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Introduction

On 1 January 2007, the Swedish legislation dealing with transfer pricing was extended substantially. The statutory rule of the Swedish Income Tax Act (SITA) adopting the arm's-length principle for transactions between related enterprises was supplemented by formal documentation requirements. Parallel to this legal framework, two cases did, during the 1990s, establish important principles for dealing with transfer pricing issues. These principles concern, in particular, the areas of thin capitalisation and the circumstances in which transfer pricing adjustments may be made.

It is worth noting that, in general, the Swedish Tax Agency (STA) is very interested in transfer pricing, using the regular tax audit as an opportunity to investigate transfer pricing issues. During the last few years, the STA has shown an increased focus on transfer-pricing-related issues through a number of detailed questions in tax audits, including questions about what comparable transactions or companies have been used as a basis for determining the transfer prices. Furthermore, a number of new cases show an increased focus on transfer pricing. A highly skilled, specialised team has also been established within the STA to continuously develop the general awareness within the transfer pricing area.

Statutory rules

Sweden has only one statutory rule on transfer pricing. Originally included in the tax code in 1929, it is now found in Chapter 14 Section 19 SITA. This section adopts the arm's-length principle for transactions between related enterprises and authorises an increase in the taxable income of a Swedish enterprise equal to the reduction of income resulting from transactions that are not at arm's length.

Besides the arm's-length rule, Chapter 19 Section 2b of Law 2001:1227 introduced documentation requirements for all corporations registered in Sweden that conduct cross-border controlled transactions. It is now compulsory to prepare written documentation on all cross-border transactions with associated companies. The statutory addendum came into effect as of 1 January 2007.

Added, as of 1 January 2010, the Law (2009:1295) on Advance Pricing Agreements Regarding International Transactions (Law on APAs) entered into force in Sweden. The Swedish legislation describes an Advance Pricing Agreement (APA) as a contract between a taxpayer and the STA, in two or more countries, specifying the transfer pricing policy and the transfer pricing methodologies that a taxpayer may use on its intra-group cross-border transactions. The STA is the competent authority for the administration of the APAs.

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Other regulations

In connection with the documentation requirement, administrative guidelines (SKVFS 2007:1) were issued by the STA on 14 February 2007. Moreover, the STA published regulations that provide further details as well as examples related to the transfer pricing documentation requirements. Guidelines and regulations are applicable retroactively as of 1 January 2007 and are further commented on below. Generally, the documentation requirements cannot be considered to be materially more demanding for the taxpayers, from an international comparison perspective.

Legal cases

During the last few years, relatively few transfer pricing cases have reached the lower courts and the Court of Appeal. However, there have been two important cases from the Supreme Administrative Court that should be noted. The first, Mobil Oil (1990), concerned thin capitalisation and the second, Shell Oil (1991), concerned the pricing of crude oil and freight. The tax authorities lost both cases.

The principle established by the Mobil Oil case is that, generally, thin capitalisation cannot be challenged in Sweden using the arm's-length rule.

The Shell case clearly demonstrates three points. First, the STA bears the full burden of proof in transfer pricing matters. Second, consideration of whether an arm's-length price has been charged should not be restricted to the facts arising in a single year, but rather, a span of years should be considered. Third, if a transfer pricing adjustment is to be justified, there must be a deviation from arm's-length pricing that is significant in size. Moreover, the Shell case was the first case in which the courts referred to the principles laid down in the Organisation for Economic Co-operation and Development (OECD) Guidelines on transfer pricing.

In Sweden a much debated court case ruling (*Diligentia*-case) was released from the Supreme Administrative Court during 2010. The case involved a Swedish tax payer that chose to replace an external loan with a loan from a Swedish related party to a higher interest rate, claiming that the loan was unsecured although the company's assets were unclaimed as no external loans existed. The STA argued that the intra-group loan was in fact secured and consequently the interest rate exceeded what could be deemed to be a market rate. The Swedish Supreme Administrative Court's verdict was in line with the STA's argumentation. The verdict stated that the insight and control of a shareholder can have an impact on the interest rate of a related party loan, but this must be evaluated on a case-by-case basis. It should be noted that the verdict is based on paragraph 16.1 SITA since the transaction took place between two Swedish entities and not 14.19 SITA which regulates cross border transactions. Thus, its application in a cross-border situation is uncertain.

Following the Supreme Administrative Court's verdict the STA decided to adopt the approach that all intra-group loans, more or less regardless of facts and circumstances also in cross-border cases, should only be deemed comparable with secured loans since, in their view, ownership automatically equals a degree of insight and control which replaces the need for security even in cases where external loans with better right to the underlying assets exist.

Currently there are many cases pending related to this issue and in 2011 the Lower Administrative (tax) Courts came with six verdicts in which this principle was applied

to cross-border transactions. The verdicts have been appealed and the current situation in Sweden is uncertain. The STA arguments are contradictory to the arm's-length principle and economic theory, wherefore we believe that intra-group loans should still be priced in accordance with comparable external loans, i.e. no particular concern should be taken for insight and control by comparing unsecured loans with secured external loans. If at all to be considered, in PwC's opinion the same type of insight and control which can be argued to exist in shareholder loans is comparable with the insight and control required by lenders for most loans.

