

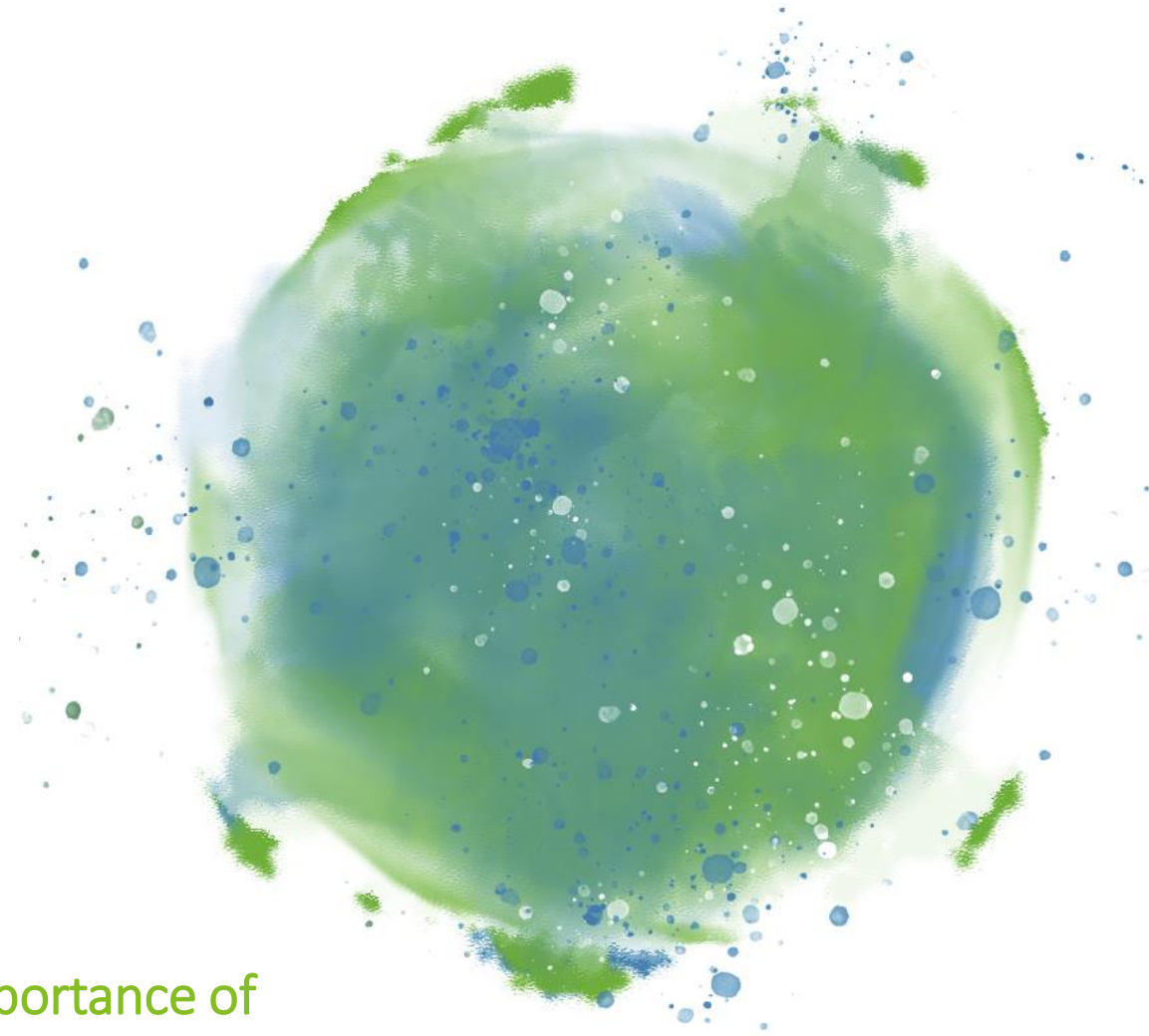


THOMAS HUG

THE EVOLVING IMPORTANCE OF TRANSFER PRICING IN SWITZERLAND & BEYOND

DELOITTE, 23 APRIL 2024

WWW.THOMASHUG.COM



Webinar: The Evolving Importance of Transfer Pricing in Switzerland & Beyond

Agenda & Speakers

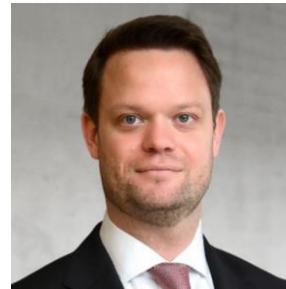
Agenda

- Overview; Thomas Hug
- General Principles; Thomas Hug
- Cost-based Transfer Pricing Methods; Markus Reese
- Specific Transactions
 - Financing; George Galumov
 - Intellectual Property; Markus Reese
 - Post M&A Reorganisations; Thomas Hug
- Transfer Pricing Documentation; Markus Reese
- OECD Pillar I / Amount B Paper; Thomas Hug
- Closing / Q&A; Thomas Hug

Speakers



George Galumov
Tax & Legal Partner
