

# Yearly Transfer Price Must Match Tax Year, Swiss Court Says

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The use of multiple years to determine the appropriate arm's-length price does not mean that the value is assessed as an aggregate figure for the audit cycle and not for a single annual tax year.

In a decision ([A 2023 1](#)) dated December 5, 2024, and published March 3, the administrative court of the Swiss canton Zug ruled that the use of a three-year-average operating margin corresponding to the lowest quartile of an arm's-length price range is not consistent with the character of the income tax as an annual tax (principle of periodicity).

"Determining the range based on an interquartile calculation is established practice in Switzerland," Thomas Hug of Deloitte AG's Zurich office told *Tax Notes* on March 17. "However, whether the Swiss arm's-length principle requires this — the OECD also permits other means to narrow the range — is another question."

Hug also wondered whether the company would be economically impoverished if the arm's-length price was not exceeded during the entire audit period. "The decision becomes problematic if such a formal legal interpretation would make year-end adjustments impossible," he said. "These year-end adjustments are intended to correct excess or shortfall profits and are usually only carried out after the preliminary annual financial statements have been approved in the following year."

## Total Profit vs. Periodicity

The unidentified taxpayer, a corporation (SA), is part of a Canada-headquartered group and distributes generic pharmaceutical products, predominantly in Central and Eastern Europe. After an audit, the Swiss tax agency of the canton Zug determined that the taxpayer's negative margin for 2018 (minus 21.8 percent) was not at arm's length under article 58(1) of the [Federal Direct Tax Act](#). After an administrative objection procedure, it determined a profit adjustment of around CHF 9 million (\$10 million at today's currency exchange rate) based on the lowest point of the interquartile range of 1.1 percent over a three-year period (2016 to 2018).

On appeal at the administrative court, the taxpayer claimed that the margin of minus 21.8 percent was at arm's length because its three-year average margin was close to the lowest point of the interquartile range. In the previous two years (2016 and 2017), the margin was far too high, which is why the margin was set to negative in 2018, it said.

The Zug court pointed to the tax agency's burden to prove that circumstances warrant a tax increase while emphasizing that Swiss tax law generally does not provide for the consolidation of group companies' taxable results but assesses each entity separately. Transactions among group

companies must therefore comply with the arm's-length principle. Entities that fulfill routine activities usually must earn a small but stable profit, whereas losses can be recognized only during start-up phases or crises, the court said.

The court agreed with the tax agency that article 58(1) stipulates that the income tax is an annual tax, which disallows a retroactive smoothing to the lowest point in the interquartile range.

While the agency had acknowledged that multiple-year data should indeed be included in the comparability analysis — especially to yield higher data quality — this does not mean that a taxpayer can arbitrarily set its results to conform with a retrospective multi-year view. Allowing such a practice would contradict the fundamental principle of transfer pricing law, which requires that each business unit is taxed according to the economic value it contributes to the value chain, and that is annually, the court said.

Since the taxpayer failed to present any extraordinary circumstances that could justify its result of minus 21.8 percent in 2018 as a price that independent parties would have agreed to, the operating margin for that year had to be adjusted upward to ensure compliance with the arm's-length principle, the court ruled.

The taxpayer's economic freedom can be preserved by using the lowest quartile that still conforms with the arm's-length standard, the court said. In principle, the taxpayer is free to set an operating target margin that is also tax-deductible as long as the selected margin conforms to a comparison with independent third parties, the court ruled, dismissing the appeal.

The decision is final and can no longer be appealed.

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