



Overview

Alvarez and Marsal Tax LLP, Taxand UK

Alvarez and Marsal Tax LLP has a dedicated and rapidly growing team of transfer pricing specialists. The team delivers the full range of transfer pricing services on a bespoke basis from start to finish.

Taxand UK's transfer pricing services include: designing global transfer pricing policies in line with clients' broader corporate goals, supply chain, and international regulatory standards; preparing supporting benchmarking studies and compliant transfer pricing documentation; reviewing intercompany financing to determine the arm's length debt capacity and interest rates; performing transfer pricing risk reviews for due diligence purposes; and supporting clients through tax audits and negotiation of Advanced Pricing Agreements ("APA") and Mutual Agreement Procedures ("MAP").

Transfer Pricing Framework

Transfer pricing legislation in the UK is contained in section 146 et seq of Part 4 of the Tax (International and Other Provisions) Act 2010 ("TIOPA 2010"). The legislation requires an adjustment to the UK taxpayer's income or corporation tax computation where:

- ❖ A provision is made or imposed in a transaction, or a series of transactions, between related parties;
- ❖ The provision departs from the arm's length standard – i.e., where a transaction has been conducted on terms and conditions other than that which would have been entered into by independent third parties; and
- ❖ A UK tax advantage is conferred on one or more of the parties.

Two or more parties are related where one party participates, directly or indirectly, in the management, control or capital of the other party or where a third party has such a relationship with each of the parties. For these purposes, common control of the board is sufficient.

There are two amendments to this general approach.

- ❖ Joint ventures which do not have a controlling part, can fall within scope where a 40% test is satisfied.
- ❖ For financing transactions, the connection is extended by section 161 and section 162 TIOPA 2010 where persons have 'acted together' in the provision of finance – this can bring in transactions with otherwise independent finance providers.

UK transfer pricing legislation requires consistency with Article 9 of the OECD Model Treaty and, at the time of writing, the 2022 version of the OECD Guidelines.

Small and medium sized enterprises ("SMEs") are exempt from making transfer pricing self assessments in their corporation tax returns, unless they elect to do so. The SME exemption applies to companies who have fewer than 250 employees, and with a turnover of less than €50m and/or a

balance sheet total less than €43m. HMRC can still make a transfer pricing related enquiry on medium-sized companies. The exemption does not apply to transactions with a non-treaty territory.

In addition, the UK largely aligns with OECD guidance with regards to the recognition, treatment and application of transfer pricing rules to permanent establishments ("PE"), as well as AOA guidance on the attribution of profits to permanent establishments, detailed in Articles 5 and 7 of the OECD's Model Tax Convention.

The UK also have a Diverted Profits Tax ("DPT"), which applies in two circumstances:

- ❖ where there is a group with a UK entity or PE with arrangements between connected parties which lack economic substance and which exploit tax mismatches; or
- ❖ where a non-UK resident company carries on activities in the UK relating to supply of goods and services or other property where that activity is designed to avoid the creation of a UK PE.

DPT started applying to profits arising on or after 1 April 2015, unless the company is a SME. It is separate to corporation tax, however, in circumstances where a transfer pricing adjustment has been made in a company's corporate tax return, a DPT charge can be removed.

The general DPT rate increased from 25% to 31% in April 2023. The DPT rate on ring-fence profits in the oil sector is 55%.

Taxpayers who are potentially in scope of the tax are required to notify HMRC within three months of the end of the respective accounting period.

Profit Diversion Compliance Facility ("PDCF") was introduced by HMRC in January 2019 as a voluntary facility for taxpayers not already under an enquiry to disclose any potential profit-diverting arrangements and structures that could be captured under DPT rules and make any appropriate adjustments.

Accepted Transfer Pricing Methodologies

Prescribed methods

UK legislation does not prescribe specific methods, but HMRC will accept the methods outlined in the OECD Guidelines. Taxpayers should demonstrate why a particular transfer pricing method has been chosen.

Priority of methods

Although no absolute hierarchy exists within the OECD Guidelines, HMRC's guidance states that the CUP method is the most effective way of assessing the arm's length price.



Transfer Pricing Documentation Requirements

Transfer pricing documentation is required to be prepared contemporaneously by the filing of the corporation tax return and submitted within 30 days of HMRC's request.