Transfer Pricing & Financial Transactions Leader



Markus Reese
Tax & Legal Partner
Transfer Pricing & M&A



Thomas Hug
Tax & Legal Partner
National Tax Office

Overview

Latest Development in Switzerland & Beyond

Latest Developments

Switzerland 

Swiss Federal Tax Administration ("SFTA")
Launch of new transfer pricing webpage with practical Q&A

Swiss Tax Conference ("SSK")
Publication of transfer pricing dossier

Cantonal Tax Administrations
Increased scrutiny of transfer prices in audits (in-/outbound)

Cantonal & Federal Tax Courts
Increased number of transfer pricing cases

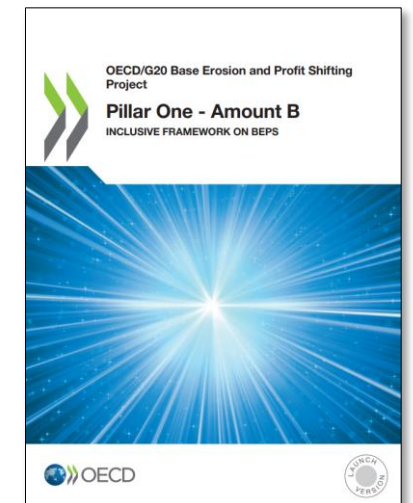
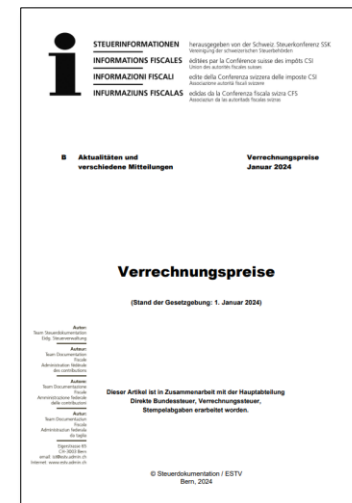
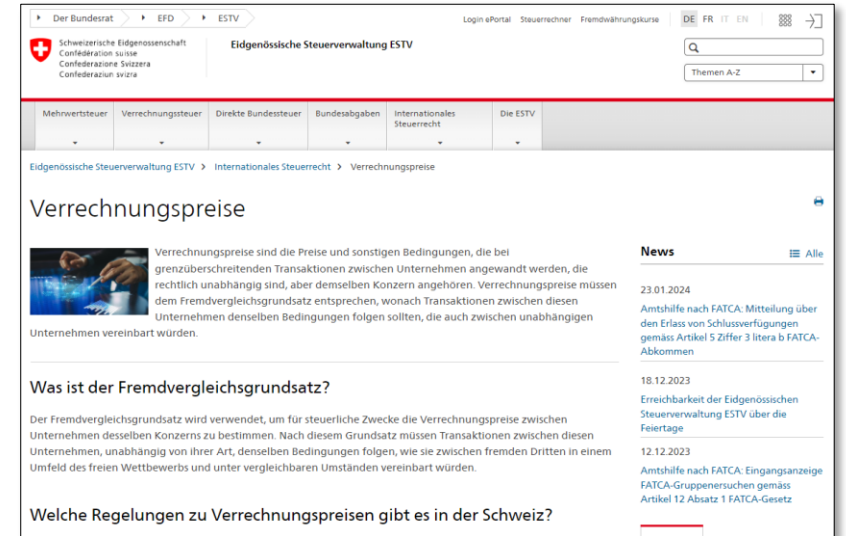
Alignment with OECD TP Guidelines

