Why this book?
Transfer pricing is one of the most important issues for multinational enterprises today. As base erosion and profit shifting (BEPS) issues have taken centre stage with a renewed focus on substance and transparency, the BEPS Action Plan has resulted in substantial changes that have significantly impacted transfer pricing regimes around the world. With greater scrutiny on transfer pricing arrangements, global entities must adapt to an environment of more complex transfer pricing rules and regulations and increasing disclosure requirements, and being aware of the specific requirements in each country in which they do business is thus now more important than ever.

This book contains the official text of the 2017 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, together with information on the transfer pricing regime in selected countries. The countries were chosen on the basis of their geographical and economic importance, as well as the amount of transfer pricing activity. Each country chapter provides a concise description of the current transfer pricing laws, guidelines and methodologies in practice in that particular country, and the information is presented in both a domestic and an international context.

This book provides a handy reference guide for those actively working in the field of transfer pricing, with a standardized country chapter outline allowing for quick and easy comparisons between countries.

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OECD member countries
The OECD member countries are currently: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea (Rep.), Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.
Part B

Transfer Pricing
Features of Selected Countries 2019
IBFD

IBFD was established in the Netherlands in 1938, and is an independent, not-for-profit foundation with offices in Amsterdam, Beijing, Kuala Lumpur and Washington, D.C. IBFD is the world’s foremost authority on cross-border taxation, providing independent tax research, international tax information, education and government consulting. IBFD currently employs over 70 research specialists from over 30 countries to help you understand cross-border taxation problems and how to deal with them.

Catering to both the private and public sectors, IBFD fulfils the information needs of tax advisory firms, multinational enterprises, international organizations, ministries of finance, tax administrations, universities and other tax practitioners from all over the world.

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Taxand is the world’s largest independent tax organization with more than 400 partners and 2,000 advisers in 50 countries. Taxand focuses on delivering high quality, integrated tax advice worldwide, free from time-consuming audit work.

Our dedicated transfer pricing and business restructuring experts work as a team to help structure your business to ensure commercial and operational needs are met. It’s more than just risk management. You might need to adapt your pricing policies to meet legal and economic requirements, or restructure to improve efficiencies and drive business performance. Whatever your approach, we’ll guide you to the most logical arrangement.

Wherever you’re based, whatever your tax issues, our organization can help turn your tax challenges into strategic solutions that will work for you and your business, both today and in the long term.
Introduction

The following country chapters provide a brief description of the transfer pricing regime in 38 countries. Each country chapter is structured according to a standard layout, as follows:

1. Tax authority and law
2. Regulations and rulings
3. Methodologies
4. Comparability analysis
5. Disclosure/documentation requirements
6. Mutual agreement procedures (MAPs)
7. Advance pricing agreements (APAs)
8. Safe harbour provisions
9. Transfer pricing audits
10. Penalties

Under each of the above headings, the domestic situation is described and is intended to provide a general overview of the country’s transfer pricing regime. The country chapters are based on information available as of 1 June 2019 in general, and every reasonable effort has been made to ensure the information is as up-to-date as possible.

It should be noted that under “Methodologies”, the prescribed methods in the countries are generally the (i) comparable uncontrolled price method, (ii) resale price method, (iii) cost-plus method, (iv) profit split method, and (v) transactional net margin method. A glossary of these methods is available at page 23. Since these methodologies tend to follow the OECD Transfer Pricing Guidelines, they have not been elaborated on in the country chapters. Where the domestic methodology includes methods other than what is prescribed in the OECD Transfer Pricing Guidelines, the details of such methods have been provided for in the respective country chapter, e.g. the United States.

Some regulations and developments are applicable to multiple jurisdictions. One of the most significant recent developments has been the OECD/G20 Plan on Base Erosion and Profit Shifting (BEPS Action Plan), which has resulted in substantial revisions to the OECD Transfer Pricing Guidelines and had an impact on global transfer pricing practices. Many countries have also signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), which contains provisions regarding mutual agreement procedures, corresponding adjustments and a binding arbitration procedure. EU Member States are subject to EU regulations and directives, such as: the EU Council Directive 2011/16 (DAC 6), which mandates the disclosure of reportable cross-border tax arrangements; the EU Anti-Tax Avoidance Directive (Council Directive (EU) 2016/1164) which forms the European Commission’s response to relevant BEPS actions and lays down rules against tax avoidance practices in the European Union; the EU Arbitration Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC); and Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the European Union, according to which EU Member States have to efficiently resolve double taxation disputes.
These measures may be mentioned in some country chapters where the domestic law has been enacted to give effect to them, but are otherwise not generally discussed in the individual country chapters.

Additionally, the latest transfer pricing developments, including case law, can be obtained from IBFD’s *Tax News Service* (online and e-mail service), while more comprehensive coverage of a majority of the countries can be found in other IBFD publications, most notably the online *Transfer Pricing Database* publication, which has detailed transfer pricing information on almost 60 countries.
1. Tax authority and law

The tax administration agency in China is the State Administration of Taxation (SAT), a ministry-level governmental department. The Ministry of Finance has a tax policy department which is responsible for the tax legislation. In most cases the new tax policies are jointly issued by the Ministry of Finance and SAT.

The International Division as well as the newly established large taxpayers service division of the SAT are in charge of the transfer pricing investigations and approval of advance pricing agreements (APAs). The respective local tax bureaus may initiate transfer pricing investigations and collect information, but the final decision must be reported to or approved by the SAT.

The first detailed transfer pricing rules in China can be traced back to 1998. In that year a circular on transfer pricing was issued by the SAT. The current laws and regulations on transfer pricing can be found in the special tax adjustment provisions of chapter 6 of the Enterprise Income Tax Law (EITL) and the Implementation Regulations of the Enterprise Income Tax Law (EITIR). The EITL was enacted on 16 March 2007 and the EITIR were released in December 2007, both of which took effect on 1 January 2008.