Other cases concerning for instance support services, usually provided from the parent company to the benefit of subsidiaries, have also been dealt with by Swedish courts. This large number of cases – by Swedish standards – in a short period of time further illustrate that the STA have acquired additional resources and have increased their focus on transfer pricing issues.

Burden of proof

The STA bears the full burden of proof when trying to establish that a transfer pricing adjustment is necessary. To support the adjustment, the STA must show that:

- the party to whom the income is transferred is not liable to taxation in Sweden on that income
- they have reasons for believing that a community of economic interests exists between the contracting parties
- it is clear from the circumstances that the contractual conditions have not been agreed upon for reasons other than economic community of interest
- the adjustment does not depend upon consideration of the facts applying to one year in isolation, and
- there has been a significant deviation from the arm's-length price, sufficient to justify an adjustment.

Documentation requirements

According to the documentation requirements in force since 1 January 2007, transfer pricing documentation has to provide for the following information:

- General description of the company, the organisation and its activities.
- Information about the nature and extent of the transactions.
- Functional analysis.
- Description of the transfer pricing method chosen.
- Benchmark analysis.

Companies entering into transactions of limited value can benefit from simplified documentation requirements. Transactions of limited value are defined as intra-group transactions of goods for a value of less than approximately 27.7 million Swedish kronor (SEK) per company within a multinational enterprise, and for other transactions, a value of less than approximately SEK 5.5 million. The concept of other transactions does not include the transfer of an intangible asset. If a transfer of intangible property occurs, no simplified documentation requirement applies.

The simplified documentation requirement stipulates that the following information should be provided, in a summary or schematic form:

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- Legal structure of the group.
- Organisation and operations of the tested party.
- A short description of the counterparties to the transactions, including their main activities.
- Actual transactions – nature, extent, value – together with the transfer pricing method applied.
- How the arm's-length principle is met.
- Comparable transactions, if appropriate and if any are identified.

The EU Code of Conduct and the EU TPD are explicitly accepted in Swedish legislation.

Transfer pricing documentation may be submitted in Swedish, Danish, Norwegian or English language.

The audit procedure

Selection of companies for audit

The 250 largest Swedish multinational groups are, on average, audited every five years. A few hundred foreign-owned companies are audited more regularly. In recent years, the STA has taken a more risk based approach. This means that the STA is more likely to audit high risk companies, from a tax avoidance perspective. Whether a company is classified as high risk is based on a score card system. Transfer pricing is currently given a high priority in Sweden, and the audits present an opportunity for the authorities to focus on the companies' transfer pricing policies.

During the course of the audit, the STA may examine all intra-group transactions. The audits are always conducted at the company premises, with key personnel being interviewed. The conduct of the taxpayer during the examination is likely to affect the outcome of the audit, and the early assistance of a competent tax adviser is therefore highly recommended. Where the STA believes that the arm's-length standard has not been applied, it might sometimes be possible to achieve a negotiated settlement.

The provision of information and duty of the taxpayer to cooperate with the tax authorities

The STA may request copies of any information that is kept on the premises of the taxpayer, and it has the authority to search the premises if it considers this to be necessary.

Revised assessments and the appeals procedure

An appeals procedure is available to the taxpayer, but it is a time-consuming process. The procedure on tax cases in the first instance of the Administrative Courts normally takes two to three years, and perhaps just as long in the Administrative Court of Appeal.

Additional tax and penalties

Penalties are normally levied at a rate of 40% of the additional tax due. Penalties paid are not tax-deductible. There is no separate penalty charge for non-compliance with the transfer pricing documentation requirements.

In theory, the tax penalty may comprise a 'serious penalty' which prevents the application of the Arbitration Convention. However, this has never been put into practice.

Resources available to the tax authorities

The resources available for the STA to conduct transfer pricing audits have historically been limited. Today, a specialised transfer pricing team is established in the STA which is continuously recruiting more inspectors and acquiring new competence within the transfer pricing area. The effect of this team is clearly shown in the increased number of cases brought before the courts. This specialised team assists the general tax auditors in the STA with transfer pricing issues as well as performs its own targeted audits towards large companies.

Use and availability of comparable information

In accordance with the legislation, the determination of an arm's-length price has to be based upon prices that would be agreed between unrelated parties in a comparable situation. In determining the relevant price, the STA prefers the traditional transactional methods, but with no preferred order of use. If none of these methods can be used, then a transactional profit method may be used. The STA considers the transactional net margin method (TNMM) to be the most frequently used method to test the arm's-length character of transfer prices in practice. The TNMM approach is also used to test another method (i.e. a secondary method for sanity check purposes).

The financial statements of all Swedish companies are publicly available in Sweden. Databases containing this information may be accessed in the search for comparables. The STA has also gained access to the most common databases used for comparability searches, such as the European database AMADEUS and various royalty databases. In recent tax audits, the STA has prepared extensive lists of questions regarding the audited company's comparable data.