 OECD

Inclusive Framework on BEPS
Final report on "Amount B" – baseline marketing & distribution activities

EU 

European Union
Draft Transfer Pricing Directive



General Principles (1)

Source: Q&A (Introduction), Transfer Pricing Dossier (Chapter 1)

Technical Background

General

- Switzerland – opposite to many other tax jurisdictions – does not have specific transfer pricing provisions in its tax law;
- Main source: art. 58 para. 1 lit. a/b DBG (mainly focusing on relationship between legal entity and private shareholder);
- Cantonal tax administrations take transfer pricing more seriously and approach it more professionally

OECD Guidelines

- Although not legally binding, OECD Guidelines are used as an instrument for interpreting the arm's length principle in Switzerland;
- Court case: OECD Guidelines need to be “considered” (2C_ 824/2021, Federal Supreme Court);
- Trend in recent years that cantonal tax administrations, Swiss Federal Tax Administration (“SFTA”) and courts are aligning their practice with OECD Guidelines

Need for Action

- Transfer pricing must be considered as a potential tax risk in Switzerland going forward
- Review of controlled transactions involving at least one Swiss group company for consistency with OECD Guidelines

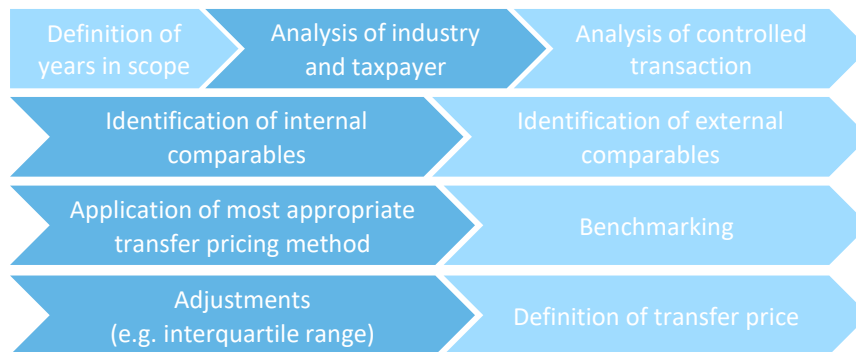
General Principles (2)

Source: Q&A (Introduction), Transfer Pricing Dossier (Chapter 1)

Technical Background

Comparability Analysis

- Taxpayers are expected to prepare an OECD compliant comparability analysis in benchmark studies, following a 9-step-approach:



Transfer Pricing Methods

- All transfer pricing methods shall be considered:
 - standard methods (CUP, PRM, Cost-plus);
 - transactional profit methods (TNMM, PSM);
 - other methods
- Taxpayers must apply the “most appropriate method”

Need for Action

- Review of benchmark analysis used/prepared for transactions involving at least one Swiss group company

- Review of transfer pricing methods used for controlled transactions involving at least one Swiss group company

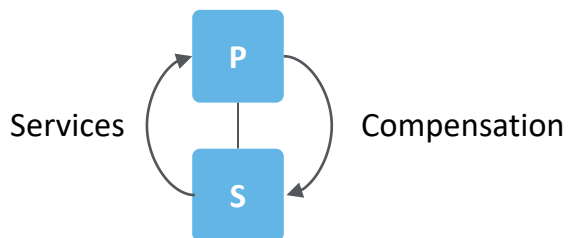
Cost-based Transfer Pricing Methods (1)

Source: Q&A (Questions 1 – 9)

Technical Background

Cost Base

- Comparable transactions and controlled transaction need to have the same cost base;
- Comparable transactions regularly do not include non-operating costs (e.g., taxes*), financing costs)

