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# Tax Penalties in Transfer Pricing

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# Abstract

The purpose of this thesis is to examine both the conditions for levying tax penalties in transfer pricing and the sustainability of the Swedish tax penalty framework in regard to transfer pricing in a post-BEPS world. This question is of relevance as BEPS has resulted in more extensive documentation requirements, affecting both the tax payer's tax assessment procedure and the Swedish Tax Agency's auditing practice.

Tax penalties were introduced in order to incentivize the tax payer to disclose relevant information for the tax assessment. The scope of relevant information is relative to the correction rule, which has a significant connection to the OECD and BEPS. This thesis concludes that in a post-BEPS world, relevant information relates to domestic developments of the correction rule produced by the legislator, case law and the Swedish Tax Agency. Furthermore, this thesis concludes that transfer pricing documentation in full compliance with the Swedish content requirements should greatly mitigate a tax payer's risk of being subjected to tax penalties.

Court rulings from the lower administrative courts regarding tax penalties in transfer pricing demonstrate contradictory views to that of statutory law, case law and preparatory works. These opposing views constitute the current framework of tax penalties in transfer pricing, which is neither sustainable nor appropriate. For this reason, the Swedish tax system requires either extensive case law or statutory reform on the subject. This thesis concludes that statutory reform would perhaps be the most appropriate development in light of certain aspects of the principle of legality. Proceeding from that conclusion, this thesis therefore presents two amendments to the Swedish tax penalty framework in regard to transfer pricing.



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*"No government can exist without taxation. This money must necessarily be levied on the people; and the grand art consists of levying so as not to oppress."*

Frederick the Great, 18th Century Prussian king

# 1 Introduction

## 1.1 Background

More and more Swedish companies are going global by engaging in international trade.<sup>1</sup> The Swedish Tax Agency ( "STA") estimate that almost 80% of global trade consist of intra-group transactions.<sup>2</sup> Consequentially, intra-group transactions contribute significantly to the Swedish GDP.<sup>3</sup> However, multinational enterprises ("MNEs") can abuse transfer pricing in their intra-group transactions for the purpose of tax evasion.<sup>4</sup> Given the importance of intra-group transactions to Sweden's tax base, sound transfer pricing regulation and practices are essential to further economic growth.<sup>5</sup>

Currently, Swedish transfer pricing rely on the arm's length principle to allocate the fair amount of tax revenue between jurisdictions.<sup>6</sup> However, as global value chains are becoming increasingly complex, so is determining the arm's length price for intra-group transactions.<sup>7</sup> In the recent years, a few notable events have made transfer pricing synonym with aggressive tax planning,<sup>8</sup> leading to a consensus that transfer pricing practices of MNEs must be adequately regulated in order to safeguard tax bases. These events contributed to the initiation of the Base Erosion and Profit Shifting project ("BEPS"), a joint effort within the international tax community that has among other objectives aimed to facilitate more sophisticated transfer pricing standards.<sup>9</sup> In today's environment, a MNE's transfer pricing policy must not only ensure that the transfer pricing is aligned to the arm's length principle but also that the relevant reporting standards<sup>10</sup> are met.<sup>11</sup>

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<sup>1</sup> EKN Dagens Industri 20/4 2018.

<sup>2</sup> The STA, *Internprissättning 2019* and *Handledning för beskattning av inkomst vid 2011 års taxering*, p. 1427.

<sup>3</sup> SCB *Sveriges Export* 06/3 2019.

<sup>4</sup> Monsenego, p. 5.

<sup>5</sup> Owens and Parry OECD Observer 2009.

<sup>6</sup> Monsenego, p. 12-16.

<sup>7</sup> Pagan and Wilkie, p. 32-34.

<sup>8</sup> Byrnes, Kluwer International Tax Blog 31/10 2016.

<sup>9</sup> OECD, *Actions 8-10 - 2015 Final Reports*, p. 13.

<sup>10</sup> These reporting standards vary per country but at a minimum usually consist of local file, master file and country-by-country reporting.

<sup>11</sup> Henshall, p. 7.

While the appropriate level of compliance burden is a subject of debate, there is consensus on applying penalties as an instrument to enforce transfer pricing provisions.<sup>12</sup>

The Swedish tax system has a general tax penalty framework in place for provision of incorrect information by the tax payer during the course of the tax assessment.<sup>13</sup> In transfer pricing, these tax penalties may be applied following adjustments of the tax payer's taxable income by the STA.<sup>14</sup> This general tax penalty framework has been favoured in place of implementing a tax penalty regulation specific to transfer pricing.<sup>15</sup> While the tax penalty framework applies to both associations and individuals, tax penalties in transfer pricing are only levied against associations. The current framework of tax penalties expects the associations conducting intra-group transactions to be well versed in transfer pricing regulation.<sup>16</sup> In the past years, tax penalties have been levied at a more frequent rate than before in transfer pricing cases.<sup>17</sup> Furthermore, it has been shown that the administrative courts demonstrate severe shortcomings in the process of levying tax penalties in regard to legal certainty and foreseeability.<sup>18</sup>

Given the consensus that transfer pricing provisions must be enforced and one of the ways to do so is through tax penalties, such a tax penalty framework should consider both the perspective of the STA and the tax payer. Thus, the framework of tax penalties in regard to transfer pricing cases must be administrable, proportionate and foreseeable. It is estimated that tax penalties contributed jurisdictions worldwide to realise additional revenue of EUR 93 billion in the period between 2009 and 2018.<sup>19</sup> However, some worry whether the marginal tax revenue gained by implementing an aggressive tax penalty system

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<sup>12</sup> Pagan and Wilkie, P. 72 and OECD, *Transfer Pricing Guidelines* (2017) p. 176.

<sup>13</sup> See Chapter 4 of this thesis for information on the term incorrect information.

<sup>14</sup> It is important to emphasize that tax penalties do not apply automatically in the case of an adjustment of the tax payer's income as there are further requisites to consider.

<sup>15</sup> Prop. 2005/06:169 p. 115.

<sup>16</sup> See prop. 1977/78:136 p. 154 as well as RÅ 1989 ref. 32, RÅ 1987 ref. 144, RÅ 2010 ref. 67 and HFD 2018 ref. 79.

<sup>17</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning* p. 7.

<sup>18</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, p. 27 and 33.

<sup>19</sup> *OECD Work on Taxation*, p. 4.

actually exceeds the generated compliance costs.<sup>20</sup> In Sweden, tax penalties are prevalent in transfer pricing audits to the degree that they can almost be viewed as a cost of doing business.<sup>21</sup>

During the process of writing this thesis, the Supreme Administrative Court of Sweden was set to deliver case law on the subject of tax penalties in transfer pricing.<sup>22</sup> The case was expected to deliver comprehensive guidance on the grounds for levying tax penalties in transfer pricing as it concerned the provision of incorrect information.<sup>23</sup> The Supreme Administrative Court delivered their ruling on June 19, 2019.<sup>24</sup> However, as the Supreme Administrative Court ruled in favour of the tax payer, the precedent only concerned a situation when tax penalties are not to be levied.<sup>25</sup> Therefore, comprehensive guidance on the grounds for levying tax penalties in transfer pricing cases is yet to be provided by the judiciary. In absence of such guidance, this thesis will hopefully deliver an adequate review of tax penalties in transfer pricing.

## 1.2 Purpose and Problem Statements

The overarching purpose of this thesis is to examine the grounds for levying tax penalties in transfer pricing cases and the sustainability of the Swedish tax penalty framework in regard to transfer pricing in a post-BEPS world. The purpose is also to provide a high-level review of the associated questions that appear as a result of the conclusions reached in this thesis.

Two problem statements will be answered in order to achieve the intended purpose of this thesis. These are as follows. First of all, what are the conditions for levying tax penalties in transfer pricing cases according to the Swedish tax system? Secondly, is the Swedish framework of tax penalties in transfer pricing sustainable in the sense that it provides the tax payer with a

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<sup>20</sup> Pagan and Wilkie p. 32.

<sup>21</sup> KPMG, *Sammanfattning från Skatteverkets informationsträff om internprissättning mm 13/12 2018*.

<sup>22</sup> Administrative Court of Appeal, Case 1610-16.

<sup>23</sup> Hellenius, Fokus på skatterna 04/10 2018.

<sup>24</sup> Supreme Administrative Court, case nr 1913-18.

<sup>25</sup> More specifically, the precedent concerned as to whether the STA had met the required burden of proof for demonstrating that the tax payer had provided incorrect information. The precedent is discussed further in section 4.5.

foreseeable and proportionate incentive to disclose relevant information for the tax assessment?

### 1.3 Delimitations

Tax penalties is a phenomenon that manifest differently between jurisdictions. However, the following delimitations have been made for the sake of delivering a meaningful thesis. Only tax penalties related to Swedish transfer pricing will be the focus of this paper. Although sanctions for tax crime in transfer pricing cases could be a related subject, it will not be addressed in this thesis. Tax penalties can be a result of four different scenarios according to Chapter 49, Article 4-6 and 8-9 of the Tax Procedures Act (“TPA”) (2011:1244). Tax penalties in the context of transfer pricing are only likely to occur in one of these four scenarios, which is when a tax payer has submitted incorrect information for their tax assessment.<sup>26</sup> Therefore, the other three scenarios are delimited. Furthermore, there is a debate within the international tax community of replacing the arm’s length principle with global formulary apportionment.<sup>27</sup> I assume that the arm’s length principle will continue to be the common standard for transfer pricing in this thesis.

The scope of this thesis is limited to the Swedish tax system but written in English. This is motivated by the desire to enlighten both Swedish and international transfer pricing professionals and scholars on the system of Swedish tax penalties and its application in transfer pricing. Furthermore, the conclusions reached in this thesis are probably not only of use for a Swedish audience, as both tax penalties and transfer pricing are a truly international field.<sup>28</sup>

Additional delimitations may be added in the subsequent chapters of this thesis.

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<sup>26</sup> Referred to as *Oriktig Uppgift* in Swedish, see section 1.6.

<sup>27</sup> OECD, *Transfer Pricing Guidelines* (2010), p. 11.6-1.32.

<sup>28</sup> Transfer Pricing is more harmonized than most areas of international tax law due to the efforts of the OECD’s *Transfer Pricing Guidelines*.

## 1.4 Method and Material

The method to be employed in this paper is the critical legal dogmatic method.<sup>29</sup> By “critical legal dogmatic method” I refer to the use of Swedish legal sources in order to conclude what the position of the law is in relation to the topic and problem statements.<sup>30</sup> The critical legal dogmatic method may assume different perspectives depending on the topic and/or author.<sup>31</sup> The judiciary perspective is assumed in this thesis (i.e. how would a rational Supreme Administrative Court levy tax penalties in transfer pricing cases).<sup>32</sup> A rational position to the question implies working towards a sustainable framework for levying tax penalties in transfer pricing cases. A *de lege ferenda* discussion will therefore be waged if the *de lege lata* discussion concludes that the current framework lacks sustainability. Here, it should be reiterated that the judiciary possesses a legislative mandate if current legislation fail to adequately address a certain situation.<sup>33</sup> Therefore, a critical mindset is essential to fulfilling the purpose of this thesis as the law<sup>34</sup> seem to offer no concrete guidance on the topic. However, as part of my *de lege ferenda* discussion I might propose statutory amendments to the current framework of tax penalties. Such proposals fall outside of the judiciary perspective and will therefore be discussed from a perspective of legal policy.

As mentioned in the previous section, this is a thesis in English on how the Swedish tax penalty framework relates to Swedish transfer pricing, which has been subject to considerable international influence in the past years.<sup>35</sup> The intended benefits of this choice of language notwithstanding, this introduces certain obstacles in regard to material. The bulk of the source material consist of Swedish sources that have developed a distinct terminology. In order to conduct an in-depth discussion, this terminology has been utilized. While borrowing the terminology as Swedish loan-words might have been an option, I have decided to

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<sup>29</sup> Kleineman, Rättsdogmatisk metod in Korling & Zamboni, *Juridisk metodlära*, p. 21.

<sup>30</sup> Olsen, *Rättsvetenskapliga perspektiv*, SvJT 2004, p. 116.

<sup>31</sup> Olsen, *Rättsvetenskapliga perspektiv*, SvJT 2004, p. 115-116.

<sup>32</sup> Olsen, *Rättsvetenskapliga perspektiv*, SvJT 2004, p. 114.

<sup>33</sup> Ramberg, *Prejudikat som Rättskälla*, SvJT 2017, p. 774.

<sup>34</sup> Here I refer to products of both the legislator and the Supreme Administrative Court.

<sup>35</sup> See Chapter 2 of this thesis.

translate this terminology into English as it facilitates a more comprehensible text. Also, this provides a university-published translation to terminology within a field that employs international professionals at both the STA and consulting firms.

For the purpose of examining what presupposes the levying of tax penalties in the context of Swedish transfer pricing framework, I will examine statutory law, preparatory documents, case law, doctrine and soft law such as the Transfer Pricing Guidelines (TPG).

As this is a paper on Swedish tax penalties, the primary legal sources consist of preparatory documents on Swedish law, which occupy a prominent position within the Swedish legal hierarchy.<sup>36</sup> Rulings from lower courts such as the Administrative Court and the Administrative Court of Appeal are on the other side of the spectrum as they are not usually granted the force of law. The same can be said of position statements from the STA.<sup>37</sup> Nevertheless, these court's rulings in cases regarding tax penalties within transfer pricing have been the catalyst of this thesis and the STA recently published a position statement on the topic at hand.<sup>38</sup> Therefore, these sources will be discussed for the purposes of examining the current framework of tax penalties in transfer pricing, providing a balanced analysis of the legal sources utilised and not for conclusions as to what the law is.

While this is a thesis on Swedish law, it is also a thesis regarding a subject in which the international field of transfer pricing play a key role. As mentioned, the TPG will therefore also be utilised as source material for a more nuanced discussion. This is motivated by the guideline's central role in shaping Swedish transfer pricing.<sup>39</sup> Furthermore, the TPG discuss tax penalties within transfer pricing which is very relevant to the topic at hand.<sup>40</sup> The TPG are developed by the Organisation of Economic Co-operation Development (OECD) and function as a more in-depth comment to Article 9 of the OECD Model Tax

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<sup>36</sup> Kleineman, *Rättsdogmatisk metod* in, *Korling & Zamboni*, *Juridisk metodlära*, p. 21.

<sup>37</sup> Pählsson, *Konstitutionell Skatterätt*, p. 105-117. According to Pählsson, position statements and administrative guidance may on the other hand serve as at least a useful indication of administrative practices of the STA.

<sup>38</sup> The STA, *Betydelsen av ett företags internprissättningsdokumentation för beslut om skattetillägg*.

<sup>39</sup> Burmeister, *Transfer Pricing Guidelines som rättskälla*, SvSkT 2016:6–7, p. 433.

<sup>40</sup> See Section 5.4.

Convention on Income and Capital.<sup>41</sup> While the TPG might provide guidance on the subject of tax penalties, the chosen method for this thesis begs the question as to what kind of status the TPG occupy within the Swedish legal hierarchy.<sup>42</sup> Case law, preparatory documents and doctrine discusses the possibility of consulting the TPG in applying the arm's length principle.<sup>43</sup> However, these sources do not provide a clear answer on whether this also extends to tax penalties in transfer pricing. This question is discussed further in-depth in section 2.5.

