection and application of methods
  - Documentation requirements
- Examples of cross border transfer pricing issues: see Exhibit

Transfer pricing methods

- OECD Guidelines are generally used when applying transfer pricing methods
  - Comparable uncontrolled price method
  - Resale price method
  - Cost plus method
  - Transactional net margin method
  - Profit split method

- No formal priority of methods

- Flexible and pragmatic approach when choosing the method

- Method used must be reliable

- Switzerland follows the Guidelines concerning the comparability factors (characteristics of goods, functional analysis and contractual terms)

Specific transactions

- Sale and use (lease) of tangible property → Resale price method
- Services → Cost plus method (FTA Circular 4 of 19 March 2004)
- Cost contribution arrangements → Profit markup always required to cover risks involved with the research and development function and to remunerate capital invested; to be regulated by APA
- Loans and thin capitalization → Safe harbor rules (FTA Circular 1997)

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Transfer pricing documentation and penalties

- No specific transfer pricing documentation legislation and penalties related hereto
- Documentation to be presented up on request by the tax authorities
- No specific penalties in connection with transfer pricing issues exist

Adjustment procedures

- Cantonal tax administrations responsible for corporate income tax assessment
- Federal tax administration responsible for withholding tax issues
- Federal tax administration responsible for granting or denying corresponding adjustments or for negotiation with treaty partners

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Primary adjustment

- Corporate income tax:
  - Increase of taxable profit or reduction of loss, as the case may be → taxable event

- Withholding tax:
  - Profit adjustment considered as hidden profit distribution:
    - Tax treaty applicable:
      - Distribution to parent company: Withholding tax rate reduced under tax treaty from 35% to 0% or non-refundable 5%
      - Distribution to sister company: Withholding tax rate reduced under tax treaty from 35% to non-refundable 15%
    - No tax treaty applicable → final withholding tax of 35% levied

- Stamp duty
  - If the beneficiary is a subsidiary
  - Hidden capital contribution (and not hidden capital distribution)
  - If beneficiary is a Swiss subsidiary: Stamp duty of 1% of hidden capital contribution due

Corresponding adjustment

- In case of primary adjustment made abroad for a transaction between a foreign group company and a Swiss company:
  - No automatic corresponding adjustment in Switzerland; request required
  - If a tax year is finally assessed a mutual agreement procedure (Art. 25 OECD MC) between the involved states is required
    - If mutual agreement procedure is successful: Agreement is basis for revision of assessed year
  - Cantonal tax administrations responsible for adjustments:
    - Tax credit; or
    - Refund

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Secondary adjustment

- Money transfer to a foreign parent due to corresponding adjustment :
  - Payments not subject to 35% withholding tax
  - Only if agreement between the involved states is found under a mutual agreement procedure (Art. 25 OECD MC)
  - Automatic internal information of Swiss withholding tax administration
- Such a transfer is no longer classified as a hidden profit distribution under Swiss case law

Tax treaty aspects

- Most of the Swiss tax treaties contain a provision on associated enterprises according to Art. 9 (1) OECD MC
- Swiss treaties do not contain Art. 9 (2) of the OECD MC, i.e. no corresponding adjustment where profits have been adjusted abroad
  - Treaties with Canada, the United Kingdom and the USA: Clause that authorities consult each other to reach agreement on adjustment
- As no treaty basis for corresponding adjustment exists → Adjustment only possible if
  - If tax assessment of relevant year not yet become final or,
  - If, in the case of final assessments, if a mutual agreement procedure has been initiated

Advance pricing arrangements (APA's)

- In complex circumstances where disputes are likely to arise (intangibles and cost contribution agreements)
- No legislation and no formal procedures for APA's implemented; Art. 25 OECD MC
- Upon request; Requests for APA's normally initiated by non-Swiss parties
- To be requested with the foreign tax administration approximately 1 year before first tax period, in which APA shall apply
- APA's apply for about 5 to 6 years; no automatic renewal
- Lately, APA requests have become more popular (due to increasing profit adjustments)
- 2 persons responsible for APA's within the Swiss federal tax administration
- APA's with Japan, USA, Korea, most of the European countries

Summary

Legislation	No
Documentation requirements	No
Enforcement activity	Developing
Penalties	No specific TP penalties
Disclosure requirements	No
Local comparables	No
Pan-European comparables	Accepted
APA’s	Yes