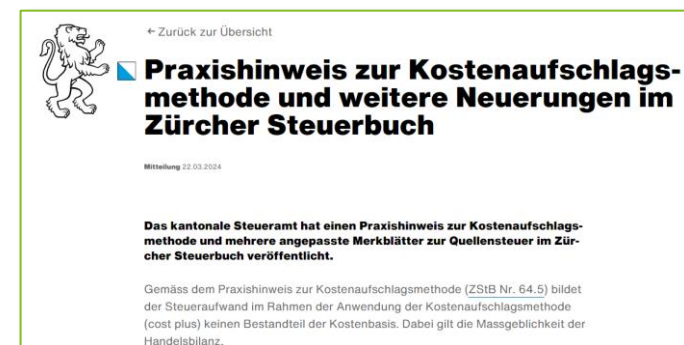


| | | |
|----------------------------|--------------|------|
| Compensation | 93'450 | ← 5% |
| - Total Costs | 89'000 | |
| = Profit before Tax | 4'450 | |
| - Taxes (17.6%) | 660 | |
| = Profit After Tax | 3'784 | |

Need for Action

- Review of cost base of controlled transactions and align with cost base in benchmark studies;
- Exclude Swiss corporate income taxes from cost base

Canton Zurich



*) Various cantonal tax administrations (e.g., Zurich) have the practice that Swiss corporate income taxes must be included in the cost base

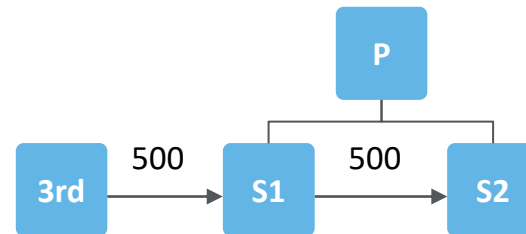
Cost-based Transfer Pricing Methods (2)

Source: Q&A (Questions 1 – 9)

Technical Background

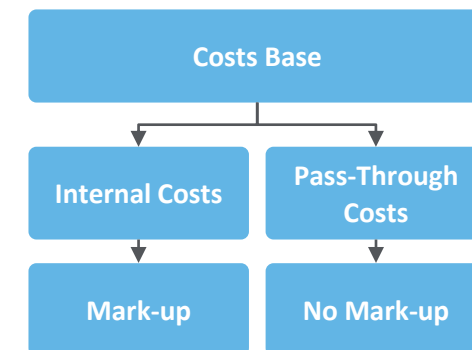
Profit Mark-up

- No profit mark-up on pass-through costs due to lack of own functions performed and risks assumed



Need for Action

- Review of cost base and distinguish between internal costs and pass-through costs



Cost-based Transfer Pricing Methods (3)

Source: Q&A (Questions 1 – 9)

Technical Background

Low-value Adding Services

- Simplified approach for low-value adding services (5% without benchmark study) included in OECD Guidelines is applicable in Switzerland;
- Requirements:
 - Supportive in nature;
 - Not part of core business;
 - No unique and valuable intangibles;
 - No substantial and significant risks

Need for Action

- Identify services in scope of simplified approach to reduce compliance costs (to be checked whether jurisdiction of country-party also applies simplified approach; e.g. India);
- Conversely, high-value adding services should not have a profit mark-up of only 5% - review all services currently being compensated with a mark-up of 5%;
- Whether services are low-value adding depends on the context of the group and industry

Specific Transactions – Financing (1)

Source: Q&A (Questions 21 – 41), Transfer Pricing Dossier (Chapter 5.4)

Technical Background

Safe-Harbour Interest Rates

- Annual safe-harbour interest rates still applicable, although not accepted outside Switzerland;
- If not in line with annual safe-harbour rates, the taxpayer must proof interest rates to be at arm's length (in line with chapter X OECD Guidelines)
- Court case: Safe-harbour interest rates only applicable to loans with a term of more than 12 months (SB.2023.00014; Cantonal Administration Appellate Court of Zurich)

Benchmark Study

- Minimum content: maturity, start date, currency, rating, guarantees/collaterals;
- Interest rate must be within interquartile range;
- Description of realistically available options (based on optimized WACC);
- Court case: Bank opinions/offers not accepted as comparable (2C_ 877/2021, Federal Supreme Court)