## 1.5 Earlier Research on the Topic

The subject of this thesis is certainly topical as it has provoked reactions from the Confederation of Swedish Enterprise, the Stockholm Chamber of Commerce, and the STA.<sup>44</sup> Furthermore, the subject is also examined in the TPG.<sup>45</sup> Lastly, as mentioned in section 1.1, the Supreme Administrative Court has delivered a ruling on the subject in case 1913-18. However, one can argue that there is a surprisingly small amount of academic research on the topic in Sweden. To the author's knowledge, the topic has not been the subject of any literature or doctoral thesis. The only research study identified which addresses the topic is a master thesis by Christoffer Baaz and Cesar Wahlbeck.<sup>46</sup> However, that thesis dates back to 2009, a point in time before the BEPS project and the Swedish reform on transfer pricing documentation.<sup>47</sup> While the conclusions reached in Baaz's and Wahlbeck's thesis are valid, they do not address the new landscape of the post-BEPS world. Furthermore, this thesis is differentiated through the proposition that there is a gap in the legislation and therefore opportunity to propose solutions steered towards a more sustainable framework for levying tax penalties in transfer pricing cases.

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<sup>41</sup> Article 9 is the OECD's version of the correction rule, see section 2.2.

<sup>42</sup> See Olsen, *Rättsvetenskapliga perspektiv*, p. 114. This discussion is warranted as the chosen method for this thesis limits the available source material to the same kind of sources available to the judiciary body.

<sup>43</sup> Burmeister, *Transfer Pricing Guidelines som rättskälla*, SvSkT 2016:6-7, p. 433.

<sup>44</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, Swedish Chamber of Commerce, *Rätt internprissättning inom bolag* and the STA, *Betydelsen av ett företags internprissättningsdokumentation för beslut om skattetillägg*.

<sup>45</sup> OECD, TPG p. 177.

<sup>46</sup> Baaz and Wahlbeck, *Skattetillägg i Internprissättningsprocesser – En studie av begreppet oriktig uppgift*, Internationella Handelshögskolan.

<sup>47</sup> Introduced in 2017, see Prop. 2016/17:47 p. 31-33.

## 1.6 Disposition

*Chapter One* establishes the scope of this thesis. One should be equipped with a basic understanding of transfer pricing regulation and recent developments within the field in order to understand the arguments delivered and conclusions reached in this thesis. Therefore, *Chapter Two* delivers a short summary on the field of transfer pricing and its position within the Swedish tax system. Those well acquainted with Swedish transfer pricing may proceed directly to Chapter Three. *Chapter Three* informs on the basic underlying logic of tax penalties, what fundamental principles govern them, and what the legal requisites are for levying tax penalties. *Chapter Four* follows up on the previous chapter by examining the theoretical and practical application of tax penalties in transfer pricing cases. More precisely, the legal requisites for levying tax penalties in transfer pricing cases and the extent of the scope of such tax penalties is evaluated. *Chapter Five* contain a more in-depth evaluation on the findings of Chapter Two, Three and, Four. Lastly, *Chapter Six* contain a comprehensive summary of the findings and conclusions reached in this thesis.

## 1.7 Definitions

This paper is directed at an international audience interested in the Swedish tax penalty framework, which consists of distinct terminology. Therefore, certain Swedish terms will be translated into English. The most important are the following.

The Swedish term *oriktig uppgift* as per Chapter 49, Article 4-5 of the TPA is vital to understanding the Swedish tax penalty system. The term is referred to as *incorrect information* in this thesis.

Perhaps equally important is the term *uppgiftsskyldighet* in Chapter 31, Article 3 of the TPA, which is replaced with *obligation to disclose*.

The same can be said for the STA's *utredningskyldighet* according to Chapter 40, Article 1 of the TPA, which is translated as the STA's *obligation to investigate*.

When using the term *tax penalty* in this thesis I mean to refer to Swedish tax penalties unless otherwise stated.

When discussing *aggressive tax planning*, I refer to transfer pricing practices intendedly in non-compliance with transfer pricing regulation or irreconcilable with the purposes of the legislator while the effect of said practice has not been intended by the legislator. There is no harmonised or statutory definition of what constitutes aggressive tax planning. In this thesis, the definition of the STA has been granted precedence over other definitions.<sup>48</sup>

In the context of this thesis the term *sustainable tax penalty framework* is used to describe a tax penalty framework that can continue or be continued for a long time. This implies a framework for levying tax penalties that succeeds in promoting MNEs to disclose relevant information for their tax assessment in a proportionate and foreseeable manner without imposing unnecessary compliance burden (both for the MNEs and STA) and/or hampering economic growth.

By *MNEs*, I refer to the category of legal persons covered by the Swedish local file and master file regulation according to Chapter 39, Article 15-16f of the TPA. These are legal persons and/or permanent establishments that are unlimitedly liable to tax in Sweden, employ over 250 people, either have an annual turnover over 450 million SEK or a balance sheet value of over 400 million SEK and transact with legal persons and/or permanent establishments that are limitedly liable to tax in Sweden. In this thesis I also discuss the situation of the small and medium sized enterprises (SMEs). By SMEs, I refer to legal persons that do not qualify for the local file and master file regulation due to the size of their staff, turnover or balance sheet value.

The above presents my definitions of terminology important to this thesis that lack a harmonised definition or have required translation. Terminology such as BEPS, Country-by-Country reporting (CbC), EBIT, the TPG etc. need no such explanation and are addressed where necessary as they appear in this thesis.

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<sup>48</sup> The STA, *Skatteverkets Verksamhetsplan*, p. 18.

## 2 Transfer Pricing in the Swedish Tax System

### 2.1 Introduction

Transfer prices affect cost and revenues on the financial statement and thereby the taxable income in the jurisdictions in which the MNEs are active. Therefore, transfer pricing is of immense importance to both MNEs and tax authorities.<sup>49</sup> Historically, transfer pricing regulation has enabled MNEs the opportunity to utilize transfer pricing as a tool to shift profits from value generating jurisdictions to low-tax jurisdictions.<sup>50</sup> This issue was acknowledged in the wake of the financial crisis of 2008, leading to considerable reform projects such as BEPS. This chapter explores the current field of transfer pricing and its Swedish characteristics in order to provide an overview of the area.

### 2.2 The Correction Rule

The Swedish general transfer pricing rule is frequently referred to as the *correction rule*. The correction rule has been part of the Swedish tax system since the first half of the 20<sup>th</sup> century, preceding its counterpart in Article 9 of the OECD Model Tax Convention on Income and Capital.<sup>51</sup> This early implementation of transfer pricing legislation was only to a small extent driven by a motivation to combat international profit shifting and base erosion. In the beginning of the 20<sup>th</sup> century, corporate tax was levied at the municipality level. Thus, if a company had subsidiaries across several municipalities, it was feared that some municipalities would lose out on their fair share of tax revenues.<sup>52</sup> The correction rule has persisted through various Swedish tax reforms, although with significant amendments. Today it only encompasses international transactions as a codification of the arm's length principle.<sup>53</sup>

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<sup>49</sup> STA, *Handledning för beskattning av inkomst vid 2011 års taxering*, p. 1427. However, it should be noted that the corporate tax only constitutes about 6% of the total Swedish tax base. One could wonder if the STA's assessment of transfer pricing's importance is slightly exaggerated.

<sup>50</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, p. 19.

<sup>51</sup> The correction rule as a statute was first proposed in 1916 in the Swedish Parliament and was later implemented in the predecessor to the Income Tax Act in 1928.

<sup>52</sup> Prop 1927:102, p. 232.

<sup>53</sup> Andersson & co., *The Income Tax Act, comment to Chapter 14, Article 19-20 (03/4 2019)*, Zeteo.

The correction rule is located in Chapter 14 Article 19 of the Swedish Income Tax Act (“ITA”) (1999:1229). The correction rule states that a tax payer’s taxable income is adjusted if the following criteria are met. Firstly, the taxable income of a Swedish enterprise must have been reduced due to terms in a transaction with an associated enterprise that deviates from what independent enterprises would have concluded. Secondly, the associated enterprise is not taxed in Sweden for the corresponding increase in taxable income. Thirdly, the terms of the transaction between the associated enterprises were concluded with no other intent than to obtain a tax advantage for the MNE. If these criteria are met, the result of the Swedish enterprise will be adjusted as if the terms were concluded between independent enterprises. For example, consider a Swedish enterprise selling goods below market value to an affiliated enterprise which has no tax liability in Sweden. If the discrepancy between the transacted price and market value cannot be motivated as business reasons, the Swedish enterprise’s taxable income will be adjusted upwards.<sup>54</sup>

### 2.3 The Science of Transfer Pricing

Transfer pricing is a multi-disciplinary field in the intersection between law, economics and accounting. This field is occasionally referred to as a science due to its associated complexities.<sup>55</sup> This section contains an introduction to the science of transfer pricing by presenting its key components: the transfer pricing methods and documentation requirements. The purpose is partly to provide a short summary for those not acquainted to transfer pricing but also to illustrate the challenges facing MNE’s and transfer pricing professionals, both on the consulting side and those on the side of the STA.

I will begin with a short introduction of the five transfer pricing methods. As discussed in the previous section, the correction rule is a codification of the arm’s length principle which requires that intra-group transactions are priced as if the transaction operated in arm’s length conditions. However, achieving arm’s

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<sup>54</sup> See for example Rå 1994 ref 85.

<sup>55</sup> Ablet, International Transfer Pricing Journal 16/1 2012.

length pricing is not a completely straight forward process as it is an artificial procedure. In the open marketplace, contracting parties approach a transaction with the same although opposing agenda, achieve the best price relative to their situation. In intra-group transactions, the MNE is negotiating with an imaginary opposing party. Although in reality, the MNE is negotiating with itself. Transfer pricing methods exist to facilitate the setting of arm's length compliant prices in these situations. The transfer pricing methods that are generally accepted in Sweden are derived from the TPG. Out of the five transfer pricing methods, three are so called transaction-based and two are profit-based.<sup>56</sup>

The first method is the comparable uncontrolled price ("CUP") method. The CUP method uses the price charged for property or services transferred in a comparable uncontrolled transaction as a basis for the price to be charged for property or services in a controlled transaction.<sup>57</sup> A comparable uncontrolled transaction refer to transactions made in comparable circumstances to that of the controlled transaction but by independent parties. A controlled transaction refers to a transaction between associated enterprises.

The second method is the resale price method. This method is appropriate for example for setting transfer prices for goods from suppliers to associated distributors. The calculation relies on the price at which an associated enterprise sells a product to a third party (the resale price). This price is subsequently reduced with a gross margin (the resale price margin) which results in the required transfer price. This gross margin is determined by comparing gross margins in comparable uncontrolled transactions, meaning that this method can only be used if comparable transactions are found. The resale price method is usually utilized by entities involved in sales and marketing.<sup>58</sup>

The third method is the cost-plus method. The cost-plus method is applied to transaction where costs are consistently a key driver of profit and there is an addition of value to a product, such as provision of services or

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<sup>56</sup> The comparable uncontrolled price, the resale price and cost-plus method are transaction based. The transactional net margin method and profit split method are profit based.

<sup>57</sup> See the TPG Chapter II, paragraph 2.6.

<sup>58</sup> Ceteris, *Guide to International Transfer Pricing*, Chapter 2, p. 10.

manufacturing.<sup>59</sup> The cost-plus method is calculated by taking the costs incurred by the associated supplier and adding a mark-up which is determined by identifying the mark-up in comparable transactions.

The fourth method is the transactional net margin method (“TNMM”). This method determines the arm’s length price by measuring the appropriate net profit in a controlled transaction of an associated enterprise. This net profit is determined by identifying comparable uncontrolled transactions and applying their net profit indicator to the controlled transaction of the associated enterprise. The net profit indicator is the ratio of net profit, usually EBIT<sup>60</sup>, relative to a given base (usually costs, sales or assets).<sup>61</sup> For example, if the comparable uncontrolled transaction has total costs of 800 SEK and an EBIT of 200 SEK, the net profit indicator is 0,25. If the controlled transaction has total costs of 400 SEK, the appropriate transfer price is 500 SEK ( $400 \text{ SEK}^{62} + (0,25 \times 400 \text{ SEK})^{63}$ ). An advantage of the TNMM is that it is generally applicable due to it being less affected by differences in functions and transaction price.<sup>64</sup>

The fifth and final method is the profit split method. By using the profit split method, profits are allocated to an entity in proportion to its contribution to the profits earned in the transaction.<sup>65</sup> The usability of the profit split method therefore presupposes that profits have been made, which is not always the case. Furthermore, there is a wide array of versions of the profit split method discussed at both the OECD level and within other organizations.<sup>66</sup> This does not mean that the profit split method is an inferior transfer pricing method. The profit split method offers more flexibility and may therefore actually accommodate the more complex value chains for which the other transfer pricing methods does not offer guidance. However, one could assume that this method does pose issues for the

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<sup>59</sup> Henshall, *Global Transfer Pricing, Principles and Practice*, p. 28.

<sup>60</sup> Earnings Before Interests and Taxes.

<sup>61</sup> Burmeister, *Internprissättning och Omkaraktärisering* p. 110.

<sup>62</sup> The cost of performing the service or manufacturing the good.

<sup>63</sup> The determined arm’s length profit of performing the service or manufacturing the good.

<sup>64</sup> Ceteris, *Guide to International Transfer Pricing*, Chapter 2, p. 13.

<sup>65</sup> Ceteris, *Guide to International Transfer Pricing*, Chapter 2, p. 13.

<sup>66</sup> See Deveraux and co., *Residual Profit Allocation by Income* as well as Andrus and Osterhuis, *Transfer Pricing after BEPS: Where Are We Now and Where Should We Be Going*, p. 102.

STA as the agency therefore has a “shifting”, rather than a standardized transfer pricing method to consider its audits.

It is generally accepted in the Swedish tax system that the criterion for applying the transfer pricing methods follows the TPG. This means that a transaction-based method is preferred over a profit-based method and the CUP method is the most preferred method if several transaction-based methods are applicable to the tested transaction. However, the STA recognizes that the choice of method is relative to the unique circumstances of the tested transaction. Thus, priority is given to the most appropriate method in relation to the tested transaction.<sup>67</sup> Therefore, the hierarchy of most/least preferred method mentioned above is not applied strictly. This is reflected in the fact that the TNMM is the most commonly used transfer pricing method.<sup>68</sup> The transfer pricing methods have a long history. However, the BEPS project has achieved tremendous advancements for the field of transfer pricing during the recent years. The most notable achievements of which is both the continued efforts on updating the TPG, as well as the newly introduced tools for the STA, such as CbC reporting, master file and local file.

