Hard to value intangibles from a Swedish perspective

by

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The purpose of this thesis is to study the work of the OECD presented in the Final BEPS-Report under Action 8 concerning hard to value intangibles in a Swedish context. Further, the OECD Model Tax Convention and its Commentaries are discussed in terms of their validity as a source of law in a Swedish perspective, or if there is a requirement now or after the implementation of Action 8 for changes to the *Inkomstskattelagen*, and particular the *Korrigeringsregeln*.

The OECD introduces in the Action 8 of the Final BEPS-Report an *ex post* approach with a correction mechanism to transfer prices set prior to the conclusion of the agreement. This change will certainly give rise to a more complicated process for the involved companies to assess the “reasonable” transfer price. The *ex post* mechanism will also increase business risks and most likely affect the structuring of the MNE's business in a way where tax concerns will at least partly overshadow strictly commercial considerations. The conclusion in this thesis is that the *ex post* adjustment mechanism constitutes a substantial risk for situations of double taxation due to uncertainties regarding whether the *ex post* adjusted price is in line with the arm's length principle, and how different states interpret and classifies the adjusted transfer price concerning if and to what extent *ex post* tax reductions are allowed.

From the Swedish case law involving transfer pricing of hard to value intangibles, the courts have without hesitation adopted the Model Tax Convention including its Commentaries as source of law. The conclusion in this paper is that after the implementation of BEPS, the courts will still accept them as a source of law, but possible situations of double taxation will eventually lead to the need for a re-write of the *Inkomstskattelagen* instead of relying on the soft law of the OECD.
Preface

When discussing transfer pricing issues in general, and situations involving MNEs in particular at least the focus of the author has been on physical products and how to compare the intra group trades with trades of comparable goods between stand alone companies. The ongoing shift in the World Economy from commodities to knowledge based economies raise questions on how to apply transfer pricing to intangibles, how to define an intangible in a tax law context and even if the arm's length principle is relevant.

This thesis highlights the recent changes to the OECD policy regarding hard to value intangibles, with a special focus set on hard to value intangibles and the profound changes introduced in the Final BEPS-Report. The thesis further focuses on discussing the recommendations of the OECD in a Swedish legal context.
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<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ALD</td>
<td>Arm's Length Distance</td>
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<td>ALP</td>
<td>Arm's Length Principle</td>
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<td>APA</td>
<td>Advanced Pricing Agreement</td>
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<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
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<tr>
<td>COMMENTARIES</td>
<td>Commentaries on the Articles of the OECD Model Tax Convention</td>
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<td>CUP</td>
<td>Comparable Uncontrolled Price method</td>
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<td>CWI</td>
<td>Commensurate With Income</td>
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<tr>
<td>DEMPE-FUNCTIONS</td>
<td>Development, Enhancement, Maintenance, Protection and Exploitation</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>G20-GROUP</td>
<td>Group of Twenty Finance Ministers and Central Bank Governors</td>
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<tr>
<td>HFD</td>
<td>Högsta Förvaltnings Domstolen (Swedish Supreme Court)</td>
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<td>IL</td>
<td>Inkomstskattelagen (Swedish Income Tax Act)</td>
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<tr>
<td>MNE</td>
<td>Multi National Enterprise</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>PE</td>
<td>Permanent Establishment</td>
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<tr>
<td>TPG</td>
<td>OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations</td>
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<td>GUIDELINES</td>
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1. Introduction

1.1 Background

Intangibles have become a significantly more important part of the economic activity with a shift from a world market based solely on the trade of commodities and low specialized industrial goods. With the evolvement of a knowledge based economy the shift from tangible products to intangibles new problems arises when attempting to apply traditional methods of internal pricing.\(^1\)

First, this thesis will discuss the relevant definition of intangibles, and differences between intangibles and physical goods when determine the correct transfer price. Also the ALP is introduced and put into a context of intangibles. The OECD Model Conventions and their Commentaries are introduced, so is the BEPS Project, with a focus on Actions 8-10 covering intangibles in particular. The changes due to the BEPS Actions 8-10 and the implications due to differences in national interpretation and application of the ALP are also highlighted. Further, this is put in a context of relevant methods to implement changes to the Convention and their Commentaries into the interpretations of international treaties – here tax treaties.

This thesis will describe the definitions of Intangibles, and that there is not one single definition. The characteristics of an intangible in itself also opens up for different interpretations and discussions upon demarcations about what is and what is not to be characterized as an intangible.\(^2\) The focus will mainly be on the OECD definition, and the discussion is held in a tax law perspective.

The businesses conducted by Multi National Enterprises – MNEs constitutes the bulk of the total World Trade, and about one third of the US trade is intra group transactions of MNE's.\(^3\) When trade is performed within a group of companies, there are specific characteristics distinguishing the actions of the group companies from business conducted between comparable stand alone companies.\(^4\) This can be seen as obvious, considering for example lower financial risks when performing intra group sales compared to doing business externally. The MNE also, for example faces substantially lower marketing and sales cost in its intra group ventures. Given this basic description of the differences involving the trade between group members and stand alone companies, this also opens up for a

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1 OECD Innovation Strategy 2010, p. 11, 32 ff.
2 Verlinden, I., and Mondelaers, Y. Transfer Pricing Aspects of Intangibles. p. 50 f.
4 Monsenego J., Introduction to Transfer Pricing, p. 3 f.
potential different treatment for tax purposes.\textsuperscript{5} The current approach by the EC in high profiled cases like Apple, Starbucks and World Duty Group (Santander/Autogrill) is rather to apply the the conditions and outcomes of stand-alone companies as an approximation for companies belonging to a group.\textsuperscript{6} Worth noting is that being an MNE performing intra group transactions does not equal tax avoidance. The EU Commission is clearly not taking into account the specific conditions of the MNE not having to carry the burdens of a sales, marketing or distribution organization when doing intra group trades.\textsuperscript{7} Whether the approach of the EU Commission can motivate a fictive recalculation of income is not within the limits of this thesis, but will most likely be discussed intensively among both tax practitioners as well as academics when the Commission's use of an artificial benchmark may find its way to the CJEU later this year.

The characteristics of an MNE, namely that they operate in several countries also opens up for tax evasion or avoidance since taxes in general are not harmonized between different countries.\textsuperscript{8} The construction with group companies in different countries therefore opens up for an incentive to shift profits from high to low tax states.\textsuperscript{9} As described, the conditions for intra-group transactions differs from transactions between independent businesses. Transfer pricing and the arm's length principle could be seen as tools for providing a fair allocation of taxes between states concerned. The transfer price could then, very simplified be described as the market price between independent contractors, and be used when calculating the correct profit split within a group of companies.\textsuperscript{10} Therefore, by practice an effective and relevant transfer pricing policy, the intra-group pricing is at an arm's length distance. The OECD has adopted the arm's length principle in Article 9 of the OECD Model Tax Convention. The arm's length principle and the arm's length distance are both widely recognized methods in most countries, but their application differs widely.\textsuperscript{11} Also worth noting is that the transfer pricing definitions and guidelines by the OECD are accepted by most states, but not by all. Also worth noting is that the works of the OECD are never binding, they should always be regarded as what they are: soft law. In the OECD definition of a correctly calculated transfer price the definition is by the author of this thesis seen

\textsuperscript{5} Ibid, p. 5 ff. Also see Luja, R. State Aid Benchmarking and Tax Rulings, p. 113 ff. Further, see the OECD: Aligning Transfer Pricing Outcomes with Value Creation ACTIONS 8-10: 2015 Final Reports, p. 68, para. 6.30 regarding synergies not being an intangible.


\textsuperscript{7} See C/2016/2946 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, and DG COMPETITION WORKING PAPER ON STATE AID AND TAX RULINGS, p. 3 ff.

\textsuperscript{8} Monsenego J., Introduction to Transfer Pricing, p. 3 ff.

\textsuperscript{9} See for example Correia M., Taxation of Corporate Groups, p. 72 ff, 116 ff.

\textsuperscript{10} See OECD TPG (2010), p. 31 f.