Need for Action

- Cross-border loans: performing appropriate transfer pricing analyses of comparable third-party arrangements in line with the requirements of chapter X of OECD Guidelines;
- Other loans: review whether interest rates are in line with safe-harbour interest rates (e.g., term, annual update of interest rate)
- Review of existing benchmark studies and alignment of new benchmark studies with minimum content according to SFTA's Q&A

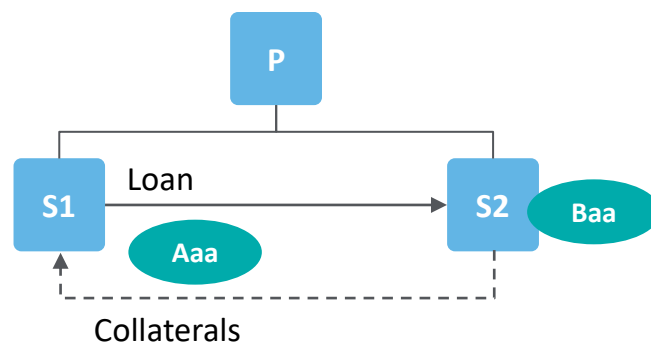
Specific Transactions – Financing (2)

Source: Q&A (Questions 21 – 41), Transfer Pricing Dossier (Chapter 5.4)

Technical Background

Credit Rating

- Benchmark studies must consider credit ratings;
- Rating should focus less on the rating of the debtor (issuer credit rating) and more on the rating of the financial transaction (issue credit rating). This also takes into account, for example, any collateral.
- External agency rating, internal rating using the same methodology as rating agencies or standard software



Need for Action

- Review of ratings used in benchmark studies, potentially change of methodology;
- If ratings are not yet considered: introduction of process to determine ratings which are used in benchmark studies;
- Although the use of standard software solutions is possible in Switzerland, this may be a problem abroad (missing transparency of the calculation)

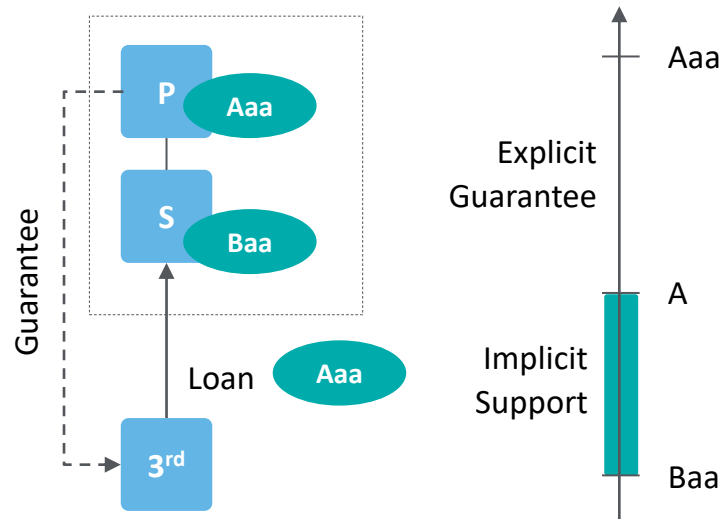
Specific Transactions – Financing (3)

Source: Q&A (Questions 21 – 41), Transfer Pricing Dossier (Chapter 5.4)

Technical Background

Implicit Support

- Implicit support must be considered when determining the credit rating of a group company / transaction



Need for Action

- Review whether implicit support is considered in different intercompany finance transactions;
- Development of group-internal methodology to determine the implicit support

Specific Transactions – Intellectual Property

Source: Transfer Pricing Dossier (Chapter 5.2)

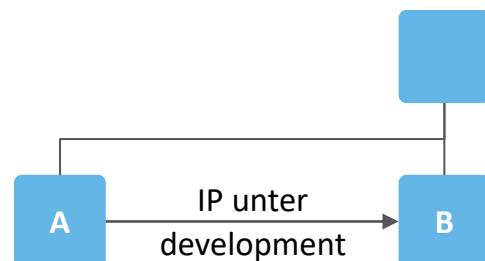
Technical Background

Ownership

- Transfer prices must be aligned with IP ownership;
- Ownership does not follow legal facts, but DEMPE functions performed and risks assumed related to IP;
- Court decision: Functional view although no direct reference to DEMPE (2C_11/2018, Federal Supreme Court)

