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Transfer Pricing corresponding adjustments as of right

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Transfer pricing adjustments under Article 9 of the model treaties are the most common form of dispute that is dealt with under the mutual agreement procedure. It is for this reason that the OECD gathers and publishes statistical data on such cases separate from all other kinds of tax treaty disputes.

Recourse to MAP to resolve transfer pricing issues may be a reason why there are few judicial decisions on the interpretation and application of Article 9. A recent decision of the Swedish Supreme Administrative Court on taxpayers' rights to a corresponding adjustment, shines a light on this largely dark corner.

Interest deduction denied

In *Played Holding AB v Skatteverket,* Mål nr 1348-24 and 1349-24(25 November 2024) a Swedish parent company loaned money to its Norwegian subsidiary at interest. The Norwegian tax authorities denied a part of the interest deduction claimed by the subsidiary as exceeding the arm's length amount, while the full amount of actual interest paid was taxed in Sweden. The Swedish parent company appealed against a refusal by the Swedish tax authorities to exclude the amount of interest that was found not deductible in Norway from taxation in Sweden. The taxpayer argued that the excess interest should not be taxed in Sweden and that Article 9(2) of the Nordic Double Tax Treaty entitled it to the relief.

Article 9(2) of the Nordic Treaty is patterned on Article 9(2) of the OECD Model. However, it also includes an expression borrowed from the OECD Commentary to Article 9 that any corresponding adjustment must be "justified both in principle and in amount".

Appellate rights

The Supreme Administrative Court noted that Sweden is bound by the treaty under international law, which has force in Swedish law and has priority over internal tax provisions. The court ruled that the Swedish tax authorities are bound to apply the treaty, including Article 9(2) and not just in their capacity as competent authority for purposes of the treaty. Furthermore, a taxpayer who is dissatisfied with the assessment of the tax authority may appeal such an assessment to the courts. It follows that, on appeal, a court may determine whether a corresponding adjustment pursuant to Article 9(2) is justified both in principle and amount and should accordingly be made.

The Court further said that the obligations on the competent authorities of the Contracting States to

consult each other, if necessary, does not mean that only the competent authorities (the Swedish Tax Agency) can make a corresponding adjustment and that the courts are prevented from doing so.

Treaty interpretation

In my view the decision is correct as a matter of interpretation of Article 9(2). First, it is clear that, if a contracting State makes a primary adjustment under Article 9(1), then the other state is required to make a corresponding adjustment by reference to arm's length conditions. This obligation is on the "other contracting State" and not only on the competent authorities. Second, the obligation on the competent authorities (as defined, for example, in Article 3(1)(f) of the OECD or UN Models) is to consult with the other competent authority if necessary. Third, there is no necessity for the taxpayer to present a case for the mutual agreement procedure in Article 25(1) of the Models. The obligation to make a corresponding adjustment arises by reason of the primary adjustment made by the other state under Article 9(1).

Paragraph 4.35 of the OECD Transfer Pricing Guidelines is misleading in saying that corresponding adjustments are non-mandatory in nature. It is only correct in saying that the courts who are requested to make an adjustment are not automatically bound by any decision in the state where the primary adjustment is made, but can consider the application of the arm's length principle independently.

Prevention of economic double taxation

The purpose of the obligation on the competent authorities to consult if necessary, is to prevent economic double taxation from arising due to potentially differing views of whether an amount is arm's length or not without the need for taxpayer intervention, thus minimising the need for cases to be presented under article 25(1). This obligation operates in parallel with, and should be viewed as an extension of, Article 25(3). As such, it is a part of BEPS Action 14 Minimum Standard 1.1.

These conclusions are consistent with the fact that the mutual agreement procedure in Article 25(1) and (2) is in addition to, and not in place of, domestic remedies.

In most cases, as indicated by OECD statistics, presentation of a case for the mutual agreement procedure will be the preferred option for resolution of transfer pricing disputes. Just as the ability of taxpayers to contest primary transfer pricing adjustments in domestic courts provides and important protection, so too does the ability to seek a corresponding adjustment in the domestic courts of the other state. The right to judicial determination of the corresponding adjustment is of particular significance where the treaty does not provide for mandatory binding arbitration if the competent authorities are unable to reach agreement.

Attribution of profits to permanent establishments

The right to judicial determination of corresponding adjustments is of equal force for the attribution of profits to permanent establishments of treaties that follow Article 7 of the OECD Model, 2010 and later versions. Article 7(3) provides for corresponding adjustments in effectively identical terms to Article 9(2). This issue does not arise in relation to treaties patterned on Article 7 of the UN Model or the pre-2010 OECD Model.

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