CbC reporting regulation was implemented on April 1, 2017 in the TPA and Tax Procedures Regulation (“TPR”) (2011:1261). A taxpayer covered by the CbC regulation in TPA Chapter 33a and TPR Chapter 7, Paragraph 2a is required to file a CbC report within twelve months after the end of the tax payer’s financial year. Thus, for financial year 2019, the CbC report is to be submitted to the STA before end of year 2020.<sup>69</sup> The Swedish tax system also requires certain taxpayers (i.e. MNEs) to provide local file and master file documentation as per Chapter 39, Article 14-15 of the TPA. The regulation governing the documentation requirement is quite detailed and comprehensive. Furthermore, the regulation is also complemented by both administrative guidance from the STA as well as guidance from the TPG.<sup>70</sup> All in all, the taxpayers covered by the transfer pricing

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<sup>67</sup> STA, *Fem prismetoder i OECD:s riktlinjer (kapitel II)*.

<sup>68</sup> Burmeister, *Internprissättning och Omkaraktärisering*, p. 111.

<sup>69</sup> Assuming that the tax payer’s financial year is between January 1<sup>st</sup> – December 31<sup>st</sup> of 2019.

<sup>70</sup> STA, *Svenska Regler om Dokumentation* and OECD, TPG Chapter V.

documentation rules therefore face an extensive compliance burden imposed in an effort to deliver adequate information for the audit practices of the STA.<sup>71</sup> It is worth noting that this compliance burden is not incentivized through specific tax penalties. No penalties are imposed for late filing of the CbC report, master file or local file. Although, the STA can fine the tax payer for not complying with a request from the STA to provide the documentation according to TPA Chapter 37, Article 2 and Chapter 44, Article 2. Such fines may not be imposed if the tax payer might be subject to tax penalties in relation to the requested documentation as per Chapter 44, Article 3 of the TPA. Furthermore, no specific penalties apply for providing inadequate documentation relative to the documentation requirements in the TPR Chapter 9, Article 9-18 and the TPA Chapter 39, Article 16b-16c. Consequentially, tax penalties require an audit by the STA, an adjustment of the tax payer's income and that the tax payer has provided incorrect information. Incorrect information usually manifests in a failure on the taxpayer's part to fulfill her obligation to disclose by providing inadequate documentation for a correct tax assessment.<sup>72</sup> Only in that case will inadequate documentation result in a tax penalty.

This section has served to introduce the field of transfer pricing and its associated challenges. Going forward, it is worth reiterating that the Swedish tax system acknowledges transfer pricing to be a complex field.<sup>73</sup> In a post-BEPS world, both the burden of compliance and monitoring said compliance has become increasingly challenging. In this regard, case law from the Supreme Administrative Court is meant to provide guidance on the application of the arm's length principle.

## 2.4 Case Law on Transfer Pricing

The Swedish civil law system relies upon authoritative case law as necessary supplement to its statutes.<sup>74</sup> This section is provided not for the purpose of summarizing every Swedish court case on transfer pricing. The purpose of this

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<sup>71</sup> Prop. 2005/06:169 p. 115.

<sup>72</sup> The relation between incorrect information and the obligation to disclose is discussed in-depth in section 4.3.

<sup>73</sup> Prop. 2009/10:17 p. 21.

<sup>74</sup> Pålsson, *Konstitutionell Skatterätt*, p. 119 as well as Prop. 1971:45, p. 89.

section is rather to present the case law that has contributed to the application of the correction rule and thereby shaped Swedish transfer pricing. Thus, this section serves to introduce the reader to transfer pricing case law.

While the correction rule date back to the 1920s, relevant case law on the interpretation of the arm's length principle isn't introduced until 1991 through RÅ 1991 ref. 107 ("Shell"). In Shell, the TPG were introduced into the Swedish tax system.<sup>75</sup> This has had an effect on the tax payer's obligation to disclose, a matter of relevance to tax penalties. It was also stated in Shell that an examination as to if a transfer price was arm's length should consider whether the financial years preceding or succeeding the year in review balanced out potential discrepancy between the transfer price and the arm's length price. Furthermore, transfer pricing of interest rates has been a frequent topic in the Supreme Administrative Court. Case law has established that the correction rule allows for interest free loans in certain cases as that may be in accordance with the arm's length principle.<sup>76</sup> Also, one of the more notable transfer pricing cases concluded that an intra-group loan to a subsidiary can be considered low-risk and therefore merit a lower interest rate due to the parent company's insight into the creditor.<sup>77</sup> Both of the above cases signify that in order to apply the correction rule and subsequently discuss tax penalties, the STA must demonstrate that the conditions of a transaction is not arm's-length, rather than simply showcasing a more arm's-length alternative. The correction rule is also applicable when a contract is prematurely replaced by a new contract containing terms that are less favorable for the Swedish entity but still arm's length, for which the opposite party is not compensated.<sup>78</sup> The above precedent entail that the STA may proceed to discuss tax penalties if the agency can prove that the Swedish entity has acted contrary to how independent enterprises would. Adjustments as per the correction rule also requires a demonstration that a deviation from the standard price has negatively affected the Swedish legal person's business profits.<sup>79</sup> This precedent, along with

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<sup>75</sup> The implications of this is to be further explored in section 2.5.

<sup>76</sup> Regr 4928-1996.

<sup>77</sup> RÅ 2010 ref 67.

<sup>78</sup> HFD 2016 ref. 45.

<sup>79</sup> RÅ 2004 ref. 13.

many others, signifies that the STA must meet a rather high burden of proof before imposition of tax penalties can be a subject of the proceedings.

## 2.5 OECD Transfer Pricing Guidelines as a Legal Source

In order to utilize the TPG as input for an analysis on the sustainability of the framework of tax penalties in transfer pricing, it is required to evaluate whether the TPG could serve as a source on the subject.

In transfer pricing, case law simply refers to Shell, concluding that the TPG can serve as useful guidance for interpretation of the arm's length principle.<sup>80</sup> Thus, the TPG has at least an impact on the contents of the tax payer's obligation to disclose.<sup>81</sup> The possibility to employ the TPG in interpreting domestic law has also been extensively discussed in doctrine. The consensus in doctrine seems to be that the TPG should provide useful guidance for the domestic law if the correction rule and the OECD Model Tax Convention on Income and Capital are based on the same underlying principles.<sup>82</sup> As that is considered to be the case, the TPG should constitute viable guidance for the interpretation of domestic law.<sup>83</sup>

The issue at hand lies in the fact that the scope of the Shell precedent extends to the application of the arm's length principle regarding adjustments as per the correction rule. The essential criteria for levying tax penalties is provision of incorrect information by the tax payer.<sup>84</sup> Adjustments under the correction rule and tax penalties do not presuppose the same requisites in order to apply. However, tax penalties are only imposed following an adjustment of the tax payer's income. That being said, tax penalties should best be seen as an indirect consequence of the tax payer's interpretation of the arm's length principle.

Bearing the above in mind, is the indirect relation between the arm's length principle and tax penalties sufficient for the TPG to be considered as a viable legal source on the topic? The Supreme Administrative Court's state in

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<sup>80</sup> See for example RÅ 2010 ref. 67.

<sup>81</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, p. 5.

<sup>82</sup> See Bjuvberg, *Rättskällevärdet av OECD:s modellavtal – synen på förhållandet mellan modellavtalet och Wienkonventionen i litteraturen*, SvSkT 2015:2, p. 115, Dahlberg, *Internationell beskattning*, p. 279 and Burmeister, *Internprissättning och omkaraktisering*, p. 192.

<sup>83</sup> Burmeister, *Internprissättning och omkaraktisering*, p. 199.

<sup>84</sup> See section 4.3.

Shell that the TPG is relevant to serve as useful guidance for the arm's length principle.<sup>85</sup> Therefore, directly relying on the Shell precedent for support to use the TPG as guidance on evaluating a sustainable application of tax penalties in transfer pricing would be a dubious proposition. A solution to the dilemma of trying to overextend the scope of a precedent could be to instead turn to the actual arguments put forth in that case for guidance. The reasoning in Shell reached the conclusion that the TPG provide well founded guidance on the (complex) subject of arm's length pricing and should therefore be relied upon as non-binding guidance in applying the correction rule as long as the TPG don't contradict Swedish law.<sup>86</sup> Such reasoning could be applied on the topic of this thesis as well. My conclusion would therefore be that the TPG could be relied upon as a source for applying tax penalties in transfer pricing. This conclusion assumes that the TPG does not contradict Swedish legislation and said legislation fail to provide adequate guidance on the topic. Furthermore, the application of the TPG has also been a subject in preparatory works regarding the transfer pricing requirements.<sup>87</sup> Therein it is stated that the TPG provides valuable guidance regarding the complexities associated with transfer pricing that faces both the tax payer and the STA. Given that transfer pricing documentation entail certain implications for tax penalties, one could argue that preparatory works imply that the TPG constitute a viable source for this topic.

Finally, although the OECD has issued updated versions of the TPG which succeeds the version in Shell, these updated versions still constitute a viable source in compliance with the Shell precedent according case law and doctrine.<sup>88</sup>

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<sup>85</sup> Shell, paragraph 5.4.

<sup>86</sup> Shell, paragraph 5.3.

<sup>87</sup> Prop. 2005/06:169, s. 89 and prop. 2016/17:47, s. 29

<sup>88</sup> See HFD 2016 ref. 45 where the Supreme Administrative Court applies an updated version of the TPG compared to the version in Shell. See also Hultqvist & Wiman, BEPS – *Implementering i svensk skatterätt*, SvSkT 2015:4, s. 321.

## 2.6 Summary

This chapter has hopefully managed to introduce those unacquainted to the subject of transfer pricing and its Swedish implementation. A short summary of the important takeaways is listed below.

Swedish transfer pricing is certainly not new. However, nearly a century of transfer pricing statutes has not been enough to counter certain challenges. In order to facilitate sustainable transfer pricing practices, a common ground between the MNEs and the STA on the applications of the arm's length principle was required. The solution consisted of embracing the TPG into the Swedish legal hierarchy, thereby granting the body of the OECD a certain status. Embracing the TPG into the Swedish tax system has entailed that both the tax payer and STA must consider this voluminous and intricate guidance from the OECD. However, these negative aspects should be considered as outweighed by the benefit of tax payers and the STA having comprehensive guidance at their disposal in this complex and abstract area of tax law. Especially as the alternative would most likely be a fragmented application of the arm's length principle. An increasingly globalized and complex economy has introduced intricate value chains within MNEs. Even equipped with the TPG, the compliance to the arm's length principle of these value chains are not entirely simple to ascertain for neither the STA nor the tax payer.

The decision to reservedly adopt the TPG, along with Sweden's commitment to the BEPS project has led to a near dualistic legislative process where the products of the OECD find their way into Swedish legislation in the shape of amongst others, documentation requirements. While the wisdom of the legislator's adoption of this route can be debated, reflection as to how this relates to tax penalties has not been the subject of much debate. This relation is to be explored in Chapter 4, following an introduction to tax penalties in the coming chapter.

## 3 Tax Penalties

### 3.1 Introduction

Tax penalties vary across jurisdictions in purpose, form and scope. The Swedish framework of tax penalties as we know it today date back to 1972.<sup>89</sup> The express purpose of introducing tax penalties at that time was to incentivize the tax payer to fulfil her obligation to disclose by leveraging on financial penalties.<sup>90</sup> The legal framework of tax penalties has been subject to considerable reform since. Part of which in order to ensure compliance with the European Convention of Human Rights (the “Convention”).<sup>91</sup> These reforms notwithstanding, the purpose of incentivization holds true still and has proven so effective that the scope tax penalties is on a path of expansion, rather than retraction.<sup>92</sup>

### 3.2 The need for tax penalties

Upon the incorporation of tax penalties into the Swedish tax system, penalties were meant to follow as a direct result of violations against the obligation to disclose in the tax return by the tax payer.<sup>93</sup> However, it was deemed necessary to implement an escape clause that grants the tax payer a reprieve from tax penalties in certain situations.<sup>94</sup> This escape clause is to be applied by the STA or the appellation courts if there is any inclination that the situation at hand merits it.<sup>95</sup>

The scope of tax penalties was to target situations where the tax payer may obtain a lesser tax burden by communicating or failure to communicate certain information.<sup>96</sup> Today, the STA is only required to demonstrate such a causality in cases concerning supplementary taxation.<sup>97</sup>

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<sup>89</sup> Prop. 1971:10 p. 2.

<sup>90</sup> Prop. 1971:10 p. 95.

<sup>91</sup> See Almgren & Leidhammar, *Skatteprocessen*, p. 191, and Simon-Almendal, *Företrädaransvar, plötsligt händer det! – Eller proportionalitet och begreppsutfyllnad i HFD*, *Skattenytt* 2017 p. 647 as well as prop. 2002/03:106 p. 72 and p. 142, prop. 2005/06:169 p. 116, prop. 2010/11:165 p. 438.

<sup>92</sup> See for example the proposition to expand the scope of tax penalties in Prop. 2017/18:144 p. 32.

<sup>93</sup> Prop. 1971:10 p. 55.

<sup>94</sup> Prop. 1971:10 p. 98.

<sup>95</sup> Prop. 1977/78:136 p. 54-55.

<sup>96</sup> Prop. 1977/78:136 p. 49.

<sup>97</sup> Almgren & Leidhammar, *The Procedural Tax Act, comment to Chapter 49, Article 4-5* (10/5 2019), Zeteo.

Taking the above into account, the legislator has clearly stated that tax penalties are to be used as an instrument to achieve a society where the tax payer submits all the necessary information for a correct tax assessment. Whether this vision has been followed through in statutory law is examined in the next section

### 3.3 Requisites for tax penalties – incorrect information

Incorrect information is the main requisite for the levying of tax penalties as per Chapter 49, Article 4-5 of the TPA. Incorrect information could either consist of disclosure of factually incorrect information (TPA Chapter 49, Article 5, paragraph 1, point 1) or the omittance of information relevant to the tax assessment (TPA Chapter 49, Article 5, paragraph 1, point 2). If the tax payer has either provided or omitted such information, it will not be considered incorrect information if the STA can make a correct tax assessment based on other information provided by the tax payer (TPA Chapter 49, Article 5, paragraph 2, point 1). Conduct under paragraph 1 will also not amount to incorrect information if the information provided by the tax payer is inconsistent or incomplete to the degree that the STA has an obligation to investigate further in order to arrive at any form of correct tax assessment (TPA Chapter 49, Article 5, paragraph 2, point 1).<sup>98</sup> The above illustrates that the imposition of tax penalties depend on the tax payer's compliance with the obligation to disclose. However, is the tax penalty a fiscal incentive for compliance or rather a punitive deterrence for non-compliance? This is examined in the next section.

### 3.4 The Legal Character of Tax Penalties

A tax penalty consists of a financial burden placed on the individual by society, an intrusion which warrants that certain principals are considered. At a minimum, compliance with the constitution and international commitments are required in order for tax penalties to be accepted in a society governed by the rule of law. In

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<sup>98</sup> Almgren & Leidhammar, *The Procedural Tax Act, comment to Chapter 49, Article 5* (10/5 2019), Zeteo.

order to facilitate an informed discussion on tax penalties in this thesis, it is necessary to examine their character as a sanction within the tax system.

The legislator views tax penalties as an economic administrative sanction, to be levied upon individuals that fail to fulfill their obligations stemming from their status as tax payers.<sup>99</sup> The classification of economic administrative sanction is reiterated by the STA.<sup>100</sup> With the introduction of the Convention and its subsequent adoption into Swedish Law, the Swedish classification came under scrutiny.