\textsuperscript{11} Ibid, p. 36. Also see Bullen, A.,Arm’s length transaction structures, p. 310 ff.
as weak when the OECD highlights that the transfer pricing should be both fair when dividing the taxes between states, as well as reasonable.\textsuperscript{12}

The development away from an economy solely based on trade with tangibles to a new economy with the lion's share of the international trade involving intellectual property like patents, trademarks, licenses and other non tangibles also opens up for difficulties when determining the correct transfer price, and consequently, what the correct ALP is. From the introduction of this thesis, the basic concepts of transfer pricing are introduced, so is the ALP. What has not been mentioned is the difficulties to determine a correct, or even a reasonable transfer price.\textsuperscript{13} When dealing with tangibles, the chances to find relevant comparables, of course varies, but in most cases it can be done, and the transfer price can be fairly more or less correctly calculated, even if the area of transfer pricing for tax purposes should be seen as doing assessments rather than finding the only correct transfer price. The length of an arm might vary. Intangibles, on the other hand, are often very specific, and can hardly be compared to another intangible. Are there any relevant comparables? And could a future cash flow be predicted with reasonable certainty? Perhaps not. Intangibles also often constitute a part of a tangible, thereby breaking out the correct value of the tangible from the total price might be difficult or even impossible. The problems with demarcations when deciding the value of an intangible as a part of a compound service or product, as well as the lack of relevant, internationally comparable data constitutes an obstacle when determining the correct transfer price. At the same time, finding relevant data and if possible comparables could be necessary for the involved companies to ensure the relevance of the transfer price applied.\textsuperscript{14}

As described above, applying cross border transfer pricing may be even more difficult in case where the nations do not have harmonized rules and polices in the field of transfer pricing. This opens up for situations of double taxation. The OECD highlighted in 2010 that transfer pricing involving intangibles was a key area of concern for both the states as well as the involved companies. This is due to the difficulties to decide the correct transfer price in general, but also due to the problems with the identification and valuation of intangibles when the guidance was found to be inadequate.\textsuperscript{15}

In the OECD Transfer Pricing Guidelines the organization provides guidance upon how to identify comparables, methods for adjustment and how to handle the determination of the correct transfer price in absence of any relevant comparables. The organization introduces some transfer pricing methods, that will be introduced and discussed later in this thesis. The Transfer Pricing Guidelines also

\textsuperscript{12} See Art. 9, para 1.12-1.13 of OECD Model Tax Convention on Income and on Capital as of 15 July 2014.

\textsuperscript{13} OECD TPG (2010), p. 201-203, para. 6.29-6.35

\textsuperscript{14} OECD: Aligning Transfer Pricing Outcomes with Value Creation ACTIONS 8-10: 2015 Final Reports, p. 34 ff.

\textsuperscript{15} OECD TPG (2010), p. 191 ff, para. 6.1-6.7
focus on the documentation required and how the involved companies have to motivate the use of a single method, as well as in what way comparables are selected and why.\footnote{OECD TPG (2010), p. 41 ff, ch. 1: d1 -d2.}

In the Action Plan on Base Erosion and Profit Shifting the background of the BEPS-project is described by the OECD as an effect of the ongoing internationalization of the world economy and the increased importance of the MNEs. The OECD further highlights the effects of tax evasion through tax treaty shopping.

The main purpose of the BEPS-project is, according to the OECD arrangements, aiming for no taxation or very low level of taxation through the shift of taxation from countries where the actual business is conducted to countries solely of tax reasons. The reallocation is possible because of intentional or unintentional gaps in tax treaties but also by differences in both, different national tax systems as well as, for example the application in the field of transfer pricing. Further background to the BEPS-project is the effects of the rapid changes driven by the technical development in the digital economy and the shift towards a significant higher part of the economy consisting of intangibles.\footnote{OECD/G20 Base Erosion and Profit Shifting Project Explanatory Statement 2015 Final Reports, p. 4.} OECD has dedicated a separate part of the BEPS-material to intangibles to be found under Actions 8-10 of the Final BEPS-report released in 2015.

\section*{1.2 Introduction to transfer pricing calculation of intangibles}

In this thesis the specific characteristics of intangibles in comparison to physical goods are described, together with the difficulties to correctly determine the transfer price. Further, the concept of Hard to value intangibles (HTVIs) is introduced, and the definition according to the OECD under both the Guidelines as well as the BEPS Actions 8-10.

The term “intangible” is by the definition in the Final BEPS-Report intended to address something which is not a physical asset or a financial asset, which could be owned or controlled for use in commercial activities, and at the same time the transfer or use would have constituted a compensation if the transaction would have happened between independent contractors in a comparable situation.\footnote{OECD: Aligning Transfer Pricing Outcomes with Value Creation ACTIONS 8-10: 2015 Final Reports, p. 67, para 6.6.}
The definition of what constitutes an “Intangible” under the definition of the Final Beps-Report have been argued to be broad due to an approach by the OECD rather to grasp for any situation instead of opening up for potential loopholes.19

In the Final BEPS-Report the term HTVI is defined as: “intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (i) no reliable comparables exist; and (ii) at the time the transaction[s] was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.”20

The stand point of the OECD is that when determining the transfer price for transactions involving hard to value intangibles, comparables should be used if available.21 Since, as described above, characteristics of the HTVI rarely enable the use of comparables or an application of a market price, the determination of the correct transfer price inevitably opens up for arbitrariness. At the same time, the calculation of the transfer price for the HTVI rest on data compiled by the involved companies, which opens up for a situation with a substantial risk for information asymmetry between the companies conducting the business on one hand, and the tax authorities on the other.22

### 1.3 Purpose and questions at issue

Considering the seemingly ambitious changes introduced under Action 8-10 of the BEPS-report regarding transfer prices, and particular HTVIs this opens according to this thesis up for potential situations of double taxation due to the different application of the Transfer Pricing Guidelines in various countries. Further, the development from the Guidelines introduced in 2010 to the wording of the BEPS-Report under Actions 8-10 raises the question if the changes automatically will be accepted as a (soft) source of law by the Swedish courts, or if there is a need for implementation.

The purpose and question at issue is:


1. Is there a need for modification of the Swedish *Inkomstskattelagen* due to the extensive changes under BEPS Actions 8-10 to avoid situations of double taxation?

### 1.4 Delimitations

This thesis focuses discusses the BEPS Action 8-10, with special focus on the changes introduced in Action 8 and their potential implication when and if the changes are implemented into Swedish law. Since the changes proposed in Action 8 also lead to changes of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, it is relevant to put Actions 8-10 in perspective of the Guidelines.

The Final BEPS Report was released in 2015, with more guidance regarding Hard to Value Intangibles the following year. The Final Report and the HTVI are within the scope of this thesis, but since the changes suggested in the BEPS-project are not by far implemented in national law or in revised tax treaties, the actual effect on both domestic as well as cross border intra group trade is not known. Therefore, the potential effects of the changes suggested in Action 8 are solely discussed in terms of current national methods for applying transfer pricing, and the writings of current tax treaties.

In the Final BEPS Report, Actions 8-10 were presented as an entity concerning the field of transfer pricing. In this thesis, the focus is on Action 8, other parts of the BEPS Report will only be commented upon in the light of Action 8. The implications of the changes introduced in Action 8 are discussed from a legal point of view. Transfer pricing could, and perhaps should also be seen and discussed from an economic perspective as well, but in this thesis, economic questions are only discussed when needed to illustrate the relevant legal questions at hand.

### 1.5 Method and material

The purpose is to analyse the potential conflicts and situations of double taxation and double non taxation involving intangibles arising from national differences in the field of transfer pricing and differences in the interpretation of the same. These potential conflicts are discussed in the light of the proposed changes presented by the OECD in the BEPS Report under Action 8.
The most appropriate method for the analysis is the legal dogmatic method. Sources are then used in accordance with the legal doctrine. Targeting an ongoing process, the implementation of the changes proposed in BEPS Action 8 by the OECD requires the use of the sources as they stand today, something significant for the legal dogmatic method, which makes its use appropriate for this thesis. Using the legal dogmatic method means that the sources of law should be treated hierarchically. Here the relevant interpretation is that national law prevails over the OECD Guidelines and the BEPS-Report.

The main sources are the works of the OECD, with a focus set on the Final BEPS-Report together with the Transfer Pricing Guidelines and its Commentaries. The material of the OECD is analysed together with relevant academic articles and books as well as Swedish case law.

### 1.6 Outline

Chapter 2 introduces the work of the OECD in the field of transfer pricing. Further, the BEPS-project focusing on the Action 8 of the Final Report regarding HTVI is presented. Chapter 2 also gives a background to the terms transfer pricing and arm's length principle together with the definitions of the OECD. Finally, the chapter highlights the distinctive characteristics of the HTVIs, and the CWI-regulations as a source of inspiration for the *ex post* mechanism introduced with the BEPS Final Report.

Chapter 3 is dedicated to the OECD's material regarding transfer pricing and the arm's length principle, focusing on the legal relevance of the Commentaries to the Model Tax Convention. The Vienna Convention on the Law of Treaties is introduced, and discussed as a relevant starting point for the determination of how to approach the Commentaries as a source of law. Further, the static and ambulatory methods of interpretation are introduced and discussed.

Chapter 4 places the work of the OECD in the field of transfer pricing with a special focus on HTVIs in a Swedish perspective. Relevant cases involving HTVIs spanning over almost 50 years are discussed with the aim to determine to what extent the Convention and the Commentaries are relevant sources of law, and if an ambulatory or static method of interpretation is advocated by the courts.