Article 41 of the EITL provides that the tax authority is authorized to make adjustments by using the appropriate methods if a transaction between an enterprise and its related party is not conducted at arm’s length and, as a result, the taxable revenue or taxable income of the enterprise or its related party is reduced. Further, article 41 states that the costs incurred by an enterprise and its related parties for the joint development or assignment of intangible assets or for the joint purchase or provision of services should be allocated at arm’s length in determining the taxable income.

Article 42 provides for the possibility of an APA. Article 43 of the EITL requires the taxpayers to submit the reporting forms on the transactions between related parties together with the annual enterprise income tax return.

The provisions are of a general nature and the scope of the application is wide. All enterprises, whether they are resident enterprises or non-resident enterprises, are subject to the rules.

More detailed rules on transfer pricing were incorporated into the EITIR, which contain many definitions and set out the rules provided under the EITL.

Although China is not a member of the OECD, the SAT has indicated that the OECD Transfer Pricing Guidelines will be followed.

1. Contributed by Eve Xiao, Taxand China. The author can be contacted at +86-21-6447 7878 and eve.xiao@hendersen.com. This chapter was originally authored by Shiqi Ma of IBFD and has been rewritten by Taxand China. This chapter is based on information available up to 1 June 2019.
2. Regulations and rulings

2.1. Regulations, rulings and guidelines

On 8 January 2009, the SAT issued Circular Guo Shui Fa [2009] No. 2: The Implementation Measures of Special Tax Adjustments (Provisional) (Circular 2/2009), which provided comprehensive provisions in the area of transfer pricing as well as general anti-avoidance administration in China. Circular 2/2009 covered various topics, including contemporaneous documentation, transfer pricing audit, APA, cost sharing, thin capitalization, controlled foreign corporation, etc. and it took effect, retrospectively, from 1 January 2008.

On 17 September 2015, the SAT released a discussion draft of the Implementation Measures of Special Tax Adjustments (hereinafter referred to as the “Discussion Draft”) for public consultation, which was expected to be effective from 1 January 2016. While it was expected that the SAT would issue a revised and final version of the Implementation Measures of Special Tax Adjustments after the release of the discussion draft, the SAT released a refined transfer pricing compliance requirement separately in the form of the Public Notice Regarding Improvement of the Reporting of Related-Party Transactions and Administration of Contemporaneous Documentation (SAT Notice [2016] No. 42, hereinafter Notice 42/2016), which was issued on 29 June 2016.

Notice 42/2016 replaces the requirements of related-party reporting and contemporaneous documentation in Circular 2/2009 as well as GuoshuiFa [2008] No.114, and will apply for the 2016 fiscal year with a reporting deadline of 30 June 2017 for the Local File and special issue file.

On 11 October 2016, the SAT issued new regulations (Notice 64/2016) to improve the administration of APAs. Notice 64/2016 is applicable from 1 December 2016, and the applicable sections concerning APAs in the old regulations (i.e. Chapter 6 of Circular 2/2009) are repealed.

On 17 March 2017, the SAT issued new regulations to improve administration of Special Tax Investigation and Adjustment and Mutual Agreement Procedures (Notice 6/2017). These regulations largely complete the revision of the transfer pricing specific clauses of Circular 2/2009 and add to the transfer pricing framework set out in Notice 42/2016. Effective from 1 May 2017, Notice 6/2017 has clarified certain key transfer pricing issues, as well as the methodology and procedures for special tax audits and adjustments.

2.2. Arm’s length principle

Under article 110 of the EITIR, the arm’s length principle is defined as the principle adopted by unrelated parties when conducting business transactions based on fair transactional prices and normal business practices.

The rules in the EITIR acknowledge the arm’s length principle as the preferred basis to be adopted in related-party transactions and this is consistent with the internationally accepted arm’s length principle set out in the OECD Transfer Pricing Guidelines.
2.3. Meaning of control and associated persons

Article 109 of the EITIR provides that two enterprises are “related” if one enterprise has the following relationships with another enterprise:

- direct or indirect control with respect to capital, business operations, purchases and sales; or
- direct or indirect common control by a third party; or
- any other relationships arising from mutual interest.

According to article 2 of Notice 42/2016, parties are considered related if one of the following situations occurs:

(1) One party holds 25% or more of the shares in the other party directly or indirectly, or a third party holds 25% or more of the shares in both parties directly or indirectly. When one party holds shares indirectly in the other party through an intermediary, as long as it holds 25% or more of the shares in the intermediary, its shareholding percentage in the other party will be computed based on the intermediary’s shareholding percentage in the other party. When two or more natural persons who are spouses, direct blood relatives, siblings or have other foster or support relations jointly hold shares in the same enterprise, the shareholding percentage will be aggregated when determining the related-party relationship.

(2) One party holds shares in the other party or a third party holds shares in both parties and the shareholding percentage does not attain the percentage stipulated in the provisions of item (1), but the total amount of borrowed funds between both parties constitutes 50% or more of the paid-up capital of either party, or 10% or more of the total borrowed funds of one party is guaranteed by the other party (except for loans or guarantees between the party and an independent financial institution).

(3) One party holds shares in the other party or a third party holds shares in both parties and the shareholding percentage does not attain the percentage stipulated in the provisions of item (1), but the conduct of manufacturing and business operations of one party requires the provision of patents, non-patented technologies, trademarks, copyrights or other concessions provided by the other party.

(4) One party holds shares in the other party or a third party holds shares in both parties and the shareholding percentage does not attain the percentage stipulated in the provisions of item (1), but the business activities of one party, such as procurement, sales and acceptance of services, are controlled by the other party. Control for this purpose means that one party has the right to decide the financial and business policies of the other party, and accordingly derive gains from the business activities of the other party.

(5) More than half of the directors of one party or more than half of the senior management personnel (including board secretary, managers, deputy managers, chief financial officer and other personnel stipulated in the company’s articles of association of a listed company) of one party are appointed or designated by the other party or are appointed concurrently as the directors or senior management personnel of the other party, or more than half of the directors or more than half of the senior management personnel of both parties is appointed or designated by a third party.
(6) Two or more natural persons who are spouses, direct blood relatives, siblings or have other foster or support relations are related to both parties in any of the ways stipulated in items (1) through (5).