For those within the scope of transfer pricing requirements, the latest UK developments include HMRC prescribing a format in line with Annex I and Annex II to Chapter V of the OECD Guidelines for large multinational groups with a taxable presence in the UK, which have global revenues of at least 750 million euros. This new requirement applies to accounting periods commencing on or after 1 April 2023.

There is a de minimis threshold of £1 million per category of controlled transactions (i.e. a grouping of similar transaction types that can be reliably priced on the same basis, for each single UK entity). Transactions with volumes below the de minimis threshold can be excluded from the documentation, but this does not apply if one or more of the below items are applicable to the controlled transactions:

- ❖ Profit split;
- ❖ Transfer or licence of intangible assets;
- ❖ Hard to Value Intangibles;
- ❖ Transfer, use, or right to use key or strategic assets that are required for the entity to carry on its business;
- ❖ Global or regional strategic or leadership services;
- ❖ Cost Sharing Agreements or Cost Contribution Agreements;
- ❖ Business restructuring, including where functions, assets or risks have been moved into or out of the UK during the relevant period; or
- ❖ Commencement or cessation of transactions in the relevant period

HMRC have explicitly stated and strongly recommend that non-large taxpayers should prepare also transfer pricing documentation in line with the OECD format.

In addition to the new transfer pricing documentation rules mentioned above, there are currently discussions with regards to a Summary Audit Trail ("SAT"), which will require businesses to complete a questionnaire detailing the main actions undertaken in preparing the local file. The SAT is currently being drafted by HMRC, and a public consultation document is expected to be released by the end of 2023.

Local Jurisdiction Benchmarks

HMRC's guidance outlines that the best source of comparables can be internal comparables. A taxpayer should be able to demonstrate that these comparables have been considered (even where they are not available) before assessing externally available comparables, with reasonably accurate adjustments made where appropriate.

For external comparables, HMRC guidance states the importance of looking to the market serviced by the tested party when searching for comparables.

In terms of frequency, fresh benchmarking studies should be prepared 'regularly'. A fresh benchmarking study is not required annually if operating conditions or functional profiles remain the same. If the business descriptions, functional analysis, and/or description of comparables have not changed significantly, the comparables may be rolled forward into the following period, with updates to financial data.

APA/Bilateral Advance Pricing Agreement "BAPA" Overview

Part 5 TIOPA 2010 (sections 218 to 230) contains guidance on APAs. Section 220 TIOPA 2010 gives effect to an APA by requiring the agreement supersede any other possible Part 4 TIOPA 2010 constructions that might be reached in respect of the transactions for the duration of the APA.

HMRC closely follows the OECD APA guidance contained in 'Guidelines for Conducting Advance Pricing Arrangements under the Mutual Agreement Procedure'. The key features of the UK programme can be summarised as follows:

- ❖ APAs are available between connected enterprises as well as for provisions within the same enterprise affected by transfer pricing;
- ❖ applications are sought before the end of the first accounts period intended to be covered by the APA;
- ❖ APAs are typically for 3 to 5 years;
- ❖ bilateral (or multilateral) APAs will be considered between two or more tax administrations;
- ❖ HMRC does not charge entry or expenses fees for the conclusion of an APA;
- ❖ HMRC reserve the right to turn down applications for APAs which do not fulfil certain criteria (e.g., if the provision is insufficiently complex); and
- ❖ an APA may be requested where there is already a tax enquiry for previous years; and
- ❖ similarly, where appropriate, retrospection of the APA may be considered for years prior to the commencement year.

The average time to reach APA agreement was 58.3 months in the 2021 to 2022 tax year.

The OECD has a UK transfer pricing country profile which contains information with regards to the UK's dispute resolution profile. For the period 2021/2022, HMRC have agreed 20 APAs.

The UK also has an Advance Thin Capitalisation Agreement ("ATCA") regime, to provide taxpayers with certainty on transfer pricing related to complex financing arrangements.



Transfer Pricing Audits

Burden of proof

Burden of proof under the self-assessment system for the accuracy of information in tax returns lies with the taxpayer. Taxpayers with related party transactions should be able to confirm that the transfer prices have been determined in accordance with the arm's length principle.

Statute of limitation

Schedule 18(24) to Finance Act 1998 states a normal reassessment period of 12 months upon timely filing of the UK tax return. After the normal reassessment period has lapsed, schedule 18(41) allows for HMRC to raise a discovery assessment. A discovery assessment can be made:

- ❖ 4 years from the end of a taxpayers accounting period where the case is not due to careless or deliberate behaviour;
- ❖ 6 years from the end of the taxpayers accounting period in the event of careless behaviour; and
- ❖ 20 years from the end of the taxpayer's accounting period in the event of deliberate behaviour.