Chapter 5 provides the final remarks with a discussion about the *ex post* adjustment mechanism introduced under Action 8 of the Final BEPS-Report and the potential risks of double taxation arising. Finally, the conclusion will be drawn by the author regarding if the changes coming out of the Action 8 implies a need for changes to the Swedish *Inkomstskattelagen* as well as tax treaties or if it is

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business as usual from the perspective of the Swedish courts accepting the soft law material of the OECD as a relevant source of law.

2. The OECD material in the field of transfer pricing

2.1 OECD Model Tax Convention

The objectives behind the Model Tax Convention as well as entering into tax treaties could be described as removing tax barriers in situations of international trade and investments. In the first paragraph of the introduction to the Model Tax Convention the OECD introduces the term double taxation, with the definition:

"International juridical double taxation can be generally defined as the imposition of incomparable taxes in two (or more) States on the matter of the same taxpayer in respect of the same subject matter and for identical periods.”

Further, the aim of the OECD Model Tax Convention is described as a tool for clarification, standardization and confirmation of the fiscal situations of companies conducting business abroad by in situations of double taxation.

2.2 The Commentaries to the OECD Model Tax Convention

Since the Model Tax Convention in itself should be seen as a framework, the OECD on a regular basis issues Commentaries to the Convention. In the introduction to the Convention, the OECD presents the approach that the Commentaries should be taken into account when applying the Convention, but not to be seen as legally binding as the Convention when incorporated with a treaty. But, further, the OECD is of the opinion that the correct interpretation of the Model Tax Convention not only should take the Commentaries and reservations made into account, a correct interpretation of the Convention should be in line with the latest Commentaries. This approach may, according to this

25 See the introduction, II to the OECD Model Tax Convention (as of 15 July 2014)
26 See the introduction, I2-3 to the OECD Model Tax Convention (as of 15 July 2014)
27 See the introduction, I 9, para 29.1-2 of the OECD Model Tax Convention (as of 15 July 2014)
28 See for example the introduction, I 11, para 36 of the OECD Model Tax Convention (as of 15 July 2014)
thesis, be problematic if and when the ongoing process of the OECD goes beyond the intentions of the concluding parties at the time they entered into the tax treaty. This will be discussed in terms of the ambulatory and the static interpretation model later in this thesis.

2.3 **Action Plan on Base Erosion and Profit Shifting**

The BEPS-Project originates from the work of the Global Forum on Transparency and Exchange of Information for Tax Purposes initiated 2009 eventually resulting in the BEPS-Project was initiated by the G20-Group and is administered by the OECD. In 2013, the G20-Group approved the BEPS Action Plan.\(^ {29}\) The project is oriented towards strategies and methods applied by MNEs to shift profits from high to low or no-tax countries because of gaps and mismatches in tax rules and the application of the same, as well as in the application of tax treaties.

In the Action Plan on Base Erosion and Profit Shifting the background for the need of the BEPS-Project is described by the OECD as an effect of the ongoing internationalization of the world economy and the increased importance of the MNEs. OECD further highlights the effects of tax evasion through tax treaty shopping. Further background to the BEPS-Project are the effects of the rapid changes driven by the technical development in the digital economy, and the shift towards a significant higher part of the economy consisting of intangibles.\(^ {30}\) These changes requires revisions of concluded tax treaties according to the OECD. Due to this fact, the OECD have in the Final Beps-Report Action 15 explored the feasibility of an instrument to modify tax treaties for an efficient implementation of the BEPS-induced changes that affects the concluding parties of a tax treaty.\(^ {31}\) Changes under Action 15 is due to have affect from 2018 by the earliest with a signing ceremony scheduled to be held in Paris on June 7th 2017.\(^ {32}\)

2.4 **The Arm's Length Principle**

The aim of the arm's length principle is to determine the hypothetical price of an transaction if the contractors would have been independent, and not related.\(^ {33}\) In

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29 OECD. Background Brief, Inclusive Framework on BEPS, OECD Publishing.

30 Ibid


33 See OECD TPG (2010), para 1.32
situations with non-related parties, the conclusion by the author is that the parties in each situation are striving for profit maximization. With an increasing part of the world economy consisting of activities of MNEs as, the economic importance of intra group transaction are consequently increasing. In these situations, it is rather the total outcome of the group, not the result of each group company that is of central interest. Given the focus on the result on a group level, a lowered total tax liability will influence the total group result in a positive way. By shifting place of taxation from high tax countries to countries with a lower tax rate, this positive effect on the overall group result could be obtained. One simple measure to do this could be by adjusting the internal prices in, “a creative way” to shift costs to high tax countries, and let the profits be taxed where the taxes are low. The intra-group pricing of transactions are handled in the Article 9 of the OECD Model Treaty.\textsuperscript{34} The definition of the arm's length principle is:

“1.a) Where an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.”

The definition of the arm's length principle as given in Article 9 of the Model Tax treaty is widely accepted among both OECD members and non members but the

\textsuperscript{34} See OECD. Model Tax Convention on Income and on Capital, 2014, p. 29 f.
application and interpretation differs substantially between different states. The methods for allocation of the total taxable amount of a group are also introduced in Article 9 of the Model Tax Treaty. The methods advocated are the market price method, cost plus method and the resale price method. For the last two methods, the calculations are based on costs and the sales price and a assumed margin based on branch average. The margins are then added respectively subtracted to decide the correct arm's length price to use for tax purposes.

The Guidelines provide guidance for what calculation method to use. The initial approach is to use a method appropriate for the actual situation. The primarily recommended method by OECD's Guidelines is the CUP-method. The Guidelines further recommends methods based on transactions prior to profit based methods.

The aim of the recommended CUP method is to calculate the arm's length price based upon the estimated price of independent contractors. The differences between the actual and the calculated price are established, and then an adjustment is made to the price of the intra group transaction for tax purposes. The method can be criticised for the difficulties to find comparables relevant to decide an correct transfer price. One method at hand is to rely on a transaction between one of the involved, or another group company with an independent contractor. On the contrary to the internal CUP method, the external method relies solely on transactions between non-related companies.

The arm's length principle should according to the author be seen as a tool putting intra group transactions on an equal setting as independent contractors. The arm's length principle is by that an unilateral method, contrary to the substance over form approach implemented in national laws. Even more important, the arm's length principle is a measure going beyond the guidance of the OECD. The guidance and interpretation given by the OECD is in this thesis seen as one interpretation among a number of interpretations of the method. But, noteworthy, the method of the OECD is the most accepted and widespread interpretation with most tax treaties based on the Model Tax Treaty. But referring to and relying on the OECD or other interpretations of the principle is according to this thesis an too

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35 Monsenego J., Introduction to Transfer Pricing, p. 15. UN, Practical Manual on Transfer Pricing, para 1.5.10
36 See OECD TPG (2010), para 2.2-2.3
37 Monsenego J., Introduction to Transfer Pricing, p. 41 ff.
39 OECD TPG (2010), para 2.14
40 See for example Her Majesty's Revenue and Customs clarification for the CUP method.
42 For example, see Swedish case law refering to the OECD Guidelines as a relevant source of law. Some relevant cases are described in this thesis in section 4.5.
shallow approach. The interpretation should instead be based on the principles established in the Vienna Convention on the Law of Treaties. The current version of the Commentaries to the Article 9, on the other hand does not give any reference to the Vienna Convention neither do the Commentaries define any clear limitations for the principle.

The Swedish case law as it stands regarding transactions with intangibles will be discussed later in this thesis. As an introductory remark about the arm's length principle in a Swedish context, it is worth reflecting on the outcome of the Graphic Design case even though the case was about financial transactions, not intangibles. In the Graphic-Design case, the court established the view that a fixed interest rate for internal financing operations was problematic, and by that, determining the arm's length distance was difficult.\textsuperscript{43}

In the Iduna case the court developed the discussion from the Graphic Design case by broadening the reasoning regarding the difficulties to determine the arm's length distance. The court here discussed the correct pricing of the intra group financing when applying an interest span, but still as described above, found establishing the proper transfer price at an arm's length distance difficult. Approaching the arm's length principle and the valuation of the financial transaction by applying a span rather than a fixed price is in line with the OECD Guidelines as well as the BEPS Actions 8-10 regarding intangibles. But as the court pointed out in the Iduna case, even to decide a correct span for the transfer price is difficult.\textsuperscript{44} The conclusion in this thesis is that the view of the court regarding an interest span also could be applied to intangibles. In this thesis the development under BEPS Action 8-10 is described and indicating the new problems arising when being implemented in a Swedish legal context. The Iduna case may imply some difficulties to determine the correct transfer price in a situation where there are several possible prices within a span being at arm's length distance. This could by some also be seen as that there is no correct Arm's length distance, or as Reuven S. Avi-Yonah puts it, there is no sensible arm's length price.\textsuperscript{45}

2.5 Hard to Value Intangibles

Transfer pricing situations involving HTVIs are addressed in the Final BEPS-Report with the aim to reduce the information gap or rather asymmetry between tax authorities and taxpayers, here in practice group members of MNEs.\textsuperscript{46} The asymmetry is described in the report as specialized knowledge, expertise and

\textsuperscript{43} Graphic Packaging International Holding Sweden AB, Case 2938—2943-05. Kammarrätten Jönköping.