(7) Both parties have other common interests substantially.

3. Methodologies

3.1. Prescribed methods

The following methods can be used in determining the arm’s length price:

- comparable uncontrolled price method;
- resale-minus method;
- cost-plus method;
- transactional net margin method;
- profit split method; and
- other methods, including asset valuation methods such as the cost method, market method, income method, etc., which are consistent with the arm’s length principle.

The first three methods are referred to as “traditional methods”, while the last two methods are known as “transactional profit methods”.

3.2. Priority of methods

There is no special order of the methods to be used. The taxpayer is given the right to choose any method or combination of the above methods as long as the method is reasonable and appropriate taking into account the factors such as type, nature of transactions and investigation results of the tax authority.

4. Comparability analysis

4.1. Comparable data

For more detailed information on Chinese companies, such as segmented profit and loss statements, Chinese-specific databases (in the Chinese language) such as Wind or Tianxiang are used. As reference, listed companies in Shanghai, Shenzhen and Shenzhen small-medium size enterprises are used for Chinese comparables. For comparables worldwide, the SAT uses the OSIRIS database.

Taxpayers are expected to determine whether internal comparable information can be found within the company. If the information is unavailable, companies are expected to carry out an external comparable study using Chinese and/or foreign comparable companies.

Based on Notice 42/2016, a comparable analysis must be made in order to select reasonable transfer pricing methods. The following factors should be considered in the comparable analysis:

- characteristics of the assets or services transferred;
- functions, risks and assets of the parties involved;
- terms of contracts;
- economic environment; and
- business strategies.
Notice 42/2016 further states that the following information in respect of the comparable analysis must be provided in the taxpayer’s contemporaneous documentation:

- factors considered in the comparability analysis, including features of property and services, functions performed, risks exposed to, assets employed, contract terms, economic conditions, business strategies, etc.;
- information on the functions performed, risks assumed and assets employed by comparables;
- an explanation of comparable transactions, for example: (i) features of tangible property and its quality and usage; (ii) interest rate and other terms of financing transactions; (iii) the nature and extent of services; and (iv) types and transaction modes of intangible assets, intangible assets use rights stemmed from the transactions and the income derived from these intangible assets;
- the method for searching, information source, selection criteria and reason for comparables;
- selected internal or external comparable uncontrolled transaction information and financial information of comparables; and
- adjustments made on comparable information and reasons for the adjustments.

4.2. Foreign comparables

Regional or global comparables are acceptable in principle. However, in most cases, the tax bureaus prefer regional comparables rather than global comparables. In China, the OSIRIS database is used by the SAT and is the main source for comparables worldwide.

4.3. Secret comparables

As explicitly stated in Notice 6/2017, the tax bureaus may use secret comparables. In practice, the tax bureaus may request for companies that have been eliminated at various stages of the benchmarking process to be included in the final set if the reasons for such exclusions are not justified. Similarly, they may exclude companies from the final set if there are reasons to believe that the particular company is not a suitable comparable.

4.4. Use of ranges

The EITL and EITIR do not specify a preference for a single figure or a range of figures. In practice, statistical tools such as the interquartile range and median are frequently used. In particular, Notice 6/2017 mentions that when the tax bureaus analyse and evaluate an enterprise’s profit by using the interquartile method, an adjustment should generally be made to no lower than the median if the enterprise’s profit is found to be lower than the median of the comparable companies’ interquartile range.

5. Disclosure/documentation requirements

5.1. Tax return disclosures

Article 43 of the EITL requires the taxpayers to submit reporting forms on the transactions between related parties together with the annual enterprise income tax return. The tax return and the reporting forms are due on 31 May of the following year.
The related-party transaction annual reporting forms include:

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5.2. **Transfer pricing documentation requirements**

In addition to the annual reporting forms (see section 5.1.) on related-party transactions, Notice 42/2016 introduces a three-tier documentation framework, as set out in the OECD’s framework in BEPS Action 13.

Transfer pricing contemporaneous documentation consists of a Master File, a Local File and a Special Issue File.
5.2.1. **Master File**

The disclosure requirements are generally consistent with those recommended by BEPS Action 13. The additional information required under Notice 42/2016 for the Master File includes:

− any business restructuring exercises and the transfer of functions, risks and assets within the group;
− the functions, risks, assets and employees of the principal research and development (R&D) facilities;
− the names and locations of the member entities for which the group will prepare and submit the CbC report; and
− a list and brief description of the group’s existing bilateral APAs.

The subsidiaries of the group that have prepared the Master File at the group level should discuss with their group’s global tax team, request that the Master File be prepared at the group level, review the new transfer pricing documentation requirements in China and address the additional information required.

One of the key challenges of the Master File is to identify the value drivers of the group and analyse the entities’ principal contribution to value creation, which requires a comprehensive value chain analysis of the group.

The SAT Public Notice 2018 No. 14, which took effect on 20 May 2018, has clarified that when a group has several subsidiaries in different locations in China, the group can designate one subsidiary to submit the Master File to its local tax authority, provided that the subsidiary is not under investigation for special tax adjustment.

The Master File should be completed within 12 months after the fiscal year-end of the group’s ultimate holding company.

5.2.2. **Local File**

Compared with the previous transfer pricing documentation requirements, the Local File requires significantly greater information disclosures and transfer pricing analyses. The new items required in the Local File include:

− value chain analysis: details on the transaction flow, physical flow of goods and cash flow within the group; allocation principles and actual allocation results of group profits among the global value chain; and annual financial statements for the latest fiscal year of each of the group entities involved in the value chain;
− financial data: financial data for each type of business and products;
− equity transfer analysis: an overview of equity transfers, information on the equity transferred, due diligence reports and valuation report of any underlying assets for the transferred equity;
− related-party services analysis: a separate analysis on related-party services, including the benefits for each party from the service transactions, methodology for determining the service costs, service items, service amount, allocation standards, calculation process and results, etc., as well as information on any same or similar service transactions that the enterprise and its group enters into with third parties;
− location specific factors: the impact of location specific factors such as location savings, market premiums, etc. on the pricing of transactions and the portion of value creation from location specific factors shared by the enterprise; and
− global APAs and tax rulings: disclosure of APAs signed and tax rulings granted in other jurisdictions that are directly related to the tested related-party transactions.