It should be noted that failure to operate compliant policies and prepare documentation could indicate deliberate behaviour.

Desk and field audits

HMRC operate a risk rating process to determine how much resource to deploy. A low risk group might have a regular dialogue with their HMRC Customer Compliance Manager and share information outside of formal audit powers. In the event that HMRC considers a taxpayer's transfer pricing documentation insufficient and fails to support the applied transfer pricing policies for the Group, HMRC will open an audit.

The purpose of a civil transfer pricing enquiry (as opposed to a criminal investigation) is to verify the accuracy of the taxpayer's self-assessed income in their disclosed tax returns. The enquiry will consider compliance with legislation, verification of the taxpayer's calculations; review supporting data, and will often involve HMRC performing their own functional interviews with the business to gather information first hand.

If HMRC disagrees with the taxpayer's self-assessed income it will make a transfer pricing adjustment to reassess the taxpayer and charge interest on any deficiency in taxes paid.

HMRC continues to make transfer pricing related enquiries. The average age of settled enquiries was 34 months for the 2021 to 2022 tax year.

Transfer Pricing Penalties

There is a penalty of £3,000 for failure to submit transfer pricing documentation within 30 days upon request by HMRC. For information that is submitted late and contains inaccurate information, it will be considered 'careless' by HMRC with penalties potentially amounting up to 30% of lost revenues. Where HMRC consider 'deliberate' inaccuracies have been made, penalties potentially amounting to 70% (for no attempt of concealment) or up to 100% (with concealment) of lost revenues could be imposed. Penalties may be deferred if the company is transparent and helpful in resolving the enquiry or where the company alerts HMRC to the error.

In addition, a Senior Accounting Officer ("SAO") must be appointed if a UK company or group of companies has a turnover greater than £200 million and/or balance sheet total greater £2 billion. Failure to keep the records may be an indication of not establishing and maintaining adequate accounting processes and arrangements. Failure to comply with the duties and responsibilities of an SAO may result in a personal fine of £5,000.

Local Hot Topics and Recent Updates

HMRC v BlackRock

The Upper Tribunal (a tax court) recently ruled in favour of HMRC in *HMRC v BlackRock Holdco LLC 5* ("LLC5") in relation to transfer pricing and unallowable purpose. Interest expenses were disallowed on \$4 billion of intragroup loan notes in a structure used by BlackRock for an acquisition. The structure included a newly formed Delaware-incorporated but UK tax resident company, LLC 5, which issued loan notes to its parent entity in the BlackRock group totaling \$4 billion ("the LLC5 loan notes"). LLC5 then contributed the funds borrowed to a US company to effect the acquisition. There was a UK tax advantage arising from the deduction of interest.

The Upper Tribunal concluded there was no apparent commercial rationale when choosing the UK entity for the acquisition other than for securing a tax advantage, and therefore an "unallowable purpose" test (separate from the transfer pricing rules) would apply to limit deductions.

However, the court also considered the position for transfer pricing, and concluded that the transaction would not have happened between independent parties. In considering that outcome, the court analysed the loan terms which they found did not include the appropriate covenants that should be expected if issued at arm's length.

UNITED KINGDOM



Documentation threshold

Master file	Required by law for large taxpayers meeting CbCR thresholds (see below) Recommended for non-large taxpayers SME exemption applies unless taxpayer elected to fall into scope of UK transfer pricing rules
Local file	As above
CbCR	Group revenue of EUR 750 million

Submission deadline

Master file	30 days upon request from HMRC
Local file	30 Days upon request from HMRC
CbCR	To be filed with HMRC within 12 months following the end of the period it relates to.

Penalty Provisions

Documentation – late filing provision	Failure to submit is £3,000. For information that is submitted late and contains inaccurate information up to 30% of lost revenues. For information that is submitted late and contains inaccurate information up to 30% of lost revenues.
Tax return disclosure – late/incomplete/no filing	£100 for initial late filing with a further £100 penalty after 3 months. Then a tax geared penalty after 6 months
CbCR – late/incomplete/no filing	£300 for a late filing with an additional £60 for each day after it is late (until submission). Inaccurate information carries a penalty of £3,000.



CONTACT

Richard Syratt

Alvarez and Marsal Tax

rsyratt@alvarezandmarsal.com

+44 20 7863 4722