Article 6 of the Convention, and its associated protocols grants certain rights in trials regarding criminal proceedings. The Convention applies not only to individuals, but also legal persons.<sup>101</sup> The Swedish implementation of the Convention assures the same rights in Swedish proceedings. This posed the question as to whether Article 6 and its associated protocols applied to proceedings concerning tax penalties levied against legal persons. The Supreme Administrative Court ruled in case RÅ 2000 ref. 66 I that even though tax penalties are characterized as an administrative sanction within the Swedish tax system, they are covered by the Convention as the tax penalty is a sanction possessing punitive and deterrent characteristics. The same question was later on brought before the European Court of Human Rights (ECHR) in case *Janosevic v. Sweden* 2002-07-23. The ECHR, acknowledging the wide scope of what constitutes a criminal offence under the Convention, ruled that tax penalties are applicable under the Convention as the nature of the penalties are both deterrent and punitive, the latter being the distinguishing feature of a criminal penalty.<sup>102</sup>

In conclusion, a legal definition which adequately reflects the tax penalty's character and status has not been produced via case law. The Supreme Administrative Court has defined it as an administrative sanction that is encompassed by the Convention considering its punitive characteristic. The ECHR, which has no mandate to alone dictate Swedish tax law, does not define

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<sup>99</sup> Prop. 2002/03:106 s. 50.

<sup>100</sup> The STA, Rättslig Vägledning, 2019, *I vilka situationer kan man ta ut ett skattetillägg?*

<sup>101</sup> Rosenquist, page 14.

<sup>102</sup> *Janosevic v. Sweden* 2002-07-23, paragraph 51.

the tax penalties whatsoever besides pointing out that the tax penalty contain an element similar to criminal penalties. However, leveraging on the reasoning of the Supreme Administrative Court and the ECHR, one conclusion could be that the legal character of the Swedish tax penalty is somewhere in the realm between an administrative sanction and a criminal penalty. The tax penalty is purely levied based on objective criteria, requiring neither intent nor negligence. Furthermore, the tax penalty exists for the purpose of deterring the subjected tax payer and other tax payer from committing the same offence. Thus, the most appropriate description of the tax penalty ought to be a deterrent administrative sanction, stemming from both the traditions of tax law and criminal law.

### 3.5 Tax Penalties and the Principle of Legality

As discussed in the previous section, tax penalties can be best described as a deterrent administrative sanction levied on tax payers. Given that tax penalties belong to the realm of tax law, they should adhere to its fundamental principles. These will be examined in this section in order to provide the necessary conditions for a subsequent discussion regarding sustainable tax penalties in transfer pricing.

The most important fundamental principle is the principle of legality.<sup>103</sup> This principle is also fundamental to criminal law, which as seen in section 3.2 is also relevant to the subject of tax penalties. The principle of legality is codified in Chapter 8, Article 2 of the Constitution (1974:152). However, doctrine has compartmentalized the principle into four aspects to facilitate a more practical application.<sup>104</sup> These four aspects being the regulatory requirement, the ban on analogue application, the ban on retroactive taxation and legal certainty.

Tax penalties are regulated in Chapter 49 of the Procedural Tax Act. Chapter 49, Article 4 states that tax penalties are levied if incorrect information has been provided during the course of the tax payer's tax assessment, which is defined in Article 5.<sup>105</sup> Article 10 stipulates the events in which a tax penalty is not to be levied. Article 11-14 regulates the size of the tax penalties, which are to be

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<sup>103</sup> Pahlsson, Skattenytt, *Principer eller regler? Legalitet och Likabehandling i beskattningen*, p. 569.

<sup>104</sup> See Hultqvist, *Hur vag får en skattelagstiftning va*, p. 9.

<sup>105</sup> The other grounds for imposing tax penalties are not mentioned due to the delimitations of this thesis.

levied at 40% of the additional tax owed or 10% of the decrease in deficit following the adjustment. The statutory requisites for levying tax penalties above ought to satisfy the regulatory requirement.

The ban on analogue application relates to the regulatory requirement in a sense. According to this aspect of the principle of legality, regulation governing a certain “covered” situation can’t be applied to another situation, even if the circumstances in the latter situation resemble those in the covered situation. This is unless that would be a reasonable interpretation of the law.<sup>106</sup> The ban on analogue application is not really directed at the legislator as it rather focuses on the application of the law at the STA and courts. This aspect is certainly relevant for this thesis even though Chapter 49, Article 4-5 of the TPA applies to transfer pricing cases. If the general tax penalty regulation is evidently ill-fitted for transfer pricing, the ban on analogue application ought to be reiterated in order to initiate a discussion for other more sustainable solutions.

The ban on retroactive taxation is also codified in the Constitution as per Chapter 8, Article 2 (1974:152). This ban prohibits taxes to be levied further than the regulation at the period in time in question allowed. This aspect of the principle of legality is of little consequence to this thesis as tax penalties do not possess the legal character of a tax.<sup>107</sup>

The aspect of legal certainty aims to ensure that a regulation is not granted a too wide scope. In other words, there is no point in requiring statutes in order to levy taxes or tax penalties if these can be imposed in any kind of situation as a result of said statutes.<sup>108</sup> Accordingly, a tax system under the rule of law should offer a much higher degree of foreseeability. This aspect is well worth remembering in the coming chapters when evaluating whether the current framework of tax penalties in transfer pricing is sustainable.

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<sup>106</sup> Hultqvist, *Hur vag får en skattelagstiftning va*, p. 9.

<sup>107</sup> See Section 3.4.

<sup>108</sup> Hultqvist, *Hur vag får en skattelagstiftning va*, p. 12.

### 3.6 Summary

This chapter has served to explain why tax penalties are needed, how they are levied, what they are, and what consideration must be made in order to ensure that they comply with the constitution and the relevant principles of tax law.

Tax penalties exist to ensure that the tax payer submit all the necessary information for a correct tax assessment, although certain lacking disclosure may not result in tax penalties depending on the situation. The tax penalties as they are regulated in their current classification as a deterrent administrative sanction is compliant with the constitution. However, as the European Convention of Human Rights applies to tax penalties, all proceedings concerning the levying of tax penalties must satisfy the rights granted in the Convention. Tax penalties also occupy a position within Swedish tax law which entails that the levying of said penalties presuppose that the principle of legality is complied with. Out of the four aspects constituting the principle of legality, the aspect of legal certainty and the ban on analogue application are the most important to consider going forward. Both of these aspects will feature in examining the conditions for levying tax penalties in transfer pricing as well as in evaluating the sustainability of the Swedish tax penalty framework in regard to transfer pricing. In the coming chapter, the applications of tax penalties in transfer pricing and the dilemmas associated by that relation will be examined.

## 4 Tax Penalties in Transfer Pricing

### 4.1 Introduction

This chapter explores the relation between transfer pricing and tax penalties.

Chapter Two illustrated that transfer pricing compliance revolves around demonstrating adequate evidence that the transfer price of a transaction is arm's length. Chapter Three demonstrated that tax penalties are levied in the case of the tax payer failing to provide the *necessary information* for the tax assessment. The object of this chapter is thus to evaluate what necessary information should encompass from a transfer pricing perspective. Bearing the legal dogmatic method in mind, relevant statutes and their preparatory documents as well as case law will be examined for the purposes of examining the requisites for levying tax penalties in transfer pricing cases.

### 4.2 Statutory Law

As mentioned in section 3.1, tax penalties pose an incentive to fulfill the obligation to disclose. If incorrect information is provided or relevant information for a correct tax assessment is omitted, the tax payer may have provided incorrect information, for which tax penalties may follow. The wider scope of the obligation to disclose is established in statute through Chapter 31, Article 3 of the TPA. The statute establishes a broad scope for the obligation to disclose by declaring that the tax payer should provide any information necessary for the STA to deliver a correct tax assessment to the tax payer. In regard to transfer pricing, the obligation to disclose is also supplemented for certain tax payers by more precise local file and master file regulation in Chapter 39, Article 14-15, as well as CbC reporting regulation in Chapter 33 a of the TPA. By observing the relevant statutes above, the obligation to disclose seemingly consist of two levels. A general one which operates as a catch-all in Chapter 31, Article 3, and a more specific one which directly relates to transfer pricing documentation in Chapter 39 and 33 a.<sup>109</sup>

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<sup>109</sup> What constitutes a correct tax assessment should be viewed in the light of Chapter 14, Article 19 of the ITA. See Almgren & Leidhammar, *The Procedural Tax Act, comment to Chapter 31, Article 1* (10/5 2019), Zetco.

The boundaries of the obligation to disclose in relation to transfer pricing documentation is seemingly straight forward. All that is required is to provide the STA with CbC documentation as per Chapter 33 a of the TPA and submit a local file and master file upon the STA's request as per Chapter 37, Article 2 and Chapter 44, Article 2 of the TPA.<sup>110</sup>

When it comes to the obligation to disclose as regulated by the catch-all in Chapter 31, Article 3 of the TPA, the boundaries appear less clear-cut. Nevertheless, the question that must be answered is what kind of reach the catch-all in Chapter 31, Article 3 has in regard to transfer pricing?

In answering the question just stated, one should bear in mind the age difference in the trinity of the correction rule, tax penalties and transfer pricing documentation, ranking from oldest to youngest. The TPA has been the subject of scattered reform since the introduction of tax penalties as Sweden has introduced new legislation as a result of both domestic and international initiatives.<sup>111</sup> A possible conclusion could very well be that Chapter 31, Article 3 of the TPA is made redundant in transfer pricing cases by the more specific transfer pricing documentation requirements that have been put in place. However, not all tax payers are covered by the documentation requirements in Chapter 39, Article 14-15 (local file and master file as well as Chapter 33 a (CbC reporting) of the TPA. Therefore, the general obligation to disclose provision in Chapter 31, Article 3 maintains relevance. Although, one could wonder whether Chapter 31, Article 3 also maintains relevance for those taxpayers covered by the documentation requirements.

It is also relevant to clarify that the obligation to disclose in transfer pricing focus on valuation/pricing data.<sup>112</sup> As opposed to the obligation to disclose in other areas of tax law, such data is subject to subjective considerations. This introduces certain difficulties as to what ought to be disclosed as tax penalties are levied on objective grounds.<sup>113</sup>

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<sup>110</sup> Prop. 2009/10:17 Page 97.

<sup>111</sup> See for example Prop. 2005/06:169 and Prop. 2009/10:17.

<sup>112</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, p. 4.

<sup>113</sup> Almgren & Leidhammar, *The Procedural Tax Act, comment to Chapter 49, Article 4* (10/5 2019), Zeteo.

For guidance on the reach of the catch all in Chapter 31, Article 3, the best course of action is to turn to the preparatory works of both the statute aforementioned, and that of the statutes governing tax penalties, local file, master file and CbC-reporting as well as relevant case law. This examination will be conducted in the following section.

## 4.3 Requisites for Levying Tax Penalties in Transfer Pricing

### 4.3.1 The Obligation to Disclose

As established previously, tax penalties were introduced to incentivize the tax payer to provide the STA with all the necessary information for a correct tax assessment. In other words, tax penalties encourage the tax payer to fulfill her obligation to disclose. The obligation to disclose is therefore a key aspect in determining as to whether the tax payer has provided incorrect information and thus may be subjected to tax penalties.

Statutory law and case law from the Supreme Administrative Court inform that the obligation to disclose extends to disclosure of factual circumstances surrounding the tax payer's profit and loss statement.<sup>114</sup> The tax payer's obligation to disclose in the context of transfer pricing is connected to regulation related to the correction rule.<sup>115</sup> Thus, it is sufficient that the tax payer informs the STA of accurate and relevant facts for a correct tax assessment related to the intra-group transactions in order to meet the obligation to disclose. Implying that such a disclosure has been made where in fact relevant information is undisclosed, constitutes a breach of the obligation to disclose.<sup>116</sup> However, the tax payer may not safeguard against such a scenario by disclosing vast amounts of data containing irrelevant surplus information for the tax assessment as that would complicate the STA's process.

As transfer pricing cases occasionally entail complex transactions, the boundaries of the obligation to disclose could be difficult to discern. It is in these

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<sup>114</sup> Prop. 2010/11:65 p. 817.

<sup>115</sup> See Almgren & Leidhammar, *The Procedural Tax Act, comment to Chapter 31, Article 1* (10/5 2019), Zeteo.

<sup>116</sup> Prop. 2002/03:106 p. 116.

cases that the tax payer might instead opt to “prune” the obligation to disclose by triggering the STA’s obligation to investigate, in order to mitigate tax penalties.<sup>117</sup>

#### 4.3.2 The STA’s Obligation to Investigate

For transactions that implies technical and complicated considerations to be made requiring in-depth knowledge, the tax payer may alternatively resort to trigger the STA’s obligation to investigate in order to fulfill the obligation to disclose.<sup>118</sup> This action requires the tax payer to disclose sufficient information in order to alert the STA of the transfer pricing issue.<sup>119</sup> Furthermore, in order to trigger the STA’s obligation to investigate, it is required that the tax payer informs on her own viewpoint on the issue at hand, so as to put the STA on track.<sup>120</sup>

Consequentially, the obligation to disclose in Chapter 31, Article 3 of the TPA does not have unlimited reach but is limited in two stages. The tax payer is either limited to an obligation to disclose all factual circumstances that are deemed relevant in relation to the correction rule. Alternatively, in very complex transfer pricing cases it is sufficient that the tax payer instead discloses a short summary of the relevant known facts of the transaction along with a notification that a complex transfer pricing case is at hand and the tax payer’s take on it. In certain cases, if the tax payer has attempted to fulfill her obligation to disclose according to the former alternative and in the process of doing so also provided contradictory or incomplete information, that may also trigger the STA’s obligation to investigate. However, case law demonstrates that such an outcome requires that the tax payer discloses a rather significant amount of information, constituting a genuine attempt to meet the obligation to disclose.<sup>121</sup>

While this conclusion provides some answers, the implications of the key phrase *relevant facts* is not yet discerned. What relevant facts entail ought to be examined in order to answer problem statement one, as it is apparent that what

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<sup>117</sup> It is worth to clarify that this action only affects the risk of tax penalties and does nothing to prevent adjustments by the STA.

<sup>118</sup> Persson Österman & Hansson, *Skattetilläg i internprissättningsmål*, p. 6.

<sup>119</sup> RÅ 2003 ref. 4.

<sup>120</sup> This conduct is often referred as “laying puzzle” for the STA so that they are able to see the picture, or at least the tax payer’s perception of it.

<sup>121</sup> RÅ 2002 ref. 20 and RÅ 2003 ref. 4 and ref. 22.

lies beyond relevant facts is also beyond the scope of tax penalties. Therefore, the scope of “relevant facts” from a transfer pricing context will be examined in the following section in order to provide a review of the requisites for levying tax penalties in transfer pricing.