The value chain analysis and the illustration of value contribution will involve the most technical analyses under the new transfer pricing documentation requirements. They are not just intended for the immediate related-party transaction covered by the transfer pricing documentation, but for the overall international group, which will require in-depth functional analyses and economic analyses of the group’s overall business. To avoid potential conflicts and inconsistency, international groups who are not required to prepare a Master File in China should still take a consistent and coordinated approach to preparing the Local Files for their Chinese subsidiaries.

It can be expected that in a future transfer pricing audit, if the tax authorities conclude that there are no appropriate comparables available, they can use a profit split or contribution analysis based on the value chain analysis to determine the transfer pricing adjustment.

Compared with the Discussion Draft, Notice 42/2016 further emphasizes the analysis and consideration of location specific advantages in the Local File. Although location specific advantages were referred to in many chapters in the Discussion Draft, it was not included as one of the requisite items for transfer pricing documentation. This new change requires multinational enterprises to take local specific advantages into account whenever they establish or review a transfer pricing arrangement.

In addition, the higher disclosure standard on intragroup services will also impact many taxpayers. It usually takes much time and effort to describe the nature and prove the benefit of intercompany services to the tax authorities, especially for group allocated service charges. In this regard, it is suggested that taxpayers with group allocated service charges start preparing the analysis as soon as possible.

The Local File should be completed by 30 June following the year in which the related-party transaction occurs.

5.2.3. Special Issue File

The Special Issue File is required for taxpayers engaging in a cost sharing agreement or falling under the thin capitalization requirement.

The requirements for the above two Special Issue Files are very similar to the contemporaneous documentation in relation to cost sharing agreements and thin capitalization provided in Chapter 7 (Administration of Cost Sharing Agreement) and Chapter 9 (Administration of Thin Capitalization) of Circular 2/2009.

The additional required information under Notice 42/2016 is as follows:
− Cost sharing agreement:
  − the use of the results of the cost sharing agreement by non-participants and the method of allocating the payment among the participants; and
calculation of the anticipated benefits, including the selection of parameters, calculation method and reason for change; and

− Thin capitalization:
  − whether an independent enterprise is capable and willing to accept the financing terms, amount and interest rate agreed between related parties.

The Special Issue File should be completed by 30 June following the year in which the related-party transaction occurs.

5.3. **Country-by-country reporting**

The CbC reporting forms are required from the Chinese resident enterprise if:

− it is the ultimate holding company of a group with consolidated revenues of over CNY 5.5 billion; or
− it is nominated as the CbC reporting entity.

If the ultimate parent company is a Chinese tax resident enterprise and the information may be relevant to national security, then part or all of the CbC reporting can be exempt based on the relevant regulation.

The CbC reporting forms provided in the new related-party transaction forms as well as the instructions are consistent with BEPS Action 13.

The annual CbC report filing requirement mainly applies to the ultimate holding company in China. However, a subsidiary of a multinational group in China may also be required to submit a CbC report in a transfer pricing investigation if its ultimate holding company is responsible for preparing the CbC report according to the regulation of the jurisdiction in which it resides and one of the following conditions are met:

− the multinational group has not provided the CbC report to the tax authority of any jurisdiction;
− although the group has submitted the CbC report, the jurisdiction collecting the report does not have an exchange of information mechanism with China; or
− although the group has provided the CbC report and the jurisdiction collecting the CbC report has an exchange of information mechanism with China, the CbC report has not been successfully exchanged with China.

The fundamental challenges for preparing a CbC report include:

− reconciliation between global and local reporting, which may create potential data mismatch issues; and
− data collection and extraction, which may create additional processes and accounting tasks for tax departments.

6. **Mutual agreement procedures (MAPs)**

Taxpayers may apply to commence a MAP in China. Pursuant to Circular SAT Announcement [2013] No. 56, a Chinese resident can submit a request to the SAT to start a MAP if he or she is of the opinion that a contracting state has not complied with the provisions of a tax treaty with China. The types of taxes eligible for an arrangement through the MAP are limited to those listed in the applicable scope of the tax treaty.
A MAP application can be filed in the following cases:
- a dispute on the determination of the residency status of the claimant of a contracting state, especially where the relevant tax treaty stipulates that dual-residency status requires final confirmation through MAPs;
- a dispute on whether a permanent establishment exists and the allocation of profits to a permanent establishment, or the deduction of costs;
- a dispute on tax collection or exemption and respective tax rates on various income and properties;
- a violation of the non-discrimination article of the tax treaty;
- a dispute on the interpretation or implementation of the relevant tax treaty; and
- issues related to double taxation in different jurisdictions.

The MAP application should be submitted to the SAT or the provincial level tax bureaus within the period prescribed in the tax treaty (normally 3 years after the first tax assessment which is in conflict with the tax treaty).

The application must meet all of the following criteria:
- the applicant is a Chinese resident or Chinese citizen who may submit a request for mutual agreement in the prescribed areas;
- the application is submitted within the period stipulated in the tax treaty;
- the matter in the application for mutual agreement is an act of a contracting state which may violate or has violated the provisions of the tax treaty;
- the facts and evidence provided by the applicant can prove or cannot reasonably eliminate the allegation that the contracting state’s act has violated the provisions of the tax treaty; and
- the matter in the application for mutual agreement does not fall under the following circumstances:
  - the applicant deliberately conceals important facts or provides falsified materials;
  - the applicant refuses to provide requisite materials relating to the case as required by the tax authorities;
  - due to various reasons, the applicant and the tax authorities are unable to obtain the requisite evidence, thus the relevant facts or the applicant’s position cannot be proven, and the MAP cannot continue;
  - the authorities of the treaty counterparty unilaterally refuse or terminate MAPs; or
  - other factors whereby the MAP cannot continue or cannot attain the objective.