\textsuperscript{44} Iduna AB, Case 5045-05. Kammarrätten Göteborg.

\textsuperscript{45} Avi-Yonah, Reuven S, p. 73.

\textsuperscript{46} OECD: Aligning Transfer Pricing Outcomes with Value Creation ACTIONS 8-10: 2015 Final Reports, p. 109, para 6.186
knowledge, further the report points at situation where the actual outcome significantly differs from the transfer price, with the question arising if the \textit{ex-ante} calculation was correct, with the deviation due to unforeseen factors or an incorrect transfer price.

Unlike the preceding BEPS working paper released in August 2014, the Final BEPS-Report advocates the use of the arm's length distance, and a method in line with the CWI-rules. The outspoken intention by the OECD is to include price adjustment mechanisms in the business agreements, mainly between group members of MNEs, especially in situations involving hard to value intangibles. As discussed in the background to this thesis, intangibles in general are significantly hard to value due, for example, due to the lack of comparables and being an embedded part of a service or product. The definition of a HTVI is an intangible asset with no comparables at the time of the transaction, and no reliable cash flow estimation of future incomes.\textsuperscript{47}

The definition given by the Final BEPS-Report includes situations where:

- The Intangible is under development at the time of the transaction
- The time of the commercialisation of the intangible is not know at the time of the transaction, or is not planned to happen until several years ahead.
- The intangible is integrated as part of the development of other hard to value intangibles.
- Historical data from previous developments of similar intangibles is not available
- The Intangible is transferred to a group company at a fixed cost.
- It is developed or used under a cost contribution arrangement.\textsuperscript{48}

The opinion of the author given by the list of characteristics and the broad definition of HTVIs, most intangibles could be classified as hard to value intangibles. Action 8 introduces the use of actual financial outcomes of a transaction involving HTVIs under certain conditions. The Final BEPS-Report especially highlights that differences between the calculation made prior to the transaction and the outcome are not in line with the arm's length principle unless unforeseen events arise.\textsuperscript{49} From a practitioners view, a correct transfer price at arm's length distance may never be entirely possible to determine.\textsuperscript{50}

\textsuperscript{47} OECD: Aligning Transfer Pricing Outcomes with Value Creation ACTIONS 8-10: 2015 Final Reports, p. 109, para 6.187-6.189

\textsuperscript{48} Ibid, p. 109, para 6.190

\textsuperscript{49} Ibid, p. 109, para 6.181

\textsuperscript{50} Bullen, A., p. 319 f.
BEPS-Report also opens up for situations where the presumption mentioned may be set aside according to this thesis.

The term “unforeseen events” may be used in situations of deviation. To start with, the taxpayer has to present documentation of the original calculations and methods used and the reasonability of the same. The taxpayer has in addition to provide facts to support that unforeseen events can explain the deviations, and further that the deviations were caused not by an underlying business risk or natural volatility but an unforeseen event. The term is most likely to be read in a similar way as ”act of good”.

As discussed, knowing the outcome of an business transaction in advance is almost impossible, The Final BEPS-Report, therefore, opens up for a span of deviation of +/- 20 % that still is considered to be at the arm's length distance.

### 2.5.1 CWI regulations

The use of CWI regulations originates from the US with no previous application in the EU pre BEPS, with the exception of Germany. The CWI regulations of both the US and Germany include the 20 % safe harbour also suggested under Action 8. The ex post corrections to previous fiscal years are adjusted the forthcoming years, no actual re taxation of previous years are made. The German method opens up for the use of the price adjustment mechanism in absence of comparables, or an adjustment clause if such a clause could have been required for independent contractors.

In countries not having CWI regulations in place, adjustment mechanisms are in many cases applied and justified as being part of the arm's length principle in accordance with the Guidelines.

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51 OECD: Aligning Transfer Pricing Outcomes with Value Creation ACTIONS 8-10: 2015 Final Reports, p. 109, para 6.194


55 See OECD TPG (2010), ch1 para 45-48.
3. The Vienna Convention on the Law of Treaties

The Vienna Convention on the Law of Treaties states how international law should be constructed and how the implementation of treaties between states should be conducted. The Vienna Convention on the Law of Treaties also defines an essential principle of the Law of Treaties, *jus cogens*.\(^{56}\) Hultqvist and Wiman points out that there is no stand alone Law of Treaties. Instead the Law of Treaties rests on independent states cooperating with the support of common norms like the Vienna Convention.\(^{57}\) Lindencrona describes the importance of the parties mutual intentions and purpose at the time the treaty was concluded. Further Lindencrona refers to the term *pacta sunt servanda*, concluded agreements should be obtained both regarding the interpretation of the agreement as well as the application.\(^{58}\) This is in line with the Article 27 of the Vienna Convention on the Law of Treaties, that also states that national law never can justify any deviations from concluded (tax) treaties between nations.

A highly debated opinion could be found in the doctrine saying that the exact wording of the treaty limits the space for its interpretation. By adapting this stand point, any further going interpretations beyond the intentions of the contracting parties at the time the treaty was conducted is avoided.\(^{59}\)

An interpretation in line with the Vienna Convention on the Law of Treaties gives rise to a situation that taxation beyond the intentions of the treaty at the time of conduct is not in line with the Convention, if adopting a static method of interpretation. The same conclusion should by that be drawn for situations excluded from the treaty. By instead adopting national law opposed to the treaty by a tax treaty override is by that to be considered as a breach of the Vienna Convention on the Law of Treaties.\(^{60}\)

The Vienna Convention on the Law of Treaties differentiates between the primary

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\(^{56}\) Vienna Convention on the Law of Treaties.United Nations Treaty Series, see section 1, art. 1-18 and section 2 art. 53.


\(^{60}\) Bring, O. Mahmoudi, S. Sverige och folkrätten, p. 44.
and supplementary interpretation method. The primary interpretation is described in Article 31 and significantly highlights the importance of the exact wording of the treaty. At the same time, the primary method opens up for interpretations in good faith, *bona fides*. By that, the primary method requires a strict interpretation if a situation or a term is distinctly defined, whether a national interpretation has come to another conclusion. The supplementary method could and should be applied in situations not covered by the primary method, or where the primary method is not relevant.\(^{61}\) Lindencrona sees the interpretation of the method to be the intention of the contracting states. The supplementary method could also be used to validate the outcome of the analysis under the primary method.\(^{62}\)

In national Swedish law, the Luxembourg-case is of special importance with the HFDs opinion that the Vienna Convention on the Law of Treaties on the Law of Treaties and especially the Articles 31 to 33 in general could be used for the interpretation of tax treaties. In the specific situation between a contractor and the Swedish tax authorities.\(^{63}\)

An interesting approach is introduced by Michael Kobetsky meaning that the model treaty should not be seen as an agreement in accordance with the definitions in art. 31.3 of the Vienna Convention. Kobetsky argues that in situations where the Commentaries are not considered for a primary interpretation, the supplementary interpretation should take them into account. This view is justified by Kobetsky due to the fact that the Commentaries in a supplementary analysis is limited to be a confirmation of the outcome of the primary interpretation. In doctrine, the opinion that the Commentaries to the Model Tax Treaty is not an agreement in line with the Vienna Convention on the Law of Treaties article 31 (3) is sometimes heard. Kobetsky argues that the commentaries are not relevant material when applying the primary method, but when using the supplementary method. Kobetsky argues that the supplementary method is not a stand-alone method, but only to be seen as a complementary method to the primary method.\(^{64}\)

### 3.1 The relevance of the revised versions of the Convention and the Commentaries

As described in Chapter 2 the OECD underpins the Model Tax Convention with regularly updated Commentaries. The conclusion in chapter 2 was further that according to the OECD the Model Tax Convention should be interpreted in the light of the latest changes and reservations made in the Commentaries. Hilling and

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\(^{62}\) Lindencrona, G. *Dubbelbeskattningsavtalsrätt*, p. 82 ff.

\(^{63}\) See Case RÅ 1996, ref 84. The Luxembourg Case. The case is discussed in this thesis in section 4.5.3

\(^{64}\) Kobetsky, M. *International Taxation of Permanent Establishments*, p. 164 ff.
Linderfalk describes this approach of the relevance of the Commentaries when interpreting previous concluded tax treaties as problematic as well as being debated among academics.  

When interpreting previous concluded tax treaties, either the static or the ambulatory approach could be used. But also a mix of approaches could be applicable.