Hard-to-Value Intangibles

- Reference to hard-to-value intangible approach although Switzerland does not officially apply



Need for Action

- Review of transfer pricing alignment with IP ownership based on DEMPE concept (e.g., legacy ownership of IP by former holding companies in Switzerland)

- Filing of tax ruling when (material) IP is transferred

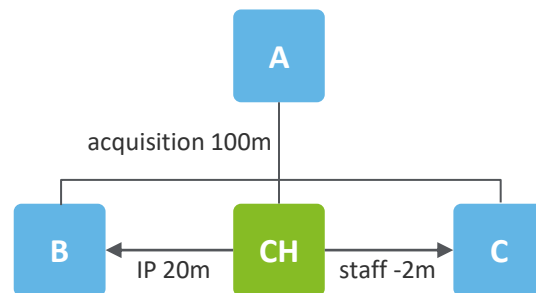
Specific Transactions – Post M&A Reorganisations

Source: Tax Administrations & Tax Courts

Technical Background

Post M&A Reorganisations

- Reorganisations and modified transfer pricing models immediately following foreign groups' acquisition of Swiss companies are increasingly scrutinised by tax administrations;
- Court case: Missing alignment of transfer pricing with purchase price allocation ("PPA") under IFRS or US GAAP (SB.2022.00060; Cantonal Administration Appellate Court of Zurich)



Need for Action

- Transfer prices for reorganisation and modified transfer pricing models post M&A need to be carefully reviewed;
- Align transfer prices with PPA prepared by group consolidation / financial account

Transfer Pricing Documentation

Source: Transfer Pricing Dossier (Chapter 6)

Technical Background

Documentation

- Switzerland does not have formal transfer pricing documentation requirements, but still requests to proof to be at arm's length (art. 126 DBG, art. 39 VStG);
- Reference to OECD transfer pricing approach (Master File, Local File);
- Court case: taxpayer's burden to proof (2C_824/2021, Federal Supreme Court);
- Tax administrations request Swiss headquarters group to provide Master File (although no legal requirement to prepare for Switzerland)

Need for Action

- Review quality of transfer pricing documentation or supporting documents for transactions involving Swiss group affiliates

Remuneration for Baseline Marketing & Distribution Activities

Source: Final Report Pillar I / Amount B

Technical Background

Simplified Approach

- Transactions in scope:
 - Buy-sell marketing and distribution transactions for wholesale distribution;
 - Sales agency and commissionaire transactions for wholesale distribution
- TNMM, based on matrix segments with the two dimensions industry grouping (vertical column) and factor intensity (horizontal column), consisting of net operating assets (“OAS”) and operating expense intensity (“OES”)

| Industry Grouping | Industry Grouping 1 | Industry Grouping 2 | Industry Grouping 3 |
|--------------------------------------------------------|---------------------|---------------------|---------------------|
| Factor Intensity | | | |
| [A] High OAS / any OES >45% / any level | 3.50% | 5.00% | 5.50% |
| [B] Med/high OAS / any OES 30% - 44.99% / any level | 3.00% | 3.75% | 4.50% |
| [C] Med Low OAS/any OES 15%-29.99% / any level | 2.50% | 3.00% | 4.50% |
| [D] Low OAS / non-low OES <15% / 10% or higher | 1.75% | 2.00% | 3.00% |
| [E] Low OAS/low OES <15% OAS / <10% OES | 1.50% | 1.75% | 2.25% |

Need for Action

- Tracking on which countries will apply simplified approach and if yes, whether the approach is mandatory or voluntary (safe-harbour)
 - India: numerous reservations;
 - New Zealand: opted-out
- Review of transfer pricing models related to baseline marketing & distribution activities (although potentially not in scope)

Closing

Three Take-aways From Today's Webinar

From the outside, these recent Swiss developments may not seem significant - but in reality, they represent a major step toward more clarification in disputed matters in Switzerland

Tax administrations in Switzerland turn focus to transfer pricing

Swiss tax practitioners need to get familiar with OECD transfer pricing concepts

MNEs need to prepare for transfer pricing challenges in Switzerland
(e.g., substance, intercompany agreements, documentation, benchmarking, operational transfer pricing)



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