7. Advance pricing agreements (APAs)

Article 42 of the EITL provides for the possibility of negotiation and entering into an APA with the tax authority. According to Notice 64/2016, APA candidates must meet all of the following requirements for 3 years prior to the application:
- the annual related-party transactions must exceed CNY 40 million;
- they have reported related-party transactions in their annual tax filings properly; and
- they have maintained the required contemporaneous documentation.

The APA concept was first introduced in 1998. On 3 September 2004, the Regulation on the Implementation of Advance Pricing Arrangements in Business Transac-
tions between Affiliated Enterprises was issued by the SAT and this provided the legal basis for the APA regime in China. This regulation was superseded by Circular 2/2009, which contained updated rules on the administration of APAs in China. According to Circular 2/2009, an APA refers to a prospective arrangement reached by and between taxpayers and tax authorities on transfer pricing methods with respect to affiliated business transactions. Notice 64/2016) applies from 1 December 2016 and repeals the applicable sections concerning APAs in Chapter 6 of Circular 2/2009.

An APA can be concluded in respect of transactions such as a purchase, sale or use of tangible assets, a licence or transfer of intangible assets or provision of services or loans between affiliated enterprises.

According to Notice 64/2016, an APA usually covers a period of 3 to 5 years following the year of application. Notice 64/2016 also allows an APA to apply retroactively to the year of application or previous years upon approval of the tax authority.

There is no filing fee for APAs in China. The applicant can submit an application to the local tax bureau, or the SAT if the APA involves more than one province or if it is a bilateral/multilateral APA. Negotiation and execution of an APA usually involves six stages, i.e. pre-filing meeting, formal application, examination and appraisal, negotiation signing of arrangements and supervision of implementation.

By 31 December 2016, the cumulative total of APAs signed was 139, including 84 unilateral APAs and 55 bilateral APAs.

To fulfil the minimum standard of BEPS Action 5, the unilateral APAs signed after 1 April 2016 will be absorbed into the compulsory spontaneous exchange framework.

8. Safe harbour provisions

There are no safe harbour provisions in China.

9. Transfer pricing audits

9.1. Burden of proof

The burden of proof on the accuracy of information in the tax return and/or transfer prices lies with the taxpayer. Taxpayers with related-party transactions should be able to substantiate, with documents, that their transfer prices have been determined in accordance with the arm’s length principle and that there has not been any abuse of the transfer prices resulting in an alteration of the incidence of taxable income in China.

9.2. Statute of limitation

There is a 10-year statute of limitation for tax adjustments. This does not apply in cases of fraud, wilful default or negligence.
9.3. **Desk and field audits**

Pursuant to Notice 6/2017, transfer pricing investigations should focus on enterprises that meet the following criteria:

- has related-party transactions with large transaction amounts or varied types of related-party transactions;
- incurs long-term losses, low profits or non-linear profits;
- profit is lower than the industry’s level;
- the profit level does not match the functional risks borne or the earnings shared do not match the costs shared;
- carries out related-party transactions with related parties located in low tax countries or regions;
- fails to declare related-party transactions or to prepare contemporaneous documentation pursuant to the provisions;
- the ratios of debt investments and equity investments accepted from related parties exceed the stipulated standards;
- an enterprise controlled by a resident enterprise or by a resident enterprise together with a Chinese national, established in a country or region with an actual tax burden lower than 12.5%, does not distribute its profit or reduces its profit distribution, and such non-distribution or reduced distribution is not due to reasonable business needs; or
- implements other tax planning or arrangements that do not have a reasonable business objective.

The transfer pricing audit process is generally initiated by a request for financial and management information such as statutory accounts, tax computation, pricing information, management accounts and transfer pricing documentation. Based on this information, the tax authority will carry out a review of the documents and decide if a more detailed review is required. A field visit will be carried out if it has been found necessary after review of the submitted information.

More details on the powers of the tax offices and tax audits process are regulated in the Administration of Tax Collection Law (TCAL).

10. **Penalties**

Taxpayers who fail to comply with the requirements for providing information or provide false information or do not provide the information in time will be fined according to the relevant articles of the TCAL. The penalty described in the TCAL could range from CNY 10,000 to CNY 50,000 in serious cases.

Penalty interest will generally be imposed on tax adjustments made under the EITL (including transfer pricing adjustment). The interest rate shall be calculated based on an RMB loan benchmarking rate published by the People’s Bank of China plus 5%. The interest on underpaid taxes is on a daily basis, starting from 1 June of the tax year following the one to which the tax payment is related until the day the underpaid tax is settled.

However, the penalty interest applies only when the transactions giving rise to the adjustment occur on or after 1 January 2008. In addition, if a taxpayer can provide
contemporaneous documentation and/or other information/documents requested by the tax authority, the additional 5% surcharge may be waived.

The additional tax assessment, together with penalty interest (if any), should be settled with the tax authority within the prescribed deadline, overdue payment would be subject to an additional 0.05% penalty interest per day.
1. Tax authority and law

Switzerland does not have specific transfer pricing legislation. Swiss tax legislation contains a few provisions that pertain to transfer pricing issues. The provisions are:

- article 58 of the Federal Income Tax Act 1990 (FITA), which states that all expense incurred without a business reason (namely hidden profit distributions and unjustified payments to third parties) will be disallowed for income tax purposes. The general principle is derived from this provision, i.e. that Swiss taxpayers must adhere to the arm’s length principle. This principle applies not only for income tax purposes but is valid throughout the Swiss tax system (the 26 cantonal tax laws, which apply to cantonal and municipal taxes, contain similar provisions);
- article 24(1) of the Federal Law on Harmonization of the Cantonal and Communal Taxes 1990 (FTHL), which creates the necessary legal basis for application of the arm’s length principle; and
- article 24(2) of the Federal Act on Value Added Tax 2009, which reflects the arm’s length principle when it states that the supply of goods and services to related parties will be taxed on a third-party basis and article 3(h) of the Act defines the term “related party” for VAT purposes.