#### 4.3.3 Incorrect Information

It is important to note that whether the obligation to disclose has been met by the tax payer is not the entirety of the issue in tax penalty cases. Rather, the question is often concerning the provision of incorrect information, in which the obligation to disclose is a subtopic relative to the STA’s obligation to investigate. Tax penalties may only be levied in the case of provision of incorrect information by the tax payer; the obligation to disclose is therefore only breached in the case of incorrect information having been provided. Accordingly, there is a close relation between the obligation to disclose and the provision of incorrect information.<sup>122</sup> Therefore, the answer to the question as to what the relevant facts are that the tax payer must disclose is found in case law and preparatory works regarding incorrect information.

Incorrect information is the main requisite for the levying of tax penalties as per Chapter 49, Article 4-5 of the TPA. The burden of proof for confirming that incorrect information has been provided by the tax payer lies with the STA. To meet the burden of proof, it must be established that it is apparently clear that incorrect information has been provided.<sup>123</sup> Whether incorrect information has been provided is largely determined on the fulfillment of the tax payer’s obligation to disclose. As the STA may only prove provision of incorrect information if it has an idea as to what the tax payer must disclose, the scope of the obligation to disclose is much discussed in preparatory works. This brings us to the subject of what relevant facts entail in the context of the tax payer’s obligation to disclose.

The scope of relevant facts is clarified in preparatory works. The tax payer’s obligation to disclose is quite extensive as the tax payer must have a certain

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<sup>122</sup> Prop. 1977/78:136 p. 154.

<sup>123</sup> Prop. 2002/03:106 s. 233.

knowledge of the statutes affecting the tax payer's tax position.<sup>124</sup> From a transfer pricing perspective, this would probably entail a comprehensive obligation for the tax payer to acquaint herself with not only Swedish transfer pricing, but also materials from the OECD such as the TPG.<sup>125</sup> Where it that relevant facts has such a wide scope, it would place quite a burdensome obligation to disclose on the tax payer. On the other hand, it would mean that relevant facts would be established by an informed source on the subject. New case law sheds light on this issue through HFD 2018 ref 79. Although the case concerned profit allocation to permanent establishments, the precedent also ought to extend to transfer pricing via the separate entity approach in Article 7 of the OECD Model Tax Convention on Income and Capital. In the case at hand, the Supreme Administrative Court stated that the requisites for profit allocation according to a report by the OECD was not encompassed by the tax payer's obligation to disclose until the STA had issued their own position statement as a result of that report. Furthermore, if a tax payer pleads for a certain tax outcome but clearly lacks functions which the STA views as prerequisites for such an outcome, the STA's obligation to investigate is triggered. In other words, as the tax payer provided contradictory/incomplete information, the STA's obligation to investigate was triggered. Thus, the scope of the obligation to disclose should only extend to transfer pricing reports from the OECD in the case of it being adopted or interpreted by the STA in the shape of a position statement or other form of legal guidance. In other words, the scope of relevant facts is relative to Swedish transfer pricing legislation, i.e. the correction rule. As the correction rule merely states a requirement that intra-group transactions must be at arms-length, extensive case law and international guidance has supplemented the legislation. Relevant facts encompass this supplementary guidance up to a point. While Swedish legislation and case law is encompassed by default, other guidance on transfer pricing must come from the STA in order to be viewed as relevant facts which the tax payer should consider in fulfilling her obligation to disclose. The consequence of this is that the STA thereby has the

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<sup>124</sup> See Prop. 1977/78:136 s. 154 and RÅ 1989 ref. 32.

<sup>125</sup> It should be reiterated that the TPG holds a somewhat prominent status in the Swedish tax system as per RÅ 1991 ref 107.

power to set the boundaries of the tax payer's obligation to disclose, which could potentially entail issues regarding the proportionality of the burden of proof placed on the tax payer.<sup>126</sup>

Furthermore, as discussed in section 4.2, paragraph five, the nature of transfer pricing means that the relevant facts which the tax payer must disclose concerns valuation and pricing data. Valuations in the context of tax penalties implicate certain difficulties as it entails subjective considerations whereas tax penalties are levied solely on objective grounds. Case law deals with this specific issue.<sup>127</sup> Accordingly, a wrongful valuation based on the tax payer's subjective perception ought not to constitute provision of incorrect information unless the wrongful valuation is especially significant.<sup>128</sup> According to the STA, whether a wrongful valuation constitutes incorrect information depends on both the relation between the original valuation to the subsequently established "correct" arm's length value and the challenges of assigning an arm's length value in the particular case.<sup>129</sup> The greater the challenges of assigning an arm's length value, the greater discrepancy can exist without the original valuation constituting provision of incorrect information. The STA's burden of proof is increased further for tax penalties. Accordingly, the STA must demonstrate that the original pricing was not arm's-length and that the tax payer had provided incorrect information regarding the pricing. Given the nature of transfer pricing, most valuations ought to contain elements of uncertainties and challenges to consider. Preparatory works inform that determining incorrect information requires careful consideration, especially regarding material that can be considered as argumentative.<sup>130</sup> This ought to be especially relevant to the field of transfer pricing and valuations, as its

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<sup>126</sup> However, this issue has been addressed by the legislator in delegating the mandate of informing the tax payers as to what more specifically should be disclosed in relation to the various fields of tax law.. See Prop. 2010/11:165 p. 290 and p. 818.

<sup>127</sup> The case law does not address transfer pricing specifically. Rather, it addresses valuations in the context of tax penalties. Nevertheless, the case law should be considered relevant for tax penalties in transfer pricing as well.

<sup>128</sup> RÅ 1999 ref. 17, RÅ 2004 not 177 and RÅ 2009 not 61.

<sup>129</sup> The STA, *Oriktig uppgift vid värdering*.

<sup>130</sup> Prop. 1977/78:136 p. 160.

application means that the tax payer argues for a certain pricing following her interpretation of the arm's length principle.

In evaluating whether incorrect information has been provided, the existence of transfer pricing documentation merits further consideration. Preparatory works regarding the introduction of transfer pricing documentation into Swedish legislation addresses the interplay between tax penalties and transfer pricing documentation. Accordingly, while no need to exempt transfer pricing from the Swedish tax penalty framework was identified, whether a tax payer had provided incorrect information requires a nuanced evaluation; this is especially true if the tax payer's income is adjusted despite having established acceptable transfer pricing documentation.<sup>131</sup> Furthermore, such a nuanced evaluation is deemed necessary in order to ensure compliance with the ECHR.<sup>132</sup> In a post-BEPS world, the transfer pricing documentation which certain tax payers are obliged to establish is both detailed and comprehensive. According to the TPR Chapter 9, Article 9-18 and the TPA Chapter 39, Article 16b-16c, the tax payer must disclose everything from value generating factors to detailed information regarding important intra-group transactions.<sup>133</sup> Preparatory works thereby inform that the existence of transfer pricing documentation ought to benefit the tax payer in evaluating whether incorrect information has been provided. However, as to what degree transfer pricing documentation affects the question of incorrect information is unclear. One conclusion could be that as transfer pricing documentation is provided unto the STA upon request, incorrect information cannot have been provided if the documentation contains information that in itself highlights the tax law matter for which the STA has adjusted the tax payer's income.<sup>134</sup> In other words, if a tax payer is adjusted for its pricing of certain goods, incorrect information cannot be at hand if the tax payer discusses the rationale behind the pricing. As such, transfer pricing documentation would contain all the

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<sup>131</sup> Prop. 2005/06:169 p. 115.

<sup>132</sup> Prop. 2005/06:169 p. 115.

<sup>133</sup> The documentation requirements can amount to a transfer pricing documentation consisting of hundred of pages. See OECD, *discussion draft on transfer pricing documentation and CbC reporting*, 2014.

<sup>134</sup> This conclusion would also be in line with HFD 2018 ref. 79.

relevant information for the tax assessment or at least trigger the STA's obligation to investigate as per Chapter 49, Article 5, paragraph 2 of the TPA. The question is if that conclusion is in line with Chapter 49, Article 4 of the TPA. Paragraph 1 point 1 and 2 of said statute declares that tax penalties are imposed if the tax payer has provided incorrect information as a basis for their tax assessment by the STA *or* in court proceedings concerning that tax assessment. As the requisites are alternating, a tax payer could provide incorrect information by *not* submitting their transfer pricing documentation to the STA along with the tax return. If this is the case, it would demonstrate a disturbing contradiction as to how transfer pricing documentation is used in the context of tax penalties within transfer pricing. Especially as statutory law indicate that transfer pricing is to be provided to the STA upon request and not with the tax return as per Chapter 37, Article 2 and Chapter 44, Article 2 of the TPA. However, this is not the case as Chapter 49, Article 4, paragraph 1 point 1 extends beyond the procedure before the tax assessment into even the re-assessment procedure.<sup>135</sup> According to the STA, transfer pricing documentation ought to negate provision of incorrect information if the tax payer submits a commented transfer pricing documentation along with the tax return.<sup>136</sup>

It is important to note that the statute governing incorrect information and tax penalties merely state that the provision of incorrect information *may* result in tax penalties being levied. Even though imposition of tax penalties presupposes provision of incorrect information, the law allows for a reprieve in certain situations. The grounds for reprieve of tax penalties when incorrect information has been provided will be examined in the following section from a transfer pricing perspective.

#### 4.3.4 Grounds for Reprieve from Tax Penalties

Chapter 51, Article 1 of the TPA allows for reprieve from tax penalties in certain situations. Accordingly, either a complete or partial reprieve may be granted if a

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<sup>135</sup> Prop. 1991/92:43 p. 80.

<sup>136</sup> Accordingly, the STA would therefore make little use of their statutory mandate to request transfer pricing documentation and instead via their position statement urge the tax payer to do the work for them. This position statement is discussed further in section 5.5.

full levy would be unreasonable. For when a full levy would be unreasonable, the statute specifically refers to instances such as the tax payer's misjudgment of the relevant statute(s) or the implications of the factual circumstances; another example which the statute expresses is if the amount levied would appear disproportionate to the error (i.e. the provision of incorrect information and the size of its associated adjustment). Misjudgment of the relevant statute(s) is often referred to as indicating the presence of a complicated tax law matter.

Preparatory works express that reprieve from tax penalties should be considered carefully if the tax payer has provided incorrect information in the context of a complicated tax law matter.<sup>137</sup> Furthermore, the legislator has specifically recognized that especially corporations are faced by such complicated tax law matters. However, unlike other areas of corporate tax, case law has repeatedly affirmed transfer pricing as a complicated area of tax law.<sup>138</sup> In light of the above, perhaps transfer pricing has earned the status of an especially complicated tax law matter? Preparatory works also express that an OECD compliant transfer pricing documentation ought to constitute grounds for reprieve from tax penalties, even if the documentation itself could be considered as provision of incorrect information.<sup>139</sup> Taking all of the above into account, grounds for reprieve from tax penalties should be granted careful consideration where incorrect information is confirmed in transfer pricing cases, especially if the tax payer has provided a satisfactory transfer pricing documentation. However, one should not assume that the call for careful consideration implies that transfer pricing cases would automatically be granted a reprieve from tax penalties, solely because of transfer pricing being the background to the proceedings. Although transfer pricing is not an exact science, it is still considered a science. As science has both truths and falsities, surely tax penalties are to be reserved for certain falsities provided by the tax payer. It should also be reiterated that reprieve from tax penalties can be granted in varying degrees, relative to how the grounds for reprieve manifest in the situation before the STA. Nevertheless, as the law allows

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<sup>137</sup> SOU 2009:58, p. 509.

<sup>138</sup> See the Supreme Administrative Court, case 1913-18 as well as HFD 2018 ref. 79.

<sup>139</sup> Prop. 2005/06:169 p. 115.

for full reprieve from tax penalties, certain transfer pricing cases should pose a strong candidate for such outcomes according to preparatory works.

## 4.4 Study on Tax Penalties in the Lower Administrative Courts

### 4.4.1 Introduction to the Study

Section 4.3 informed on the requisites and considerations required for levying tax penalties in transfer pricing as per statutory law, preparatory works and case law. The above section concluded that tax penalties ought not be levied unless in exceptional cases as the STA must first prove that incorrect information has been provided and if so, the STA must also consider the potential multitude of grounds for reprieve from tax penalties. However, the STA and lower administrative courts have interpreted the law differently, seemingly levying tax penalties at a more intensive rate. This section demonstrates this development by providing a short overview of the more recent court rulings regarding tax penalties in transfer pricing from the lower administrative courts.

This use of source material is not in line with the critical legal dogmatic method as court rulings from the lower administrative courts do not represent what the law is. However, in the absence of case law from the Supreme Administrative Court on the subject, the court rulings from the lower administrative courts represents perhaps the new reality for tax penalties in transfer pricing.

The case law overview is retrieved from a report published by the Confederation of Swedish Enterprise.<sup>140</sup> In making use of this study, I want to emphasize that the conclusions derived in this section belong to the study unless otherwise stated. In this study, all cases from The Administrative Court of Appeal concerning tax penalties in transfer pricing between 2008 until 2016 were reviewed.<sup>141</sup> The study population sample consisted of cases from the

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<sup>140</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, page 16–32.

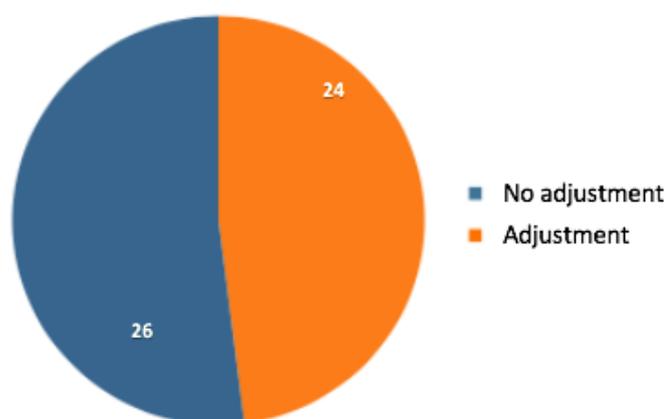
<sup>141</sup> The population sample was retrieved from the legal databases Infotorg (<https://www.infotorg.se/>), Karnov (<https://www.karnovgroup.se/>) and Zeteo (<https://www.nj.se/cms/pub/zeteo-startsida>) with the search terms “korrigeringsregeln + skattetillägg”, “korrigeringsreglerna + skattetillägg”, “internprissättning + skattetillägg”, “prissättning + skattetillägg”, “korrigeringsregeln”, “internprissättning”, “14 kap. 19 § IL” and “14:19 IL”. The result from the search

Administrative Court of Appeal as it is usually the highest court in cases concerning tax penalties within transfer pricing.<sup>142</sup> Also, the study assumes the rulings of the Administrative Court to follow those of the Administrative Court of Appeal.<sup>143</sup>

The study consisted of 50 cases in total. It is important to emphasize that the main question in the proceedings were regarding adjustment of the tax payer's income as per the correction rule, tax penalties being a subsequent issue only to be discussed if an adjustment was made. The study should not represent the STA's opinion on requisites for tax penalties in transfer pricing as that would require a review of the cases in which the STA has decided not to proceed to the courts. However, the study should serve as a fair representation of the position and thought process as to how tax penalties are to be levied in transfer pricing cases according to the Administrative Court of Appeal.