Arguments for the static approach could be found in the fact that the actual wording of the Convention and the Commentaries constitute what the parties agreed upon, and no further developments beyond the intentions of the parties will distort the interpretation of what actually was agreed upon when entering into the treaty. On the other hand, the wordings of the Convention and the Commentaries are not static due to the mere fact that the work of the OECD has the purpose to be a tool for avoiding double taxation. The view in this thesis is that the parties entering into a tax treaty wish to achieve this. The assumption that both the Convention and the Commentaries have to adopt to external factors to fulfil the underlying aim by that suggests at least a partially ambulatory approach instead.

Hilling and Linderfalk point out that among international tax law experts, the general approach to the ambulatory method is in general averse. The method is according to Hilling and Linderfalk questioned on the grounds of how Commentaries written decades after the treaty was entered into could support the interpretation when establishing the intention of the concluding parties of a tax treaty.

But further, and more interesting is that Hilling and Linderfalk on the other hand also refers to the consensus of the current expertise as being rather a discussion when and how the ambulatory approach should be adapted, than a strict choice between an ambulatory or static method. This is also the opinion of Lang limiting the use of the ambulatory method to only exceptional cases. Further Lang argues that the changes to the Commentaries after the conclusion of the treaty rarely can represent the intentions of the parties. An exception is found in situations where the forthcoming changes were known in beforehand at the time of entering into a tax treaty.

65 Linderfalk, U., Hilling M. The Use of OECD Commentaries as Interpretative Aids-The Static/Ambulatory–Approaches Debate Considered from the Perspective of International Law. Nordic Tax Journal, 2015:1, p. 34. Also see Linderfalk and Hillings references to Vogel and Avery Jones.
66 Ibid
67 Ibid
68 Ibid, p. 45 f.
69 Ibid, p. 34
70 Lang, M., (2013)
Vogel on the other hand introduces a method to settle upon the relevance of the Commentaries in a specific situation. Vogel's five step method focuses on the time elapsed from the changes made to the Commentaries and if the changes have found acceptance within the tax law community. Vogel rests his reasoning on the Vienna Convention's Articles 31.1 and 32 respectively when concluding that recent changes only should be interpreted supplementary while the older, broadly accepted Commentaries, open up for an ambulatory interpretation.71

The changes made to the Commentaries after a treaty was concluded are discussed from a lack of democracy perspective by Wattel and Marres, who state that the updates do not have legitimacy since not being known for the states – or the citizens of the states when entering into the tax treaty. From that standpoint Wattel and Marres recommend the static approach as the first choice of method.72

From the Swedish doctrine Sallander discusses the approach by the HFD in the Luxembourg-case by concluding that the court by initially refering to the Commentaries at the time of conclusion of the treatie, but then also investigating the following versions to find guidance regarding the interpretation. The conclusion by Sallander that the HFD took an ambulatory approach is in line with the opinion of the writer of this thesis. Also Burmeister agrees with Sallander, and adds that Commentaries post the signing of a treaty is only a relevant source in situations of legal certainty.73

3.2 A broader definition of the aim of the treaty

In the discussion made by Hilling and Linderfalk the authors rephrase the definition of the treaty interpretation process as "the common intention of the treaty parties laid down in the Vienna Convention" to "establish the communicative intention of the treaty parties".74 In this thesis the opinion is that accepting the definition by Hilling and Linderfalk – what is the meaning the treaty should communicate, also opens up for an acceptance of the ambitious changes suggested under BEPS Actions 8-10 without making updates to most of the concluded tax treaties.

The argumentation for accepting the stand point of Hilling and Linderfalk is that

72 Wattel, P., Marres, O. (2003), p. 224, 228
their definition is broader, but at the same time takes into account the essence of the concluding parties' intentions at the time of entering into the treaty. If the changes suggested in the Final BEPS-Report will be accepted by various states is eventually for the respective national legal systems to decide. At this point, the conclusion in this thesis is that the risk of different interpretations about if and how to accept the changes in the Final BEPS-Report opens up for situations of double taxation, as yet anyway will result in the need for revised tax treaties.

4. A Swedish perspective

4.1 Introduction to the Swedish application of the arm's length principle and the OECD Guidelines

In this chapter the Swedish transfer pricing legislation is introduced, with a focus on intangibles. Further, the national legislation in the light of the changes suggested in BEPS Actions 8-10 with a special focus set on the possible implications arising when being incorporated into national Swedish law is highlighted.

4.2 The arm's length principle in Swedish law

The term “arm's length principle” is not defined in itself in national Swedish law, neither is the term “transfer pricing” distinctly described. The Swedish income tax act, Inkomstskattelagen instead solely handles incorrect internal pricing in the Korrigeringsregeln, the Correction regulation found in Inkomstskattelagen, 14 ch. 19 para.

The Korrigeringsregeln targets situation of intra group transactions not being at arm's length. Any reference to the OECD Model Convention or other OECD material regarding transfer pricing is not given by the wording of the Korrigeringsregeln. The preparatory works and case law on the other hand clearly states the importance of the Model Convention with an interpretation fully in line with OECDs regarding the definition and how to determine the arm's length distance of an intra group transaction.75 As described earlier in this thesis regarding the arm's length principle according to the OECD definition, the Korrigeringsregeln solely aim at incorrect (here higher) intra-group pricing, in

75 See Prop. 2005/06:169, pp. 89-90. Also see section 4.5 for the discussion about relevant Swedish arm's length principle related cases involving intangibles.
comparison to a transaction between independent parties.\textsuperscript{76} By that, the \textit{Korrigeringsregeln} is not targeting abusive practices, neither is it a tool for annual concluded contracts irrespective of the underlying motive behind.\textsuperscript{77}

The wording of the \textit{Korrigeringsregeln} and the preparatory works gives little guidance on how to establish the correct arm's length distance. The implementation of the \textit{Korrigeringsregeln} therefore rests essentially on case law.\textsuperscript{78}

The application of the arm's length principle through the \textit{Korrigeringsregeln} rests at some basic conditions. Initially, the taxable person has to be liable to pay taxes in Sweden, under the definition of a business, not a physical person. Any income from capital is as well excluded. The parties should be group members, in line with the definition of privity. For the \textit{Korrigeringsregeln} to be applicable, the favoured party should not be subject to tax in Sweden. To determine if a group company is subject to Swedish tax, the definitions of the \textit{Inkomstskattelagen} are initially applied. If the answer is "Yes, taxes should be paid in Sweden", any double tax treaty at hand should be consulted with the effect that the \textit{Korrigeringsregeln} is applicable also in situations where taxes are not due according to the treaty.\textsuperscript{79}

The application of \textit{Korrigeringsregeln} requires an agreement concluded between two or more parties resulting in the taxable amount being lower due to terms in the contract deviating from the terms that would have been agreed upon between independent parties. By this definition, the \textit{Korrigeringsregeln} is in line with the Cup method recommended by the OECD in BEPS Action 8.\textsuperscript{80} Arvidsson concludes that from the available case law, comparison between one party and an independent contractor or the actual market price are accepted methods to determine the correct transfer price at arm's length distance.

Further, the companies involved should be part of the same interest sphere in accordance with the definitions of \textit{Inkomstskattelagen} 14 ch 20 para. The definition describes two main situations of interest spheres arising from ownership or control. The doctrine describes that the definition for ownership includes both direct and indirect ownership. From the wording of \textit{Inkomstskattelagen} and the preparatory works no specified level of interest is defined. The works of Arvidsson indicates that the ownership definitely not has to reach 50 \% of the capital or votes, instead significant lower levels still constitute a situation where an interest sphere is at hand.\textsuperscript{81}

\begin{itemize}
\item \textsuperscript{76} See Korrigeringsregeln, IL 14:9, especially p.1. Read about the required documentation in \textit{Inkomstskattelagen} ch.19:2:2.
\item \textsuperscript{77} Wiman, B. Koncernbeskattning med särskild inriktning på omstruktureringar, p. 81.
\item \textsuperscript{78} See the Commentary to Korrigeringsregeln by Lars Jonsson. Downloaded from https://www.karnovgroup.se/tjanster/juridik/karnov-lagkommentarer 2017-05-23
\item \textsuperscript{79} Ibid. Also see the preparatory work "Prop 1982/83:73", p. 11
\item \textsuperscript{80} See section 2.4.
\item \textsuperscript{81} Arvidsson, R., p 123 ff, 143 ff.
\end{itemize}
The OECD Model Convention together with the Commentaries opens up for situations where deviations from the arm's length principle are justified as described earlier in this thesis. This approach can be found in the *Korrigeringsregeln* and the preparatory works as well. The deviations could arise in situations when entering into a new market or launching new businesses. Also specific market conditions, for example hyper competition could justify deviations. In summary, the tax authorities should take into account situations resulting in deviations from the arm's length principle if the underlying motive to the pricing could be found in other factors then allocation of profits due to tax reasons.