With regard to interest charges to related parties, there is a specific provision in article 65 of the FITA that disallows such interest charges if made on deemed equity, i.e. on debt which corresponds to an equitable interest.

As there is no specific transfer pricing legislation in Switzerland, there is also no specific tax authority for transfer pricing issues. The Swiss Federal Tax Administration (SFTA) is in charge of all transfer pricing matters with regard to withholding tax, stamp duty, tax treaties and VAT. Bilateral or multilateral transfer pricing agreements also have to be addressed with the SFTA. Unilateral transfer pricing issues for income tax purposes for years which are not yet finally assessed have to be addressed with the tax authority in the canton in which the taxpayer is registered.

Switzerland is a member of the OECD and therefore endorses the OECD Transfer Pricing Guidelines as well as the OECD BEPS Project. Switzerland has already taken into account some BEPS Project outcomes. Notably, the Federal Act on Tax Reform and OASI\(^2\) Financing (TROF Act) enters into force on 1 January 2020. The TROF Act includes among other measures the abolition of tax privileges, super deductions for research and development costs, and the introduction at cantonal level of a mandatory patent box in line with the OECD standard.

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2. Old Age and Survivors’ Insurance.
2. Regulations and rulings

2.1. Regulations, rulings and guidelines

There are no specific transfer pricing regulations in Switzerland. However, the SFTA issued a Circular on 4 March 1997, instructing the cantonal tax authorities to adhere to the OECD Transfer Pricing Guidelines for the taxation of multinationals. It has since endorsed this instruction in a Circular of 19 March 2004. Circular 4 specifically covers the taxation of service companies (application of the arm’s length principle).

Furthermore, the SFTA has published the following guidelines for specific transfer pricing issues or transfer pricing-related matters:
– Circular Letter of 31 January 2019, containing safe harbour interest rates on Swiss franc-denominated loans to and from related parties (annual publication);
– Circular Letter of 1 February 2019, containing safe harbour interest rates on loans in currencies other than the Swiss franc (annual publication);
– Circular 6 of 6 June 1997 regarding thin capitalization rules;
– Circular 9 of 22 June 2005 regarding proof of commercially justified business expense in foreign-to-foreign transactions;
– Circular 8 of 18 December 2011 regarding principal structures; and

Circulars and circular letters published by the SFTA do not carry legislative authority. However, in practice such publications are observed by taxpayers, tax authorities and, for the most part, tax courts.

In addition, there is an informal practice of the tax authorities with regard to standardized valuation of businesses and intangibles when transferred within a group. The informal practice takes inspiration from the Guideline under the Wealth Tax for the Valuation of Securities without Securities Exchange Market Prices (on the Circular Letter No. 28 of August 2008). Such standard valuations are often the starting point for an advance tax ruling.

2.2. Arm’s length principle

There is no legal definition of the arm’s length principle in Switzerland. However, it is generally interpreted to the effect that transactions between related parties have to be considered on the basis of comparable uncontrolled transactions. The key question asked is whether unrelated parties would have entered into the transaction under the same conditions. The appropriateness of a transaction is generally not judged.

Only if the conclusion is reached that the specific transaction is not at arm’s length, i.e. the consideration is blatantly inadequate, will the tax authority proceed to determine the appropriate consideration and the resulting adjustment for tax purposes.

2.3. Meaning of control and associated persons

Swiss corporate law defines a group as one or more companies which are controlled by another company by way of votes or other means (article 963 of the Swiss Code of Obligations). In principle, this definition of control is also valid for tax purposes.
For Swiss tax purposes, associated persons or related parties are (Notice S-02.141 of February 2001 concerning the beneficiary for withholding tax purposes):
– the shareholders of a company;
– family and friends of an individual shareholder; and
– a group company belonging to the same group of companies.

3. Methodologies

3.1. Prescribed methods

Switzerland applies all the transfer pricing methods mentioned in the OECD Transfer Pricing Guidelines, i.e.:
– comparable uncontrolled price method;
– cost-plus method;
– resale price method;
– transactional net margin method; and
– profit split method (contribution or residual analysis).

The transfer pricing method to be applied can be agreed upon upfront with the competent tax authority. In general, the tax authorities will agree to any method, even a method not mentioned in the OECD Transfer Pricing Guidelines, as long as the result is adequate in view of the circumstances.

Switzerland applies the OECD Transfer Pricing Guidelines and its recent update in 2017, which resulted from BEPS Actions 8-10.

3.2. Priority of methods

Due to the lack of explicit transfer pricing regulations in the Swiss tax laws, Switzerland relies on the methods suggested in the OECD Transfer Pricing Guidelines.

As a consequence of the 2010 update of the OECD Transfer Pricing Guidelines, there is no longer a preference for the traditional transactional method. However, in practice, the comparable uncontrolled price method is still the preferred method, when deemed applicable. The transactional net margin method remains the most widely used by taxpayers.

4. Comparability analysis

4.1. Comparable data

There are no guidelines on the search for comparable data. The tax authorities follow the guidance on comparability analysis outlined in Chapter III of the OECD Transfer Pricing Guidelines.

Due to the fact that no filing of financial statements and additional financial data with the public bodies, such as the Register of Commerce, etc., is required in Switzerland, searching for comparable data within Switzerland is generally difficult. Normally, comparable data is evaluated through internationally available databases and, as a result thereof, such data is often not specific to Switzerland.
4.2. *Foreign comparables*
Due to the lack of availability of domestic comparable data, often foreign comparables are relied upon. Such foreign comparable data is then to be leveraged to the Swiss transaction under review.

4.3. *Secret comparables*
Secret comparables are generally not used by the tax authorities. The use of secret comparables could not be sustained in court, i.e. the comparables would have to be disclosed to the taxpayer.

4.4. *Use of ranges*
In accordance with the OECD Transfer Pricing Guidelines, the use of ranges is in principle accepted, although no detailed guidelines exist in this regard. In practice, it is not uncommon that ranges are used and statistical tools such as the interquartile range are used to narrow the range.