#### 4.4.2 Adjustment vs Incorrect Information

**Diagram 1: Did the case result in an adjustment as per the correction rule?**



Out of the 50 cases, 24 did not result in an adjustment as per the correction rule. Out of the 26 cases where the tax payer's income was adjusted, the court ruled that the tax payer had provided incorrect information in all 26 cases. As pointed out in

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terms were compared to the STA's report *Utfall efter domstolsprocesser – internprissättning, 2016-12-09*, dnr 480-542838-16/1211.

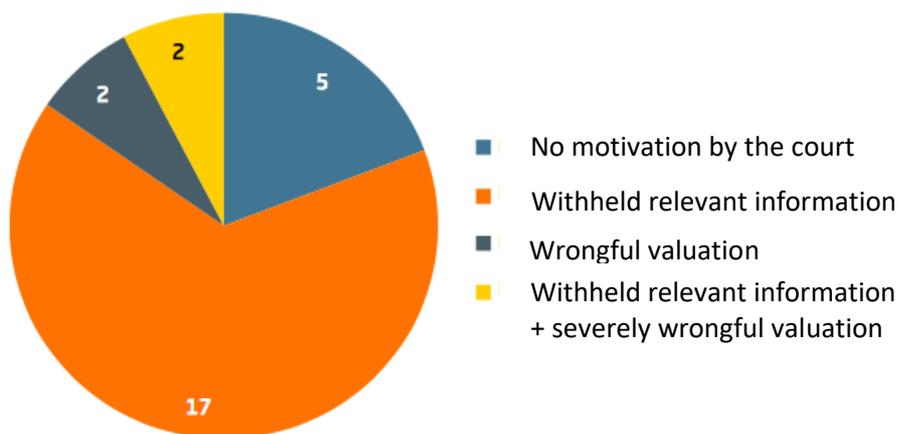
<sup>142</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, page 17.

<sup>143</sup> *Ibid.*

the study, this statistical correlation indicates that the courts view provision of incorrect information as a composite to the application of the correction rule, rather than a separate issue. This could indicate that the imposition of tax penalties is subsidiary to adjustments as per the correction rule which would be troublesome considering that they presuppose both different conditions and burden of proof.

#### 4.4.3 Incorrect Information in the Administrative Court of Appeal

**Diagram 2: What was the court’s reason for determining incorrect information?**



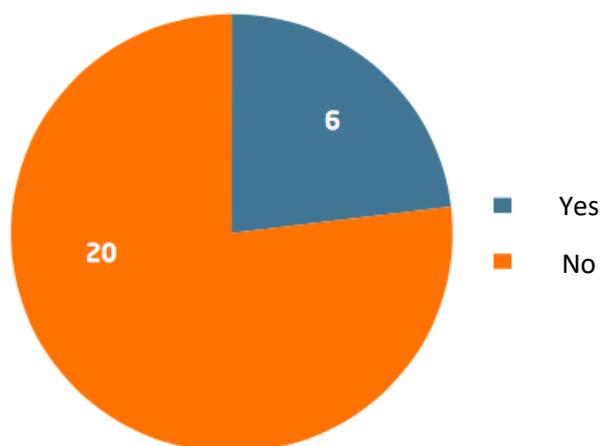
Of the 26 cases in which incorrect information had been provided according to the court, 17 cases of incorrect information were motivated by the tax payer’s failure to submit relevant information. Two cases were motivated partly due to the tax payer’s failure to submit relevant information but also because the tax payer had conducted a “severely” wrongful valuation. Two cases of incorrect information were found as a result of the tax payer having conducted a wrongful valuation. Lastly, in five of the cases the court did not motivate as to how it arrived at the conclusion that the tax payer had provided incorrect information. As discussed in the study, the fact that 25% of tax penalty cases in transfer pricing lacked a motivation from the court represents an issue of legal certainty. Furthermore, the court detected incorrect information in two cases as a result of a wrongful valuation and not a “severely” wrongful valuation as stated in two other cases. Accordingly, it seems that the courts do not reserve tax penalties only for the more flagrant

wrongful valuations but also for less grave errors in valuations.<sup>144</sup> The majority of cases (21 out of 26) did include a motivation by the court as seen in the above diagram. However, 11 cases did not discuss the information that the tax payer had provided for the tax assessment or as to how the tax payer had failed to meet the obligation to disclose.<sup>145</sup> Thus, the court either did not discuss the obligation to disclose or if it did, decided not to include that discussion in the ruling. Both options pose a threat to the principle of legality.<sup>146</sup>

On 20 March 2019, a case specifically concerning tax penalties in transfer pricing went before the Administrative Court of Appeal as the tax payer had only appealed the levying of tax penalties and not the adjustment.<sup>147</sup> More precisely, the case concerned profit-allocation to a permanent establishment. The court stated that the incorrect information consisted of the non-arm's length allocation which the tax payer had not disclosed as to how or through which method it had arrived at said allocation.<sup>148</sup>

#### 4.4.4 Burden of Proof in the Administrative Court of Appeal

**Diagram 3: Did the court observe the burden of proof regarding incorrect information?**



<sup>144</sup> This should be compared to how the Supreme Administrative Court views valuations in the context of incorrect information. See RÅ 1999 ref. 17, RÅ 2004 not 177 and RÅ 2009 not 61.

<sup>145</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, p. 28, Diagram 8.

<sup>146</sup> See section 3.5.

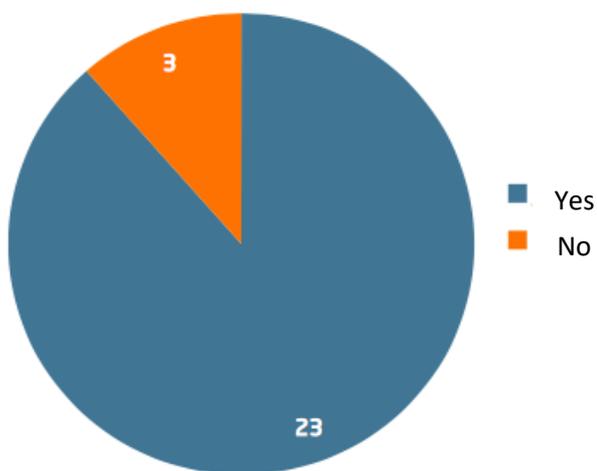
<sup>147</sup> This case was not included in the Persson Österman and Hansson's study but is discussed here as it sheds some light as to what the Administrative Court of Appeal views as incorrect information.

<sup>148</sup> Administrative Court of Appeal case 8962-18.

As to the heightened burden of proof in tax penalties, the courts are required to ascertain that the STA has demonstrated that it is apparently clear that the tax payer has provided incorrect information. Out of the 26 cases of incorrect information, only 6 cases heeded this requirement. As observed in the study, this implies that the courts do not observe the heightened burden of proof which must be met in order to demonstrate that incorrect information has been provided by the tax payer.

#### 4.4.5 Grounds for Reprieve from Tax Penalties

**Diagram 4: Did the court address grounds for reprieve from tax penalties?**



Out of the 26 cases where incorrect information had been provided according to the court, grounds for reprieve from tax penalties were addressed in 23 cases. One case out of 23 was granted a partial reprieve from tax penalties and four were granted a full reprieve. These statistics indicate that the courts might not observe the sort of nuanced evaluation required as per preparatory works.<sup>149</sup> Rather, the courts seem satisfied in stating that the case at hand does not qualify for reprieve from tax penalties. In 16 of these 26 cases, the court had expressed that the transfer pricing issue at the case at hand was complicated, but only granted a reprieve in 5 cases.<sup>150</sup> This would seem to indicate a stricter interpretation of the grounds for relieve from tax penalties than that of previous case law and preparatory works.<sup>151</sup>

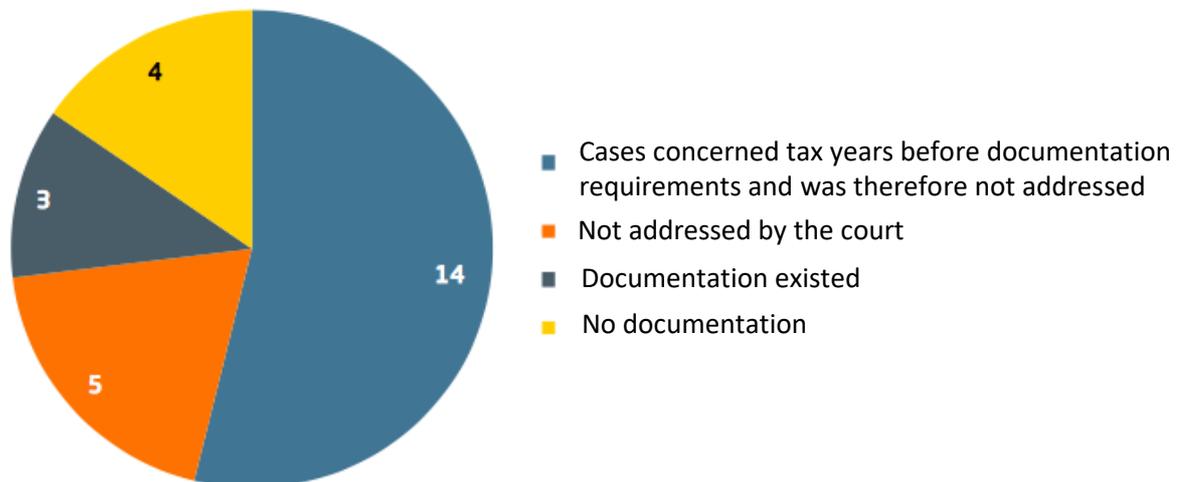
<sup>149</sup> See Section 4.3.2 paragraph 2.

<sup>150</sup> See Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, page 23, diagram 4.

<sup>151</sup> SOU 2009:58, p. 509. Reprieve from tax penalties should be considered carefully if the tax payer has provided incorrect information in the context of a complicated tax law matter. See Section 4.3.2 paragraph 2.

#### 4.4.6 Implications of Transfer Pricing Documentation

**Diagram 5: Where incorrect information had been provided, did the court address the existence of transfer pricing documentation?**



Lastly, as to the implications of transfer pricing documentation for tax penalties, the statistics are less conclusive, as the majority of cases concerned fiscal years that preceded the introduction of transfer pricing documentation. However, of the 26 cases in which incorrect information had been provided regarding fiscal years following the introduction of transfer pricing documentation, five cases did not address the existence of such documentation. If the tax payers in these five cases qualified for such documentation, this statistic would demonstrate only a slight indication that the courts view transfer pricing documentation as non-decisive for the levying of tax penalties. All in all, the courts position on the importance of transfer pricing documentation for tax penalties is not clear.

#### 4.5 Tax Penalties in the Supreme Administrative Court

The previous section served to present the recent years developments regarding tax penalties within transfer pricing in the Administrative Court of Appeal. However, case law on the subject from the Supreme Administrative Court has been absent during the time in which this new direction was formed at the Administrative Court of Appeal with the exception of RÅ 2010:67

(“Diligentia”).<sup>152</sup> Furthermore, the Supreme Administrative Court (henceforth referred to as the “court” in this particular section) has delivered new case law on the subject as of June 19, 2019 through case 1913-18 (“Absolut”). Both cases concerned supplementary taxation as per Chapter 66, Article 22 of the TPA in place of ordinary re-examination as per Chapter 66, Article 21. Furthermore, the proceedings encompassed as to whether tax penalties were warranted. Both supplementary taxation and tax penalties presuppose a provision of incorrect information by the tax payer. Therefore, incorrect information and the associated questions of tax penalties were featured somewhat extensively in both Diligentia and Absolut. This section examines the available precedents regarding tax penalties in transfer pricing from these two cases, starting with Diligentia.

In Diligentia, the court found that the conditions surrounding a loan from a parent company to its subsidiary warranted a lower interest rate than that which was charged. The STA had successfully met their burden of proof. As such, the court determined that the correction rule as per Chapter 14, Article 19 would apply since it had been made apparently clear that the tax payer’s interest rate was not arm’s-length. Thus, it was established that the information submitted by the tax payer was factually incorrect. As to tax penalties, the court stated that the tax payer had disclosed the existence of the loan by enclosing the previous year’s annual report for the tax assessment. The annual report displayed the monetary sum of the loan and in the notes of the report it was specified that the loan concerned an intra-group transaction. The court went on to state that the tax payer had neither disclosed or otherwise notified the STA as to the surrounding circumstances of the loan nor the terms of the loan and the conditions governing the size of the interest rate. Following this statement, the court concluded that the circumstances constituted provision of incorrect information. Tax penalties were thus imposed as no grounds for reprieve of tax penalties had materialized in the proceedings. The court’s reasoning indicates that the tax payer’s obligation to disclose would have been fulfilled if information detailing the surrounding

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<sup>152</sup> A database search has been conducted in order to confirm this statement. The legal databases were Karnov (<https://www.karnovgroup.se/>) and Zeteo (<https://www.nj.se/cms/pub/zeteo-startsida>) using the search terms “skattetillägg + Internprissättning”, “skattetillägg + transfer pricing”.

circumstances and terms of the loan as well as the conditions governing the size of the interest rate would have been provided. Such a disclosure would therefore negate tax penalties. The new transfer pricing documentation requirements as per the TPR Chapter 9, Article 9-18 and the TPA Chapter 39, Article 16b-16c should be addressed in light of this precedent. Considering that these documentation requirements oblige such disclosures, would the court have determined the provision of incorrect information if the tax payer were to have submitted such documentation? I would dare to assume that such an outcome would not be the case. Thus, bearing this precedent in mind, would it not be so that an adequate transfer pricing documentation should suffice to fulfill the tax payer's obligation to disclose in most cases in the post-BEPS world?

In *Absolut*, the court found that it had not been demonstrated that the tax payer's pricing was not arm's-length and thus ruled in favor of the tax payer. The STA did not succeed in meeting their burden of proof. As such, the tax payer was not adjusted as per the correction rule and avoided tax penalties. Given the outcome of *Absolut*, there is not much of a precedent in terms of tax penalties with the exception as to the matter of the burden of proof. The court indicates that it is not enough that the STA demonstrates that it is apparently clear that their opinion is arm's length, as it must also demonstrate that the tax payer's pricing is not arm's length. In terms of precedents, *Absolut* delivers far more guidance regarding the use of comparables, a subject for the correction rule and the transfer pricing methods. All in all, *Absolut* offers little guidance as to what the requisites are for levying tax penalties in transfer pricing. Especially as the case concerns a situation in which tax penalties are not to be levied rather than the opposite.

Despite the multitude of court cases regarding tax penalties in transfer pricing, few have been granted a leave to appeal. Potentially, the court might be of the view that the precedent from *Diligentia* should provide enough guidance on the subject. However, I would argue otherwise given the fragmented application of tax penalties in the Administrative Court of Appeal. Nevertheless, as to how the precedent from *Diligentia* relates to the new documentation requirements represent an interesting topic worth of further consideration in the next chapter.

## 4.6 Summary

Tax penalties were legislated in order to incentivize the tax payer to disclose relevant information for the tax assessment. The spirit of that purpose is reiterated in the law. The legal requisites for levying tax penalties in transfer pricing has been examined in section 4.3. While the discussion did reach certain conclusions in the light of new case law and BEPS, a number of unclaritys remain unanswered for which case law is required. This is most likely a result of tax penalties being treated as a subsidiary issue to the application of the correction rule. It is questionable if a tax payer could provide incorrect information despite having submitted an adequate transfer pricing documentation. Furthermore, statutory law, case law and preparatory works acknowledge that the complex nature of transfer pricing calls for careful consideration when levying tax penalties in transfer pricing cases.