The Guidelines should according to Burmeister not be seen as a traditional source of law, instead it is rather as to be seen as a guidance. In Article 9 of the Model Tax Treaty the reference to the Guidelines is introduced, and by that, the Guidelines should be seen as source of guidance to the interpretation of tax treaties based in the Model Tax Treaty.\(^82\) Since most tax treaties, including the ones concluded by Sweden are based on the Model Tax Treaty with its underlying Commentaries, the role of the Guidelines should be seen with reference to the interplay between the Model Tax Treaty, concluded tax treaties and domestic law.\(^83\) For example, Burmeister by that sees the Guidelines as a source of law anyway, due to its relation to the Model Tax Treaty and the definition of the ALP to be found in Article 9.\(^84\)

Tjernberg describes the situation as problematic regarding the relation between the Guidelines and the Swedish law in strictly domestic situations with risk eventually risks for double taxation due to the incomparability between the Guidelines and the application of Swedish law, *Korrigeringsregeln* in particular.\(^85\) Caldron describes a development in many state with an adaption of national law to be as Caldron puts it, “TPG-legime”. Still, as Caldron points out, the content of the TPG has to be implemented before constitute national law.\(^86\) Rick sees in general the work of the OECD as not fitting into the Swedish legal tradition.\(^87\) Burmeister reflects on the Swedish law as being strictly normative with the HFD having a dogmatic approach to the sources. From the approach of Burmeister, Tjernberg concludes that the methodology of the Swedish courts results in a narrow perspective in the discussion. Tjernberg also describes the role of the Guidelines in the case law as a result of the lack of precision in the wording of Korrigeringsregeln as well as the preparatory work. Tjernberg refers to the case law of HFD and comes to the same conclusion as this thesis that the court

\(^82\) See Burmeister, J., p. 189 f and Sallander, A-S. Svensk Skattetidning, p. 177 ff

\(^83\) See Burmeister, J., p. 186. Also see Dahlberg 2014, p 255.

\(^84\) Ibid, p. 186 f


\(^86\) Calderon, J., p. 11.

\(^87\) Rick, J., p.541 f.
undoubtedly sees the Guideline as a relevant source of law. This view is fully in line with the preparatory work stating that the Guidelines constitutes international accepted opinions and a well balanced approach to Transfer Pricing. Further, the preparatory work opens up for the use of the tax authorities of the Guidelines. From the doctrine as well as the preparatory work, the conclusion in this thesis is by that, rather not surprisingly, that the Guidelines serves as one relevant source of Swedish law. The requisites of the *Korrigeringsregeln* discussed by for example Arvidsson is according to this thesis fully compatible with the Guidelines. On the other hand, the opinion of Burmeister, that there is a difference to what extent the Guidelines serves as a source of low dependent on if the specific situation refer exclusively to domestic law or interpretation of tax treaties is reasonable, due to the fact that the Guidelines do not constitutes preparatory work to the *Korrigeringsregeln*. At the same time, the Model Tax Treaty is closely linked to the Guidelines. Bjuvberg on the other hand lifts the importance of the intentions of the parties at the time of conclusion of the treaty. Bjuvbergs opinion that changes adopted after the entry of a treaty by that should be accounted for if being in line with the intentions of the parties. The opinion in this thesis is that Bjuvb ergs approach could be seen as the consensus of the Swedish doctrine, and in line with the opinion of the HFD.

The discussion by Vogel regarding tax treaties and the domestic perspective is valuable by highlighting the development of the tax treaties in comparison with domestic law in a number of states. Vogel sees an ongoing development toward a situation with unwritten constitutional law binding the legislators in many countries. Vogel also concludes that tax treaties are lex specialis overriding domestic tax law. The author of this thesis sees nothing controversial about Vogels classification, instead, according to the author, the standpoint could be seen as generally accepted among Swedish scholars. The Swedish doctrine as well as the case law clearly shows the difficulties to prove whether deviations from the arm's length principle are a result of an incorrect transfer price or if they are justified due to reasons being a reasonable exception. The case law also states, that deviations from the arm's length distance not only have to be proven, they should also be considerable. This interpretation is in line with the definitions by the OECD. Further, the case law concludes that the tax authorities have to prove any situations falling under the scope of the *Korrigeringsregeln*, not the other way around. From the Shell case an interesting reference to the OECD Model Treaty was given. The court found the Model Treaty to be a relevant source of law and commented that the Treaty and the works of the OECD are soft law but constitute a relevant guidance and are not in opposition to the *Korrigeringsregeln*.

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88 Tjernberg, M., p. 120 ff.  
89 Burmeister, J. p. 189 ff.  
90 Bjuvberg, p. 427 ff and HFD 2016 ref 57. Also see HFD 2016 ref 23.  
91 Vogel, K. The domestic law perspective, p. 3,6,8.
Intangibles are covered in a few Swedish cases. RÅ 1998, ref 213 touches the area of how an intangible should be defined in accordance with the Swedish law. The case narrows down the definition. The definition in the case could be described as restrained but following the guidance by the OECD. Nevertheless, the suggestions given in the Final BEPS-Report under Action 8 is significantly broader than the definition in the RÅ 1998, ref 213 case.

On the other hand, the under court case 6885-6889-12 regarding royalty payments to a foreign group company indicates an approach from the court in line with the changes suggested under BEPS Action 8. The case comprises of a situation with an intangible developed by the Swedish company, but with the ownership transferred to a foreign group company. The reasoning by the court was that the development of the intangible by the Swedish company had caused costs, and should be compensated. The court took a comprehensive approach considering the value creation and where and when risks had occurred The outcome of the case were that part of the taxing rights was allocated to Sweden.

To conclude, the Korrigeringsregeln and its preparatory works give a weak guidance regarding how a correction in situations of incorrect intra-group transactions should be performed. From the case law the relevance of the work of the OECD is established. So is the use of the term arm's length distance following the definition of the OECD. Of special interest from the case law is further the relative limited definition of intangibles and the significant high evidentiary for the tax authorities to prove situations of incorrect pricing due to tax reasons instead of any of the accepted dispensations. In case 6885-6889-12 the court did interpret the Korrigeringsregeln and the soft law of the OECD extensively by what now can be described as being in line with the changes suggested in the BEPS-Report under Action 8.

4.3 Introduction to BEPS Actions 8-10 from a Swedish legal perspective

The suggested changes in the Final BEPS-Report under Actions 8-10 have been described earlier in this thesis, with a special focus set on the changes suggested to the definitions of the HTVIs. As described in the previous paragraph, the national Swedish law contains limited guidance regarding definitions of arm's length distance as well as the relation between Swedish law and the source value of the material of the OECD in the field of transfer pricing. In this section, problems arising from the implementation of BEPS Actions 8-10 into Swedish national law are discussed from a position questioning if the changes are in line with Swedish law, and if not, what changes have to be made to fully implement...
the outcome of the Final BEPS-Report regarding intangibles in general, and HTVIs in particular.

4.4 Implementation of BEPS Action 8

Previous in this thesis the work of the OECD in the field of corporate taxation, including the Final BEPS-Report was described as soft law, with no binding effect for either states or tax payers. The Swedish legal system is dualistic, with a requirement for the national parliament to incorporate international agreements, like tax treaties into national law before they can have any legal value. The opposite to the dualistic systems is the monistic system where no implementation into national law is required to attain effect of concluded bilaterally agreements. The dualistic view can be described as approaching the national law respectively international law as two stand alone judiciales.

The fact that Sweden practices the dualistic approach, results in a situation where changes to the Model Tax Treaty have to be incorporated into national law to have legal effect. But worth nothing is the shallow wording of both the Korrigeringsregeln and the preparatory works. As Hultqvist and Wiman further concludes, also the changes suggested by the OECD in The Final Beps-Report require the approval of the Swedish parliament before implementation. The same applies to any changes to double tax treaties. The conclusion by Hultqvist and Wiman is in line with the opinion of the author of this thesis. According to this thesis, the changes, here focusing on the Action 8 in particular will result in 1000+ tax treaties that needs to be renegotiated. The Commentary on the other hand may be approached from a static as well as an ambulatory approach, and, a combination of the methods. Hultqvist and Wiman highlights the possible implications of major changes to the Commentaries, resulting in deviations from the wording of the original treaty concluded.

Further, as discussed by scholars the Swedish case law, signals an ambulatory rather than static interpretation of internationally concluded agreements, like tax treaties in accordance with the OECD Guidelines. A conclusion that a taxable situation could occur due to the reference to concluded international tax treaties with referral to the OECD Guidelines may at a glance seem to be sensible. But, as Lindencrona states that the function of tax treaties is to limit the taxing right, never extend the obligations.

From the Swedish case law discussed in this chapter the OECD Transfer Pricing Guidelines are without doubt used by the Swedish courts as a relevant source of law. Since the Transfer pricing guidelines constitutes soft law, and is not

95 Ibid, s. 313.
96 See Lindencrona, G., Vad är internationell skatterätt?, p 354. Also see Pelin, L. Internationell skatterätt i ett svenskt perspektiv, p. 90.
implemented in Swedish law this is evidently an opening for future deviations from the Guidelines by Swedish courts. As concluded, the courts have so far adopted the Guidelines, and implemented changes made by the OECD on an ongoing basis into the interpretation of Korrigeringsregeln.