Risk transactions or industries

Related party transactions within all industries can be subject to audit. The most common issues scrutinised by the STA regarding intra-group transactions relate to financial transactions (such as interest rates) and business restructuring, including particularly valuations and transfers of intangible property. Particular focus is also directed at sizeable MNEs reporting low or negative operating margins.

Following the implementation of documentation requirements, audit procedures commonly include scrutiny of the complete transfer pricing documentation including all transactions and benchmarks applied. In this context, it can be noted that it is becoming more and more common that the STA performs benchmarks by means of in-house resources.

Limitation of double taxation and competent authority proceedings

Swedish law, currently, has no regulation that automatically relieves a company from juridical and/or economic double taxation caused by an adjustment of its transfer prices. The problem of double taxation is, instead, usually handled through bilateral tax treaties. Swedish tax treaties are usually based on the OECD Model Tax Convention. Some older agreements existing between Sweden and developing countries are based on the UN Model Tax Convention.

Sweden has entered into bilateral tax treaties with the majority of countries in which Swedish-based multinational enterprises conduct business. These agreements provide

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a good basis for the elimination of juridical and/or economic double taxation for both Swedish multinationals and foreign multinational companies conducting business in Sweden.

The competent authority procedure functions fairly well in Sweden. According to the Ministry of Finance, full or partial relief has historically been obtained in more than 90% of cases where competent authority relief has been claimed. The competent authority's responsibility and the mutual agreement procedures (MAPs) were recently transferred to the STA. However, one problem with competent authority claims is the amount of time necessary to settle each case. After the transfer of responsibility for the MAPs to the STA, the effectiveness of these procedures has increased considerably. Delays in current processes are often the result of delays in the other countries. The normal handling period for the competent authority procedures is about two years.

Sweden has signed the EU Arbitration Convention which applies from 1 November 2004. The EU Arbitration Convention constitutes a powerful incentive for the STA to make every effort to ensure that the administrative process is more efficient, and to reach a mutual agreement in relation to all MAPs within the set time limit of two years.

Advance pricing agreements (APAs)

As of 1 January 2010, the Law (2009:1295) on Advanced Pricing Agreements Regarding International Transactions (law on APAs) entered into force in Sweden. The STA was appointed as competent authority for the administration of APAs.

Under the law on APAs, any corporation which is (or is expected to become) liable to taxation, in accordance with Swedish taxation regulations and which is subject to the provisions of a tax treaty, can apply for an APA. The application shall be made in writing and shall contain all information deemed necessary to enable the STA to make a fair decision as to the appropriateness of the taxpayer's suggested transfer pricing set-up. Prior to filing an application, the taxpayer may request a pre-filing meeting with the STA to discuss the conditions of a potential APA and what information should be included in the application.

A Swedish taxpayer can apply for either a bilateral or a multilateral APA. The APA is based on a mutual understanding between the countries involved for a predetermined period of three to five years.

The STA is authorised to grant an APA if the relevant transaction can be regarded separately from any other intra-group transactions, and if sufficient information is provided to the STA to enable it to determine whether the proposed set-up is at arm's length. Some of the basic information which must be filed in order for the STA to grant an APA is a functional analysis, an economic analysis and a comparables search, which supports the selection of transfer pricing methodology.

An APA is granted only if the mutual understanding between the countries involved reflects the basis of the taxpayer's application or if the taxpayer approves any amendments proposed in the STA's decision. An APA is normally not granted if the transaction is considered to be of limited importance or of minor value.

In cases where a taxpayer seeks an APA, the STA charges an administration fee which is based on the type of application. The following fees apply in relation to each country involved in the relevant transaction:

- SEK 150,000 (approx. 17,000 euros [EUR]) for an application of a new APA.
- SEK 100,000 (approx. EUR 11,000) for an application regarding renewal of a previous APA.
- SEK 125,000 (approx. EUR 143,000) for an application regarding renewal of a previous APA (including amendments).

Anticipated developments in law and practice

The current documentation guidelines provide for a general framework. The documentation guidelines issued by the STA clarify certain aspects of the legislation, but certain areas may lead to conflicts in interpretation for which it may be up to case law to solve.

Liaison with customs authorities

We are currently not aware of any cooperation between customs authorities and the STA, since they are separate government bodies.

OECD issues

Sweden is an OECD member state. There was a Swedish representative on the OECD Transfer Pricing Task Force, and Sweden has agreed to the OECD Guidelines.

Joint investigations

The STA has taken part in simultaneous tax audits from time to time and is more likely to join with other Nordic countries in such audits. Also, the STA has taken part in a few simultaneous audits with the US and German tax authorities, respectively.

Thin capitalisation

A principle established by the Mobil Oil case is that the arm's-length principle cannot be used to challenge a taxpayer on the grounds of thin capitalisation. Furthermore, there are no rules dealing specifically with thin capitalisation and no set permissible debt-to-equity ratios. Interest paid to a foreign associated entity is deductible for tax purposes without any restrictions as long as arm's-length interest rates are applied. However, in special situations with unique circumstances, interest deductions may be challenged and therefore, even if the tax authorities have not yet successfully challenged any instances of thin capitalisation, taxpayers should remain cautious in this area.