However, the lower administrative courts appear to move in another direction. An overview of 50 cases from the Administrative Court of Appeal showcase certain flaws in the court's process, such as not providing a reasoning as to how it determined that a tax payer had provided incorrect information. However, the court's rulings also demonstrate elements which could be seen as an evolution of tax penalties in transfer pricing. It would seem that the courts levy tax penalties due to errors in valuation or choice of transfer pricing method.<sup>153</sup> Thereby, a tax penalty is levied more as a result of the adjustment itself, not considering that the adjustment must be accompanied by a failure on the tax payer's part to fulfill her obligation to disclose. Furthermore, the rulings from the lower administrative courts demonstrate a strict interpretation of the grounds for reprieve from tax penalties. Preparatory works informs that this approach is contrary to the legislator's intent. However, the legislator introduced tax penalties before the dawn of aggressive transfer pricing practices and subsequent comprehensive documentation requirements. Although the lower administrative courts deviation from past practices of tax penalties does not hold legal status due to their lack of legislative mandate, whether they can be justified as part of a sustainable tax penalty framework will be explored in the next chapter.

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<sup>153</sup> See section 4.3.

## 5 Evaluation of Tax Penalties in Transfer Pricing

### 5.1 Introduction

The previous chapter established that the requisites for levying tax penalties are somewhat contradictory. The Swedish tax system as it stands now has one model according to preparatory works. Meanwhile, the lower administrative courts seem to have moved in a new direction and thereby diverged from this model.<sup>154</sup> Although this new direction is not a uniform divergence from preparatory works by the Administrative Court of Appeal, it is significant enough to merit an examination.

Apart from the current transfer pricing documentation requirements, all statutory aspects of tax penalties in transfer pricing have been developed before BEPS.<sup>155</sup> The new direction of tax penalties in transfer pricing at the Administrative Court of Appeal has been developed in tandem with BEPS. This new direction could indicate the court's interpretation of how tax penalties should be levied in a post-BEPS world; although this new direction does not constitute law as the lower administrative courts lack a legislative mandate. However, in a sense, both the model according to preparatory works and the new direction at the Administrative Court of Appeal could be said to represent the Swedish framework on tax penalties in transfer pricing. This chapter contains both an evaluation on the measure of sustainability of that framework and a *de lege ferenda* discussion regarding said framework.

The evaluation proceeds from the assumption that an appropriate tax penalty framework in a post-BEPS world must be sustainable in relation to fundamental principles of tax law and the interests of the Swedish tax base. Furthermore, both the OECD and the STA have contributed with their views on tax penalties in transfer pricing, these will be examined for a nuanced discussion on the sustainability of the Swedish tax penalty framework.

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<sup>154</sup> See section 4.4.

<sup>155</sup> Introduced in 2017, see Prop. 2016/17:47 p. 31-33.

It is to be acknowledged that the critical legal dogmatic method at first hand would not appear to be the method of choice for an evaluation of tax penalty frameworks. However, given that this evaluation stems from an inconclusive examination as to what the law is, it is only natural that the critical legal dogmatic method is employed here as well.<sup>156</sup>

## 5.2 Benefits of a Sustainable Tax Penalty Framework

The current framework of tax penalties in transfer pricing consist of a comprehensive compliance system where non-compliance on the tax payer's part results in severe tax penalties. Case law and court rulings from the lower administrative courts during the past decade illustrate the difficulties facing the tax payer as to what ought to be reported in order to mitigate the risk of tax penalties. One example is the question of profit allocation to permanent establishments, which was the subject of considerable dispute before the Administrative Court of Appeal after the STA published a new position statement in 2012.<sup>157</sup> The subject matter of these cases was granted a leave of appeal where the Supreme Administrative Court subsequently ruled against the STA.<sup>158</sup> Clearly, confusion as to what the law is, exists not only on the tax payers' side, but also at the STA.

A confusing tax penalty framework shrouded in legal uncertainty is not in the interest of any kind of tax payer, MNE or not. The employees of the STA are financed through the nation's tax revenue but do not generate any value per se. Instead they are tasked with policing the entities that do generate value by making sure that they pay their fair share of tax. Those MNEs failing to comply with the obligation to disclose may face tax penalties, regardless whether the miscalculation and associated negligence regarding documentation being intentional or not. It is worth considering if the goal of ensuring that MNEs pay their fair share of tax can be achieved through other more sustainable means than resource-intensive auditing

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<sup>156</sup> Ramberg, *Prejudikat som Rättskälla*, SvJT 2017, p. 774.

<sup>157</sup> See case 1389-16, 1089-15, 1341-15, 808-15, 909-16, 370-16, 2385-16 and 4320-16. The cases in question concerned supplementary taxation which is related to the subject of incorrect information and therefore within my delimitations. These cases have been retrieved from the legal databases Karnov (<https://www.karnovgroup.se/>) and Zeteo (<https://www.nj.se/cms/pub/zeteo-startsida>) with the search terms "Internprissättning + Vinstallokering", "fast driftställe + Vinstallokering".

<sup>158</sup> HFD 2018 ref. 79.

by the STA. While certain MNEs have been identified as engaging in aggressive tax planning, not all MNEs are the same. The majority of MNEs that face adjustments according to the correction rule do so due to a mistaken application of the arm's length principle, rather than conscious tax evasion.<sup>159</sup> Regarding tax penalties in transfer pricing, one could argue that increased foreseeability and legal certainty, other things being equal, would help ensure that the fair amount due and the documentation necessary to prove it is less open to debate. Thus, the resources invested in auditing MNE's transfer pricing, which after all only constitutes less than 6%<sup>160</sup> of the national tax base, could be redirected to other activities. One example could be the auditing of VAT practices, an area constituting 27%<sup>161</sup> of the national tax base, or another area of interest to the public. Also, the public expenditure associated with arbitrating transfer pricing disputes in the courts would certainly be mitigated to an extent.

A more sustainable tax penalty system could also contribute to further economic growth. What prompts this proposition of mine are two facts that are frequently repeated in the public debate. First of all, both Swedish and foreign MNEs with a Swedish tax liability form the core of the Swedish economy.<sup>162</sup> While the corporate taxation of MNEs constitute less than 6% of the Swedish tax base, they contribute to VAT as well as tax revenue through employment; these taxes far outweigh the size of the corporate tax. Secondly, in order to attract said MNEs to place their value-generating activities in Sweden, a foreseeable and somewhat accommodating tax system is required. Historic aspects of the Swedish tax system, such as the wealth and inheritance tax should serve as a reminder for the negative impacts of an unsustainable tax system.<sup>163</sup> In order to promote Sweden as a viable location for value-generating functions, a sustainable framework of tax penalties in transfer pricing cases would be of assistance.

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<sup>159</sup> Prop. 2005/06:169 p. 88.

<sup>160</sup> See Ekonomifakta, March 2019.

<sup>161</sup> Ibid.

<sup>162</sup> Andersson, *En Skattereform för 2000-talet*, p. 156.

<sup>163</sup> Henreksson, *En Skattereform för 2000-talet*, P. 146–147.

### 5.3 Tax Penalties and Enterprises

A further aspect to consider in evaluating both the requisites for levying tax penalties in transfer pricing and whether that framework is sustainable, is the subjects mainly affected by it, the enterprises.

The statute in which the levying of tax penalties is regulated is addressed to all taxpayers. Thus, the regulation does not differentiate between the average Swedish citizen earning about 22 000 SEK per year and Volvo, Sweden's largest company with a yearly turnover almost 15 million times that of the average Swedish citizen. While Volvo should be 15 million times more capable to successfully comply with their obligation to disclose and thus avoid tax penalties, one could also argue that Volvo could be 15 million times more complicated to oversee. Furthermore, unlike the average citizen, one could say that Volvo has a fiduciary duty to invest all of its resources in the business itself, generating innovation that propels the business and by extension, its shareholders and employees towards greater economic growth. Instead, considerable resources are invested in compliance.

In 2012 at the dawn of the BEPS project, 30% of big-company CFOs regarded transfer pricing as their company's number one tax-related risk.<sup>164</sup> In 2017, 75% of respondents in a survey listed transfer pricing as a risk and key uncertainty.<sup>165</sup><sup>166</sup> MNEs are faced with considerable challenges in the current complex transfer pricing environment, their resources notwithstanding. Tax penalties are a common feature in transfer pricing cases.<sup>167</sup> The issue of tax penalties in transfer pricing cases also affect SMEs.<sup>168</sup> Given the severity of Swedish tax penalties, maybe the issue is not a lack of incentive to fulfill the obligation to disclose. Given the findings of the study in section 4.4, could it be so that in the aftermath of BEPS, the boundaries of the obligation to disclose are simply too blurred for both the tax payer, the STA and the courts? Proceeding from

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<sup>164</sup> Baker Tilly, International Tax Survey Report 2012.

<sup>165</sup> EY, Transfer Pricing Survey 2016.

<sup>166</sup> As I have not been able to find a study covering the years 2012-2016, I have used two different studies that use an adequately similar population sample.

<sup>167</sup> See section 4.4.

<sup>168</sup> See Section 5.7, paragraph 3.

that assumption, greater clarity as to what the tax payer should disclose is warranted. However, considering that transfer pricing deals with unique and varied circumstances, this is no small feat. In the aim of providing greater clarity, the opposite could end up as the result.

#### 5.4 OECD Transfer Pricing Guidelines

According to the OECD, promoting compliance should be seen as the main objective of tax penalties.<sup>169</sup> However, acknowledging the complex and comprehensive challenges of transfer pricing, it is emphasized that a tax penalty system must be fair and not sanction the tax payers in an unduly onerous manner.<sup>170</sup>

Compliance can relate to complying with either transfer pricing documentation obligations or complying with the arm's length principle.<sup>171</sup> Tax penalties can either be of the administrative or criminal type for which the monetary amount sanctioned varies.<sup>172</sup> While, the more significant administrative tax penalties are reserved as sanctions for understatement of tax liability, the less severe penalties are directed towards procedural compliance, i.e. timely filings of returns and information reporting.<sup>173</sup>

Although Swedish tax penalties may only be levied following an adjustment of the tax payer's income, the actual penalties depend on the tax payer's fulfillment of the obligation to disclose, which requires that the tax payer submit all the necessary information for a correct tax assessment. Thus, the Swedish tax penalty is directed at information reporting, which the OECD imply is reserved for the less severe tax penalty. However, the Swedish tax penalty at its maximum levy is quite severe. Furthermore, the OECD specifically discuss tax penalties as a method of promoting tax payers to submit their transfer pricing documentation along with the tax return.<sup>174</sup> According to the OECD, such penalties would consist

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<sup>169</sup> OECD, TPG p. 176.

<sup>170</sup> OECD, TPG 178.

<sup>171</sup> OECD, TPG p. 177.

<sup>172</sup> Ibid.

<sup>173</sup> Ibid.

<sup>174</sup> OECD, TPG p. 239-240.

of a lesser monetary amount compared to those that target understatement of taxable income.<sup>175</sup>

Accordingly, upon reviewing the TPG, there is certain consensus that reprieve of tax penalties should be granted due consideration in transfer pricing and that the Swedish tax penalty system could benefit from introducing specific tax penalties for transfer pricing.

## 5.5 The STA's Position Statement

The STA published a position statement in 2018 on the relation between transfer pricing documentation and tax penalties; representing the agency's position as to how transfer pricing documentation affects the question of incorrect information and potential relief from tax penalties.<sup>176</sup> The position statement is based on the agency's own interpretation of relevant preparatory works.<sup>177</sup>

According to the STA, transfer pricing documentation must be submitted along with the tax return in order to influence as to whether the tax payer has provided incorrect information. From the tax payer's perspective, this statement can appear confusing. Other countries apply tax penalties to incentivize the tax payer to provide their transfer pricing documentation before a certain deadline, usually end of fiscal year.<sup>178</sup> On the other hand, Swedish law only requires the tax payer to supply transfer pricing documentation upon the STA's request as per Chapter 37, Article 2 and Chapter 44, Article 2 of the TPA. The STA's statement essentially implies a hidden requirement to instead supply transfer pricing documentation with the tax return.

The STA states that transfer pricing must be submitted with the tax return in order to influence as to whether the tax payer has provided incorrect information. Although, merely submitting an extensive transfer pricing documentation along with the tax return does not suffice. However, if the tax payer specifically references a certain section or a certain question within the

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<sup>175</sup> OECD, TPG p. 177.

<sup>176</sup> The STA, *Betydelsen av ett företags internprissättningsdokumentation för beslut om skattetillägg*.

<sup>177</sup> See Prop. 2005/06:169.

<sup>178</sup> OECD, TPG p. 177.

documentation, the STA's obligation to investigate would likely be triggered. Thus, incorrect information would not have been provided. This interpretation contradicts earlier case law and preparatory works.<sup>179</sup> It appears that the STA views transfer pricing documentation submitted with the tax return as an instrument to trigger obligation to investigate, rather than an instrument for fulfilling the obligation to disclose. This is an interesting interpretation by the STA as resorting to trigger the STA's obligation to investigate presupposes that the transfer pricing matter constitutes a complex issue.<sup>180</sup> Upon reviewing preparatory works, the legislator expresses that obliging tax payers to establish transfer pricing documentation enable the STA to assert the tax payer's compliance with the arm's length principle.<sup>181</sup> All in all, the STA's interpretation imparts an obligation on the tax payer beyond that of the legislator's intent. On the other hand, such an interpretation could be in line with the legislator's intent as it further enables the STA to assert the tax payer's compliance with the arm's length principle. However, to reduce transfer pricing documentation to an instrument for triggering the STA's obligation to investigate in the context of incorrect information appears contradictory as such documentation in itself could provide all the relevant information for a correct tax assessment.

According to the STA, transfer pricing documentation may provide the tax payer a relief from tax penalties if the following criteria are met. Firstly, adequate transfer pricing documentation must be provided to the STA upon its request.<sup>182</sup> Secondly, the transfer pricing policy in the documentation must not deviate significantly from common international transfer pricing standards. Thirdly, the tax payer must comply with the documented transfer pricing policy in practice. If these criteria are fulfilled, the tax penalty will be reduced by half. Furthermore, a full relief from tax penalties are granted if the tax payer has complied with the above and misinterpreted what constitutes the correct transfer price. However, a full relief would probably only be granted in extraordinary cases

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<sup>179</sup> See Section 4.3.2.

<sup>180</sup> See section 4.3.2.

<sup>181</sup> Prop 2005/06:169 p. 115.

<sup>182</sup> "Adequate" entails compliant with Swedish transfer pricing documentation content requirements.

as the STA also states that MNEs can be expected to be well versed in transfer pricing.

## 5.6 Sustainability of the Swedish Transfer Pricing Framework

This section addresses whether the Swedish framework of tax penalties in transfer pricing is sustainable in the sense that it provides for a foreseeable and proportionate incentive for the tax payer to disclose relevant information for the tax assessment.