The Swedish law, Skatteförfarandelagen, ch. 67 para 38 gives the government or authorities with the delegated power by the government the right to make changes to a decided taxation if required in accordance with a tax treaty. Together with the dispute settlement mechanism of the Guidelines, this could according to this thesis suggest that changes to the Guidelines might not constitute a significant risk for double taxation due to different interpretations of the correct arm's length distance. This conclusion is in line with the opinion of Hultqvist and Wiman. Hanko Farago on the other hand, sees substantial effect from changes to the Guidelines post BEPS on both the calculation of profits and the application of the ALP.97

The Transfer Pricing Guidelines as an non-binding legal act, and how they should be adopted into national law is discussed by Bonucci with the conclusion that the Guidelines never constitute a legally binding act, but nevertheless the underlying recommendation by the OECD to the member states is to implement the Guidelines into national legislation. A further dimension of the OECD material in the tax field is the fact that the OECD only consist of 35 members plus the participation of the EU Commission. Since the model tax treaties are widely adopted, the majority of countries referring to the OECD material and the Model Tax Treaty are non members with no influence on the development of the OECD works.

Under Action 15 in the Final BEPS-Report, the OECD presents the Multilateral Instrument with the intention to create a tool for implementation of changes to concluded treaties. When the Multilateral Instrument is implemented into national Swedish law, if agreed so, changes to the definition of the ALP involving tax treaties concluded will not require changes to the treaties in itself. Once signed and effective, the Multilateral Instrument will eventually modify the existing tax treaties, but also open up for individual options for each state regarding how and if the Articles should be applied and if any Reservations are made.98

The discussion regarding the effects of the Multilateral Instrument introduced in BEPS Action 15 is according to the this thesis a revolution when implemented. The mechanism of the Multilateral Instrument will when being in full force make the discussion about the interpretation methods irrelevant. The road to an implementation of Action 15, the risks for considerable reservations and partial implementations is considerable. The Multilateral Instrument is not within the


limitations of this thesis but is a relevant area of research set in a Swedish ALP context.

4.5 Swedish case law concerning hard to value intangibles

Cases involving transfer or pricing of intangibles have been treated by the Swedish courts in a number of cases over a period of 40 years time. Below relevant cases selected by the author are presented. From the case law, a distinctive approach from the courts with regard to both the Model Convention and the Commentaries arises.

4.5.1 Case: RÅ 1979, 1:98. Findus

In the Findus case, the question was if the Swedish company Findus AB had the right to deduct royalties paid to a Swiss group company within the MNE “Nestlé”. The dispute had its background in the royalty payments made during 1968 to the company Produit Findus SA as payment for rights to use certain intangibles like trademarks. Noteworthy was that the trademarks former was owned by the Swedish company but were transferred without any payment to the Swiss group company. The tax authorities claimed that the payments were not in line with the *Korrigeringsregeln*. The court argued that royalty payments made in a situation where the intangibles were transferred for free constituted a situation not comparable to that of an corresponding agreement between independent parties. The court by that opened up for a correction and an increased taxation of the Swedish group company.

The Findus case established that corrections can be justified in situations where the ownership of an intangible had been transferred for free. Due to other reasons not discussed here no correction for the taxation year 1969 was ever made.

From the case it is also of importance to take into account the conclusion of the court that independent companies never would have entered into an agreement regarding the transfer of the intangibles for free, as was made between the Swedish and Swiss group companies of Nestlé. The court's reasoning was in line with the OECD Guidelines at that time, but may not correspond with the wording and motives of either chapter 6 of the current Guidelines or Actions 8-10 of the Final BEPS-Report. In the Findus case, the focus was solely set on ownership of the intangible, instead of the current approach to assess the distribution of risk involved and the functions performed by each involved party. Interestingly, the transfer of the intangible for free to the Swiss group company by that could open up for a situation where the ownership was basically given away for free by the Swedish company, but no risks or right to return on investment was assigned to the Swiss company.
4.5.2 Case RÅ 1991, ref 107. Shell

In the Shell case, RÅ 1991 ref 107 the high court concluded that the US-based Shell International Petroleum Company Ltd had the right to add a mark-up when acting as an independent middle-man when taking part in oil deliveries to the Swedish affiliated company Svenska Shell. The court especially highlighted the relevance and importance of the – at least to some extent independent right of Svenska Shell to take decisions regarding the size of the purchased quantity and from who the purchases should be made. The interpretation was therefore that Shell International Petroleum Company Ltd in the agreements with the Swedish company was allocated some risks, motivating part of the return. In the Shell case, the Svenska Shell had for a time of 5 years purchased the oil distributed in Sweden from Shell International Petroleum Company Ltd. The tax authorities claimed that prices of the transaction were not in line with the arm's length principle resulting in a lower profit attributed to the Svenska Shell, and by that less tax paid in Sweden.

Further, the court came to the conclusion that each and every transaction did not have to be priced separately. Instead, the court concluded that the overall pricing of the deliveries should constitute the basis for the further comparison when deciding if the transfer price was at arm's length distance. The court's statement is by that an opening for netting profits and losses arising under the same year of taxation. The court goes further by stating that the taxation should be based on that taxation year, but some deviations over several periods could be accepted. As described earlier in this thesis, the courts have adopted a view that the effects and motives of the transactions should be taken under consideration when deciding if the transactions are concluded at an arm's length price.

Of particular interest from the judgement in the Shell case is the reference to the OECD Guidelines. The court points out in its judgement that the OECD Transfer Pricing Guidelines seek to avoid the arising of situations of double taxation in situations where the tax authorities of the concluding states does not apply the transfer pricing rules in a similar way. From the Shell case the statement of the court that the Transfer Pricing Guidelines therefore could contribute with a guidance to the application of the Korrigeringsregeln had substantial significance establishing the role of the OECD material when applying the Korrigeringsregeln. In later Swedish cases the importance and relevance of the OECD Guidelines has been confirmed. Among Swedish scholars as well as the tax authorities, the conclusion that the OECD Guidelines constitutes a relevant source is not questioned.
4.5.3 Case RÅ 1996, ref 84. The Luxemburg Case
The Luxemburg case, RÅ 1996 ref. 84 applies to a situation where a Swedish company held ownership and control over a Luxemburg based company being tax exempt in its state of residency.

The Swedish tax authorities questioned if this situation was solely due to an allocation of taxing rights from Sweden to the tax exempt Luxemburg based operation even though the construction was in line with the double tax treaty between Sweden and Luxemburg. The reasoning of the court in the Luxemburg case discusses the intentions of the parties at the time the treaty was concluded. The view of the court was that if the double tax treaty was in line with the OECD Model Tax treaty, this constitutes evidence for the concluding parties acceptance of the OECD Model Tax Treaty, but also the Commentaries.

The court based its reasoning on the common wish of Sweden and Luxemburg when entering into the double tax treaty on the Vienna Conventions Article 31 to 33, with special focus on the Article 31 and 32. With the Luxemburg case the Swedish courts went further than in the Shell case by expressly giving the Commentaries to the OECD Model Tax Treaty a significant value. On the other hand, the wording of the judgement in the Shell case, signals that the court already at that time gave significant importance to the common wish of the OECD member states regarding content of the Model Tax Treaty as well as the Commentaries when applying the Korrigeringsegralen. So, the interpretation in this thesis is that the Luxemburg case is in line with the Shell case, but phrased in another way, with a clearer definition from the court regarding the value of the Commentaries rather than adding a new dimension.

4.5.4 Case KRNS 2013-09-12, 6885-6889-12
The case 6885-6889-12, earlier discussed in this thesis indicates clearly that the Swedish courts have adopted the current OECD approach regarding the definition of the arm's length principle in situations where the risk and /or cost for the development of an intangible to some extent was charged from the part also paying for the right to use the intangible. The court's reasoning that both being liable for the costs or the risks of the development of the intangible as well as paying a fee for the exertion of the same was not a correct transfer price. In this situation, the general picture should be considered and the price charged should be put into relation of the risk undertaken by the licensee. Interesting from the reasoning in 6885-6889-12 is the adoption of the OECD Guidelines at that time, instead of relying on earlier reasoning by national Swedish courts, like the Findus case.
4.5.5 Cases involving valuation of trademarks

The lower case Kammarrätten have in three cases dealt with the sale of trademarks to group companies. In case 7476—7477-13 a valuation of the assets was made prior to the transaction, but not taking into account tax effects for neither of the contracting parties due to the fact that the transaction was intra group between two domestic Swedish companies. The tax authorities argued that not taking into account the tax situations that would arise for two hypothetical independent contractors resulted in a situation where the arm's length distance not was met. The court accepted the reasoning by the tax authorities but had some objections regrading the determining of a valuation span of the arm's length price used by the SKV. Also in KRNS 2014-02-26, case 2360-13 and KRNS 2015-09-16, case 797-14 the courts came to the conclusion that the tax effects of a transaction involving intangibles should be paid attention to when deciding the arm's length price. The opinions of the courts that the tax effects should be taken into account is in line with BEPS Actions 8-10. The discussion by the court in the cases also is in line with the outspoken principle laid down in the Final BEPS-Report that the tax effects of all involved parties should be taken into account.