5. *Disclosure/documentation requirements*

5.1. *Tax return disclosures*
General tax documentation rules apply, which do not prescribe any specific transfer pricing information.

Together with the income tax return, the annual financial statements prepared according to Swiss statutory generally accepted accounting principles (GAAP) have to be filed. In the tax return, further information with regard to depreciation, amortization, provisions as well as directors’ fees is requested. Furthermore, all lenders (third-party and intercompany), the amount of loans payable and debt interest have to be disclosed and the same applies to loans receivable. There is no specific disclosure requirement for related-party transactions.

Upon request of the tax authorities, all information necessary for a correct assessment has to be disclosed. This includes detailed accounts, including the various ledgers maintained, as well as invoices, contracts/agreements and even business correspondence, if necessary.

Income tax returns have to be filed annually. The filing deadline varies in the different cantons (typically within 6 or 9 months as of the end of the underlying tax/business year) and can be extended up to 11 months in most cantons.

5.2. *Transfer pricing documentation requirements*
Currently, there are no specific transfer pricing documentation requirements in Switzerland, neither for general nor for tax return filing purposes.

However, for general statutory and tax purposes all business transactions have to be recorded in the company accounts and must be reflected by the annual financial statements. Not only must all business transactions be recorded in the company accounts, but all documentation related to them, such as agreements, contracts, in-
voices and correspondence, also have to be kept on file as part of the business records. For transactions with related parties, this means that all transactions and their base have to be properly documented, which possibly necessitates some form of transfer pricing documentation. In complicated cases, especially if intellectual property is involved, transfer pricing documentation is recommended for audit defence.

Detailed business accounts and business records, including transfer pricing documentation (if existent), have to be disclosed to the tax authority only upon request, i.e. in the course of a tax assessment or a desk audit. Company records should be kept in an official language (i.e. German, French or Italian, depending on place of business) or in English. If kept in a different language, the tax authorities can request translation into one of the applicable languages.

5.3. **Country-by-country report**

Switzerland has signed the Multilateral Competent Authority Agreement for the Automatic Exchange of Country-by-Country Reports. Hence, Swiss ultimate parent entities and surrogate parent entities with a group revenue exceeding CHF 900 million are required to file an annual country-by-country (CbC) report.

The corresponding Federal Act on International Automatic Exchange of Country-by-Country Reports of Multinationals (CbCR Law) entered into force on 1 December 2017. Consequently, as of 2018, qualifying Swiss entities are required by law to file CbC reports on an annual basis.

The filing deadline is 12 months after the end of the respective business year (article 11 of the CbCR Law). Switzerland will thus exchange CbC reports with its partner states from 2020 and will be able to receive such reports from then at the latest.

Multinationals can voluntarily submit a CbC report for the 2016 and 2017 fiscal years, and the FTA started transferring the reports to partner states from 2018.

6. **Mutual agreement procedures (MAPs)**

The taxpayer can request a MAP based on a tax treaty if the treaty provides for a MAP. However, the taxpayer still has to exhaust all national possibilities for an appeal against the disputed tax assessment.

In accordance with the OECD Model Tax Convention, the taxpayer has to request the MAP within 3 years from the first notification of the action resulting in double taxation.

The competent authority to which a MAP application has to be addressed is the State Secretariat for International Financial Matters (SIF). The application must be made using the appropriate form as provided by the SIF.³

The taxpayer will not be party to the MAP. The negotiations will be conducted through authority channels and usually several cases will be dealt with at the same

time. If the tax treaty does not contain an arbitration clause, no conclusion of the MAP has to be reached by the involved states.

If the two countries have reached an agreement through a MAP, this will be grounds for a revision of a final tax assessment in Switzerland. On request of the taxpayer, the competent tax authority will adjust the tax assessment according to the mutual agreement between the two countries.

The payment of tax and interest will not be suspended by a MAP. If a mutual agreement is reached in favour of the taxpayer, tax payments will be refunded to the taxpayer, including interest.

7. Advance pricing agreements (APAs)

Unilateral APAs

All Swiss tax authorities traditionally grant advance tax rulings. This also includes unilateral APAs. There are no formal procedures. For reasons of proof such advance tax ruling requests are generally made in writing.

There is no legislation with regard to advance tax rulings or, specifically, advance transfer pricing agreements. Only article 82(1)(f) of the VAT Act alludes to the possibility of advance tax rulings. Case law and practice view advance tax rulings as official advice about a specific case given to the taxpayer by the competent tax authority upon which the taxpayer may rely under the bona fide principle.

The tax authority in charge of an advance tax ruling is the same authority which is in charge of the tax assessment. Therefore, the competent authority will depend on the place of business of the taxpayer. The SFTA has to be addressed for advance tax rulings concerning withholding tax, stamp duty, tax treaties and VAT. Advance tax ruling requests for income tax purposes have to be addressed to the tax authority in the canton in which the taxpayer is registered. Several cantonal tax authorities have published notices with regard to advance tax rulings containing general guidelines, the competent authority and the procedures to be followed.

In general, there are no filing fees for advance tax rulings. However, small administrative fees may be charged to the taxpayer.

Advance tax rulings are usually granted for an unlimited time, provided the circumstances remain the same as presented in the ruling request and there are no legislative changes or changes in the tax authorities’ practice. The taxpayer is under the obligation to notify the tax authority of any changes. The advance tax ruling will lose its validity if a significant change of circumstances has occurred. Usually, an advance tax ruling is valid from the time of the ruling request or the granting of the ruling. Rollbacks are allowed for all tax years that have not yet been finally assessed. Certain advance tax rulings are granted for a limited duration of time and have to be renewed after that. There are no limits to possible renewals.
Bilateral and multilateral APAs

Switzerland will participate in a bilateral or multilateral APA procedure with another country with which Switzerland has concluded a tax treaty containing a provision for mutual agreements. The competent tax authority for bilateral and multilateral APAs is the SFTA in collaboration with the SIF.

In general, there are no filing fees for advance tax rulings. However, there may be small administrative charges.