The fact that preparatory works argue for a careful application of tax penalties in transfer pricing whereas the lower administrative courts seemingly levies tax penalties in an arbitrary fashion is alarming from a perspective of legal certainty. Although the tax payer might be aware of the rulings from the lower administrative court, the legal sources available are most of all preparatory works which argues for an application of tax penalties in relative stark contrast to that of the courts. It would be preferable if the Supreme Administrative Court delivered substantial case law on the subject in this post-BEPS world. The current framework of tax penalties in transfer pricing as a whole is not sustainable, as the preparatory works say one thing, and the courts another, resulting in compliance costs that could be avoided with a more foreseeable framework. The STA's position statements and administrative guidance on the subject is helpful in this regard. However, it does not solve the issue of foreseeability as those publications may not correctly reflect the law and therefore be overruled in the courts. Furthermore, it is debatable whether these publications constitute a legally binding position for the STA.<sup>183</sup>

The more interesting question is whether the new developments regarding tax penalties in transfer pricing within the lower administrative courts that have been made in tandem with BEPS can be regarded as appropriate and sustainable. The court rulings from the lower administrative courts imply that if the court finds reason to adjust the tax payer's income as per the correction rule, the court will also determine that the tax payer has provided incorrect information

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<sup>183</sup> Pålsson, *Skatteverkets Styr signaler – en ny blomma i regelrabatten*, p. 405.

and therefore levy tax penalties. By extension, the courts imply that tax penalties in transfer pricing are levied as a result of the tax payer's understatement of income. Seeing as the tax payer's understatement of income is only one of the conditions necessary for the levying of tax penalties, this new direction seemingly foregoes the STA's burden of proof to ascertain that it is apparently clear that the tax payer has provided incorrect information. The OECD expresses that such tax penalties can be warranted in transfer pricing.<sup>184</sup> However, such tax penalties would require that the STA demonstrates a willful intent in the tax payer to mislead the STA.<sup>185</sup> Preparatory works and older case law indicate that the Swedish tax penalties could be applicable to tax payers who conduct themselves in such a way, although only in select cases as there is a high burden of proof for the STA to meet.<sup>186</sup> Given the context of MNEs engaged in aggressive and illegal tax planning, countering such conduct has merit. Although, the significant burden of proof must be observed in order to view such a development as sustainable, rather than arbitrary. Furthermore, the lower administrative court have displayed a strict interpretation regarding the possibility to grant relief from tax penalties. Given the complex nature of transfer pricing and the need for proportionate tax penalties, applying such a strict interpretation would perhaps be unwise.<sup>187</sup> Such a policy would result in significant tax penalties for misapplications of the correction rule made in good faith which produces unnecessary compliance costs.

## 5.7 Tax Penalties in Transfer Pricing – an Area for Reform?

It ought to be reiterated that tax penalties were introduced in order to incentivize the tax payer to provide all the necessary information for a correct tax assessment. A correct tax assessment implies that there is but one correct outcome. However, the subjective elements of transfer pricing mean that there can be several arm's length prices for one given transaction or even several different but nevertheless correct transfer pricing methods.<sup>188</sup> Coupled with the complex nature of transfer

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<sup>184</sup> OECD, TPG p. 177.

<sup>185</sup> Ibid.

<sup>186</sup> See Prop. 2002/03:106 p. 116 and RÅ 1981 1:25.

<sup>187</sup> Prop 2005/06:169 s. 115 and OECD, TPG p. 177.

<sup>188</sup> Prop. 2009/10:17 p. 21.

pricing, there are good grounds for only applying tax penalties in select transfer pricing cases, observing that tax penalties may only be levied following distinct criteria.<sup>189</sup> The legislator has expressed that transfer pricing cases ought not be exempt from tax penalties.<sup>190</sup> However, one could consider the possibility of applying another type of framework of tax penalties to transfer pricing than the one in Chapter 49, Paragraph 4-5 of the TPA. Here, both the ban on analogue application and the aspect of legal certainty contained within the principle of legality should be reiterated.<sup>191</sup> By observing the new direction regarding tax penalties in transfer pricing at the Administrative Court of Appeal, the current framework could be in conflict with the ban on analogue application. Potentially, the courts levy tax penalties in transfer pricing cases in a fragmented manner because the current tax penalty regulation does not accommodate the nature of transfer pricing as cross-breed between tax law, economics and accounting. In other words, the fragmented diversion from the model of levying tax penalties in transfer pricing cases according to preparatory works could indicate that the general tax penalty regulation is ill-fitted for transfer pricing in a post-BEPS world. Furthermore, in the context of the voluminous TPG, it is worth considering whether the scope of the obligation to disclose as per Chapter 31, Article 3 of the TPA is appropriate. In other words, does the scope of the obligation to disclose in the context of transfer pricing lead to tax penalties at a more frequent rate than what the aspect of legal certainty allows? Taking the above into account, an alternative to the current framework of tax penalties in transfer pricing must also consider the challenges associated with the position of both the Tax payer and the STA. In connection to the potential need for reform, it should be mentioned that an official government report regarding overhaul of the calculation of tax penalties was submitted in 2017.<sup>192</sup> To the author's knowledge, this report has as of yet not amounted to any reform.

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<sup>189</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, page 9.

<sup>190</sup> Prop. 2005/06:169.

<sup>191</sup> See section 3.5.

<sup>192</sup> SOU 2017:94.

One possible amendment to the framework of tax penalties in transfer pricing would be to oblige the tax payers covered by transfer pricing documentation requirements (i.e. MNEs) to submit their documentation along with the tax return. This obligation would be coupled with new administrative tax penalties for non-compliance so as to incentivize the tax payer adequately. The size of these administrative tax penalties would not relate to potential additional tax owed or the like. Rather, these penalties would be standardized in size as they would be imposed in only one scenario. However, the penalty could be progressive, thereby relating to for example the turnover of the MNE for which the penalty is imposed. This proposal would require amendments to Chapter 39, 49 and 49 b of the TPA. Such an amendment would probably aid in incentivizing the tax payer to disclose necessary information for a correct tax assessment in transfer pricing cases, the goal for which tax penalties were introduced in the first place.<sup>193</sup> It should be addressed that this amendment would result in additional administration for the STA as the agency would be required to oversee that the MNEs covered by the documentation requirements had complied with their new obligation. However, the additional administration would most likely be marginal, especially compared to the administration of having to issue a request for transfer pricing documentation from a tax payer as per Chapter 37, Article 2 and Chapter 44, Article 2 of the TPA. Also, the benefit of having immediate access to transfer pricing documentation should also help to outweigh the negatives of potential additional administration. Preparatory works inform that the introduction of the new documentation requirements following BEPS would facilitate both the tax payer's fulfillment of her obligation to disclose and the STA's auditing practices. However, the current regulation seemingly does not make use of the tool the transfer pricing documentation's full potential by not requiring the documentation along with the tax return. It should be addressed that this proposed amendment only encompasses MNEs as not all tax payers are covered by the documentation requirements. Therefore, this amendment doesn't solve the issues related to the current framework of tax penalties in transfer pricing for the SMEs. To consider

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<sup>193</sup> Prop. 1971:10 p. 95.

excluding these kinds of tax payers from tax penalties all together would be contrary to the legislator's intention.<sup>194</sup> To me, a more appropriate solution could be to maintain the status quo for these tax payers. As such Chapter 49, Article 4-5 of the TPA would continue to apply the same way for these tax payers. If so, it would be appropriate if the courts observed especial consideration regarding reprieve of tax penalties in transfer pricing for the SMEs, as they possess less resources to oversee this complex area of tax law.

A further possible amendment to the framework of tax penalties in transfer pricing would be to reserve tax penalties for very select transfer pricing cases. If the tax payer provides the transfer pricing documentation as per the previous paragraph, tax penalties under Chapter 49, Article 4-5 of the TPA would only apply if the STA could demonstrate that the tax payer intended to mislead the STA. Thereby, the STA could only levy tax penalties if for example the transfer pricing documentation supplied with the tax return contained information that provided for arm's length pricing but did not reflect reality as in conduct by the contracting parties or their listed functions. Accordingly, incorrect information would only be at hand if the tax payer objectively demonstrated an intent to mislead the STA. The demand for intent borders on the requisites for charges of tax crime in Article 2 of the Tax Offences Act (1971:69) ("TOA"). However, as the subject between tax penalties (a legal person) and tax crime (an individual) differs, so does the burden of proof and thereby also the conditions for the sanction. To demonstrate that a legal person has submitted transfer pricing documentation that lowers its tax bill even though the information therein does not reflect reality, is far easier than proving that an individual has had that intent. Especially as an individual does not stand to immediately benefit from that lower tax bill. Therefore, such an amendment would not interfere with the application of the TOA and also succeed in reserving transfer pricing for select cases, as per the legislator's desire.<sup>195</sup> Such an amendment would preferably be introduced through case law or an amendment to Chapter 49, Article 4-5 of the TPA. It should be clarified that as

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<sup>194</sup> Prop. 2005/06:169 p. 115.

<sup>195</sup> Persson Österman and Hansson, *Skattetillägg i mål om internprissättning*, p. 9.

this second amendment relates to the first amendment, it only covers MNEs. A counterargument to this kind of solution is that it could be in conflict with the principle of equal treatment, as it would differentiate between tax payers. However, to me this argument is invalid as the SMEs do not have to establish transfer pricing documentation according to the TPA and TPR which means that they are not in a similar position compared to the MNEs. Also, it is probable these tax payers generally do not manage the kind of complex intra-group value chains found in MNEs due to their small size. Therefore, they should not face the same kind of challenge in constructing transfer pricing policies as the MNEs do. However, all court cases before the Administrative Court of Appeal in 2019 concerned SMEs.<sup>196</sup> Accordingly, SMEs could perhaps after all be more likely to submit incorrect information as per Chapter 49, Article 4-5 of the TPA. It is not impossible that this proneness to submit incorrect information is due to the fact that the SMEs lack the detailed requirements as to the information they must disclose regarding their intra-group transactions that are in place for the MNEs. Therefore, one possible solution that would cater to the SMEs is if transfer pricing documentation requirements would be developed for the SMEs. Of course, these documentation requirements would have to be somewhat less comprehensive compared to those applicable to MNEs in order to be proportionate. Where this solution to be implemented, the first and second amendment would be applicable to the SMEs as well.

The two amendments to the regulation concerning tax penalties in transfer pricing represent a significant step away from the general system of tax penalties in Chapter 49, Article 4-5 of the TPA. A very well-founded counterargument to these proposed changes is to practice patience and allow the general system of tax penalties to process the post-BEPS world. Thereby simply writing of the fragmented application of tax penalties in the Administrative Court of Appeal as growing pains. After all, the general tax penalty framework has proven

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<sup>196</sup> A database search has been conducted in order to confirm this statement. The legal databases were Karnov (<https://www.karnovgroup.se/>) and Zeteo (<https://www.nj.se/cms/pub/zeteo-startsida>) using the search terms “skattetillägg + Internprissättning”, “skattetillägg + transfer pricing” for the year 2019. As this thesis has been written during 2019, it only covers the period 01/1 2019 – 16/7 2019.

to be an effective regulation as its general application means that it is difficult to circumvent, much like a general anti-avoidance rule. However, such a mindset fails to accommodate the need for foreseeability, especially as tax penalties at first-hand incentivize disclosure, rather than only deterring avoidance. Also, an argument for maintaining the status quo should be reminded of that it is acknowledged that a general anti-avoidance rule functions best if accompanied by a specific anti-avoidance rule.<sup>197</sup> Therefore, if reform were to deliver a framework of tax penalties in transfer pricing which is both foreseeable and in full compliance with the principle of legality, it is well worth considering.

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<sup>197</sup> OECD and IMF secretariat, *Tax Certainty, IMF/OECD Report for the G20 Finance Ministers*, p. 46.

## 6 Comprehensive Summary

The purpose of this thesis has been two-fold. The first objective has been to examine the conditions for levying tax penalties in transfer pricing cases. The second objective has been to evaluate the sustainability of the framework of tax penalties in regard to transfer pricing. Both objectives have been pursued bearing the legal landscape of the post-BEPS world in mind.

Tax penalties were introduced in order to incentivize the tax payer to disclose relevant information for the tax assessment. The scope of relevant information relates to the correction rule, which has a significant connection to the OECD and BEPS. As it stands now, relevant facts relate to domestic developments of the correction rule produced by the legislator, case law and the STA. However, a number of unclarities regarding tax penalties in transfer pricing remain unanswered for which new case law is required. One of the more interesting questions in this regard is whether providing transfer pricing documentation, such as local file and master file, could eliminate the payer's risk of being subject to tax penalties in transfer pricing cases. The findings of this thesis indicate that transfer pricing documentation should have that effect in most scenarios. Statutory law, case law and preparatory works acknowledge that the complex nature of transfer pricing calls for careful consideration when levying tax penalties in transfer pricing cases. This entail a high burden of proof for the STA to demonstrate provision of incorrect information and a liberal position towards relief from tax penalties. Consequentially, tax penalties should only be levied in a select number of cases.

Rulings from the lower administrative courts demonstrate certain flaws in the court's reasoning when levying tax penalties. A number of court rulings also demonstrate a contradictory view to that of statutory law, case law and preparatory works. This fragmented application of tax penalties constitutes the current framework of tax penalties in transfer pricing, which is neither sustainable nor appropriate. Given the importance of sound transfer pricing regulation and practices to further economic growth, tax penalties should incentivize fair transfer pricing practices but also avoid becoming unnecessarily onerous or unforeseeable.

A solution to the current situation could be clarifying case law from the Supreme Administrative Court. However, certain flaws in the current framework could be a result of the general tax penalty system proving an unsuitable incentive to promote compliance within transfer pricing. Therefore, one could reflect as to whether transfer pricing require a specific tax penalty regulation.

Two amendments to the current framework of tax penalties in transfer pricing have been considered. The first amendment is regarding provision of transfer pricing documentation to the STA. The proposal is to oblige the tax payers covered by transfer pricing documentation requirements to submit their documentation along with the tax return. This obligation would be coupled with new administrative tax penalties for non-compliance. The second amendment concerns the implementation of an additional requisite to provision of incorrect information in transfer pricing cases. If the tax payer provides the transfer pricing documentation as per the first amendment, tax penalties under Chapter 49, Article 4-5 of the TPA would only apply if the STA could sufficiently prove that the tax payer had objectively demonstrated an intent to mislead the STA. Accordingly, tax penalties would apply more seldom through an increased burden of proof for the STA. Acknowledging that the two amendments do not cater to the needs of the SMEs, a solution could consist of imposing documentation requirements for these tax payers. These documentation requirements would be less comprehensive compared to those that apply to MNEs. If such a solution was to be introduced, the two amendments would apply to the SMEs as well.

There are both arguments for and against a reform of the general tax penalty system. However, the fragmented application of tax penalties in transfer pricing does not fully succeed in incentivizing the tax payer to fulfill her obligation to disclose. The current framework of tax penalties in transfer pricing instead instill confusion as how the regulation is to be applied and thereby what the scope of that obligation actually is. Therefore, amendments that achieve a framework that is foreseeable and in full compliance with the principle of legality should be considered.

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