4.6 Application of the Transfer Pricing Guidelines and BEPS Actions 8-10

In this thesis, the conclusion is that, based on the transfer pricing cases involving intangibles discussed, the Transfer Pricing Guidelines have been fully adopted by the Swedish courts. The recognition of the Transfer Pricing Guidelines first occured in the Shell case, and has since then never been questioned. This adoption of the OECD material in the transfer pricing field could be seen as a recognition of the OECD Guidelines constituting a best practice regarding how to decide the correct transfer price and how to define the arm's length distance. By adopting a best practice approach, the changes suggested by the OECD in the Final BEPS-Report under Actions 8-10 could be seen as an development of the content published in the Guidelines to adopt to the changes taken place in the economic reality to maintain a effective tool to be used to determine the correct arm's length distance.

The described approach implies a non problematic incorporation into the practical application of the Korrigeringsregeln. In this thesis, the conclusion is that the national Swedish courts, in the way the Guidelines of OECD have been adopted, have fully accepted the arm's length principle, but also the updates made to the Guidelines. By that, the Swedish courts have accepted an ambulatory approach rather then a static view. Since both the Guidelines, the Commentaries and the Final BEPS-Report are soft law, this approach could and according to this thesis should be questioned by the courts when major changes are made by the OECD. As the law stands today no such a questioning has ever appeared in the
judgements in the Swedish transfer pricing cases. The changes suggested in the Final BEPS-Report under Actions 8-10 regarding the hard to value intangibles is in this thesis seen as an ambitious development with the introduction of methods never seen at least in the Swedish legal systems opening up for the tax authorities to take into account deviations occurring after the agreement was conducted, and after the transfer price was decided. Noteworthy is that the method increases the uncertainty in consideration of how the correct arm's length distance should be decided. The uncertainty about the actual outcome and the correct pricing of an intra-group transaction may be the result of the changes suggested regarding the hard to value intangibles. The view in this thesis is that this hardly could be the intentions of either the OECD or its members.

Monsenego concludes that the mechanism with a subsequent adjustment can result in a situation where the pricing in accordance with recommendations of the OECD will fall out of the arm's length principle. Monsenego further argues that the construction with an immanent method for correction of the agreed transfer price at an estimated arm's length distance at the time of conclusion of the contract never would have appeared between independent contractors.\(^99\)

The reasoning by Monsenego is interesting, and can hardly be questioned since no companies entering into an agreement with a non-related partner will ever have a price adjustment clause due to tax reasons just to allocate excessive profit arising from unknown events taking place. The opinion in this thesis, is that the objections made by Monsenego are relevant.

The opinion in this thesis is also that the changes to the transfer pricing methods for hard to value intangibles will make it harder for intra-group transactions to establish correct arm's length distance. And, to simplify the discussion even further, by introducing a method that with some certainty may open up for alternative arm's length prices, the method in itself is not in line with the underlying characteristics of the model; the arm's length principle is about putting related parties in an equal situation as unrelated parties entering into an agreement. From this discussion and the standpoint of, for example, Monsenego one could argue that the transfer pricing methods under Actions 8-10 regarding hard to value intangibles have to be implemented into national Swedish law to represent a relevant source of law. This approach to the ambitious changes introduced by the BEPS-project would lead to a totally new course of action regarding the handling of the sources used by the courts together with the Korrigeringsregeln.

In this thesis, the opinion is that the changes may be substantial, but at the same time previous changes to the Guidelines and the Commentaries have been accepted by the Swedish courts without being incorporated into the Inkomstskattelagen. If the changes under BEPS Actions 8-10 are neglected by the courts, a relevant way of incorporation according to this thesis would be to add a subsection to the Inkomstskattelagen. Still, by doing so, also a codification of Korrigeringsregeln may be a relevant step. In such a case, the current recognition

5. Final remarks

5.1 The *ex post* approach entails a substantial risk for double taxation

The advanced changes in the Final BEPS-Report regarding hard to value intangibles introducing the *ex post* correction mechanism in situations deviating from the estimated arm's length price at the time of conclusion of contracts constitutes a substantial risk for double taxation as discussed earlier in this thesis. Even if the method in itself should be recognized as being corresponding with the definitions of the arm's length principle, the risk for double taxation is considerable. The situations of double taxation may occur due to the fact that in situations were the transfer prices deviates from the arm's length distance the tax authorities of the concerned country should make an upward adjustment of the taxable amount. At the same time, the authorities of the other state(s) should make a correlative downward adjustment of the taxes due, or a repayment of already charged tax. Since Article 9 of the OECD Model Convention only requires intra state adjustments of the transfer prices to avoid double taxation exclusively in situations where the compensation is in line wit the arm's length principle, the suggested *ex post* mechanism might open up for the situations of double taxation mentioned above. This reasoning may result in a situation where State 1 makes an *ex post* adjustment resulting in a tax surcharge, but the adjustment is not recognized by the other state(s). Accordingly is no downward tax adjustment made, and a situation of double taxation is at hand. The situations of double taxation could also be a result of two or more states having a different approach assessing the *ex ante* calculations made earlier by the contracting parties. A situation where State 1 recognizes the methodology made *ex ante*, but the other state(s) does not, is may potentially result in double taxation. The view in this thesis is that the correction mechanism introduced in the Action 8 of the Final BEPS-report significantly increases the risks for double taxation.

The opinion in this thesis is that the changes suggested in the Final BEPS-Report will find their way into national legislation, but the different interpretations of the correct arm's length distance in situations relying on the correction mechanism might be problematic, and eventually result in situations of double taxation. The opinion is further that MNEs already with the publishing of the Final BEPS-Report should consider re-organization of the business to avoid potential
situations of double taxation. Also the complex calculations to be made *ex post*, but still with no guarantees for a prospective tax recalculation and a possible double tax situation should be considered carefully. By that, the actual effect of the changes introduced under BEPS Action 8 may lead to situations where MNEs allocate a significant larger share of the business to low or no tax countries, due to the increased legal risk of allocating the activity solely on a strict economic basis, without considering the potential tax risks. The changes will according to this thesis also result in an increased interest for advanced APAs. But it needs to be considered that the APAs have to be coordinated with at least two states to avoid potential future situations of double taxation. The Multilateral Instrument introduced with the BEPS-Project under Action 15 could be the reasonable approach to avoid the need for an extensive number of renegotiations of tax treaties. At the same time, the Multilateral Instrument rises new questions, and new risks that is beyond the scope of this thesis. The opinion of the author about the Multilateral Instrument is that it is revolutionary, but with significant implications due to its large extent, the amount of possible reservations and adjustments for each state concerned. It is also an instrument that according to the author also has a democratic dimension far beyond its purpose to simplify interpretation of (tax) treaties.

5.2 BEPS Action 8 as a Swedish Source of Law

The review in this thesis of relevant Swedish cases concerning intangibles, with a special focus set on hard to value intangibles gives undoubtedly a clear picture of the law as it stands. From the Findus case, via the Shell and Luxemburg cases, to recent cases from *Kammarrätten* the courts have both treated the Convention as well as the Commentaries as a relevant source of law. Further, from the case law it is obvious that the courts on an ongoing basis have adapted to the most recent versions of the Convention as well as the Commentaries. This clearly signals that an ambulatory rather than a static approach has been adopted by the Swedish courts. From that conclusion, it is easy and perhaps fair to come to the conclusion that this automatically will make the changes under BEPS Actions 8-10 a source of law in the eyes of the Swedish courts as well. The opinion in this thesis is that it might be problematic for the Swedish courts to continue to more or less automatically accept the changes made by OECD of the Convention as well as the Commentaries. This is due to the extensive changes and the far reaching effects of especially the suggested *ex post* adjustment mechanism introduced in Action 8.

Perhaps the suggestion by Hilling and Linderfalk to change and perhaps broaden the definition of the Commentaries is the way to take on Action 8 in a Swedish legal perspective. In this thesis, the opinion is that the Swedish courts initially will go on with business as usual also independent of the changes post BEPS. But, more interesting is what will happen in situations where double taxation occurs on a regular basis due to the *ex post* mechanism? Such a situation may lead to a
situation where the acceptance of the Convention and Commentaries has to be questioned. The expected effect will in such a case be a revision of the Swedish law with focus on the *Korrigeringsregeln* bringing specific definitions instead solely relying on the soft law of the OECD as the conductive source of law.
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