The procedure to be followed, the term or duration and possible rollbacks of bilateral and multilateral APAs will largely depend on the other country or countries involved. In principle, Switzerland allows unlimited APAs and rollbacks for all tax years not yet finally assessed.

8. Safe harbour provisions

Switzerland has safe harbour provisions for debt interest between related parties which are updated annually. The current safe harbour interest rates and the minimum interest spread for back-to-back financing are contained in the following circular letters:

- Circular Letter of 31 January 2019, containing safe harbour interest rates on Swiss franc-denominated loans to and from related parties (annual publication); and
- Circular Letter of 1 February 2019, containing safe harbour interest rates on loans in currencies other than the Swiss franc (annual publication).

Furthermore, Switzerland has safe harbour provisions for thin capitalization contained in SFTA Circular 6 of 6 June 1997. Based on an asset class test, the company debt capacity is determined. Intercompany debt exceeding this amount will be disallowed as deemed equity. Debt interest on deemed equity will be disallowed even if it is within the safe harbour interest rates. Therefore, intercompany interest has to be within the general safe harbour rates and the thin capitalization requirements.

Additional safe harbour provisions exist for the minimum remuneration for fiduciary arrangements (SFTA Notice S-02.107, reprint of 1993).

9. Transfer pricing audits

9.1. Burden of proof

As a general principle, the burden of proof lies with the party that makes the claim. For tax purposes, this means that the tax authority bears the burden of proof for circumstances increasing the tax liability, whereas the taxpayer bears the burden of proof for circumstances reducing the tax liability. Therefore, the taxpayer generally has to substantiate and corroborate all expenses. This means that, if challenged by the tax authority, the taxpayer has to demonstrate that any intercompany expense was based on sound economic and commercial reasoning and is at arm’s length.

Provided the financial statements filed with the tax return are formally correct, it is assumed by law that the content is also correct, unless there is evidence to the contrary. However, the taxpayer is obliged to provide the tax authority with any infor-
mation requested by the tax authority. The refusal to comply with such an information request will lead to a shifting of the burden of proof onto the taxpayer. Such a shifting of the burden of proof will also occur if no tax return has been filed or the filing is incomplete or formally incorrect. This means that basically the tax authority has to prove that intercompany income does not correspond to the arm’s length standard. The taxpayer will have to facilitate this task of the tax authority by providing any requested information with regard to intercompany and other income.

9.2. Statute of limitation

For income tax purposes, the tax authority has to claim an adjustment based on new facts within 10 years. The additional tax has to be determined and assessed within 15 years. Adjustments relating to tax losses can be made even without the detection of new facts during the loss carry-forward period of 7 years.

For purposes of withholding tax, stamp duty and VAT, the tax authority has to claim an adjustment within 5 years. Such a claim will cause the limitation period of 5 years to restart. VAT has an absolute statute of limitation of 10 years, whereas withholding tax and stamp duty do not have an absolute statute of limitation.

9.3. Desk and field audits

All Swiss tax authorities may request additional information from the taxpayer in the course of a tax assessment. The taxpayer is obliged by law to provide the requested information to the tax authority. Desk audits are made if the tax inspector in charge of assessing the company deems the additional information necessary for the tax assessment, often if extraordinary circumstances occur or on a random basis.

Field audits usually are made on a random basis or upon occurrence of extraordinary circumstances. However, the tax inspector in charge of assessing the company can request a field audit if he or she deems it necessary. The taxpayer is notified of the field audit in advance, rarely on a short-term basis. All documents relevant for taxation have to be disclosed to the inspector. The duration of the audit may vary and will depend on each individual case. Usually, a field audit takes a couple of days or up to a week, but rarely longer. Commonly, the inspector reviews the company accounts and all documentation connected to it, such as invoices, contracts, agreements and business correspondence. Interviews with key personnel are not common. Mostly, accounting personnel are asked about the records. It can be to the advantage of the taxpayer if a knowledgeable staff member or an outside tax professional can provide satisfactory answers to the inspector during the field audit. Findings of a field audit are commonly notified to other tax authorities, as well as to the social security authority.

Focus of tax audits is often on transactions with offshore entities, transfers of investments and intangibles and – especially in privately owned businesses – transactions with the ultimate individual shareholder.

Until an income tax assessment has been rendered the taxpayer can file for an adjustment of the tax return with the tax authority competent for the tax assessment. After the assessment has been rendered an adjustment can only be requested by filing an objection within a 30-day period. After that, an adjustment has to be formally re-
quested by the taxpayer based on new facts. An upwards adjustment will be accorded in most cases. A downwards adjustment, i.e. a revision of the tax assessment in favour of the taxpayer, will only be allowed under very restrictive conditions.

10. Penalties

There are no specific penalties for transfer pricing matters. The ordinary tax penalties will apply, as follows:

– disregard of procedural obligations by the taxpayer can lead to smaller fines;
– negligent and intentional tax evasion will be fined, usually in the amount of the tax evaded. In minor cases the fine can be reduced to a third of that amount; in severe cases it can be tripled; and
– tax fraud is punishable by prison.

Generally, penalties are measured according to the amount of tax involved, based on the severity of the act committed and the guilt of the taxpayer. Efforts in good faith of the taxpayer will also be taken into account.

Self-initiated penal proceedings will lead to a substantial reduction of the penalties. The voluntary disclosure of tax evasion will lead to a maximum fine of a fifth of the amount of tax evaded. The first voluntary disclosure will be completely penalty free.

Penalties, underpaid tax and late-payment interest have to be paid upon request by the tax authorities. Terms for payment are, in most cases, 30 days. Instalments can be negotiated with the tax authorities. However, interest on unpaid tax will continue to accrue as long as the original tax liabilities remain unpaid.

The law on CbC reporting provides penalties for non-filing, incorrect filing and late filing of reports, violation of the registration obligation and general non-compliance with the orders of the SFTA. In the case of an intentional offence, the fine may amount to a maximum of CHF 250,000 (article 24 of the CbCR Law).
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