



Transfer Pricing  
**Country Summary**

**United Kingdom**

April 2023



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## 1. Introduction

Following public consultation on TP documentation, the government has decided to legislate, so that it will require large businesses to maintain a local and a master file, as well as a supporting summary audit trail. This will come into effect from FY 2023 (April). It shall be mentioned that the government has applicable TP rules. These can be found in the Taxation (International and Other Provisions) Act 2010 ('TIOPA 2010') Part 4. The applicable rules are based on the arm's length principle, under article 9 OECD MTC. The rules are not formulaic but instead are based on existing principles. The TP rules are based on a self-assessment regime and therefore, TP filling is not yet mandatory. However, TP documentation may help to prevent fines.

## 2. Laws & Regulations

### a) References to OECD/EU/Local Rules

The UK transfer pricing legislation is contained in Part 4 of Taxation (International and Other Provisions) Act (TIOPA) 2010. All legislative references herein are to TIOPA unless specified otherwise. Two key statutory requirements of the legislation are: 1. taxpayers are required to use arm's length transfer prices in making their own assessment of their taxable profits; and 2. the rules, as matters of law have to be construed consistently with Article 9 of the OECD Model Tax Convention and the OECD's Transfer Pricing Guidelines. HM Revenue & Customs (HMRC), the UK tax authority, has also published detailed guidelines on transfer pricing notably within the International Tax Manual INTM410000 to INTM539000 and the Tax Compliance Risk Management Manual. It is also important to note whether an entity is within the scope of the UK's transfer pricing legislation depends on the size of the Group. The size is determined in line with the EU definition set out in the Annex to the Commission Recommendation of 6 May 2003 (2003/361/EC) concerning the definition of micro, small and medium-sized enterprises. All large enterprises are within the legislation. Medium sized enterprises are within the legislation if HMRC issues them with a Transfer Pricing Notice or if the other party to the relevant transaction is resident in a territory with which the UK does not have a Double Taxation Convention or if the UK does have a Double Taxation Convention (DTC), the convention does not have a non-discrimination article or the territory is on a list published by the UK Treasury. Small enterprises are only within the scope of the legislation if the other party is in a similar territory to that which brings a medium sized entity within scope or if the transaction is taken into account by anyone for the UK Patent Box purposes and HMRC issues a Transfer Pricing Notice. HMRC has also published a number of Statements of Practice that set out how they will apply the rules in certain circumstances. For instance SoP 1(2012) sets out how HMRC will deal with applications for Advance Thin Capitalisation Agreements and SoP 2 (2010) deals with HMRC's interpretation of the Advance Pricing Agreements legislation. Taxpayers are allowed to reply upon Statements of Practice when making their tax returns. As the OECD's Transfer Pricing Guidelines are imported directly into UK law by s164 the changes to them as a result of the OECD Base Erosion and Profit Shifting (BEPS) project have been implemented in UK law. Any further changes will be implemented by way or an order issued by HM Treasury. It is important to note however that the OECD 2010 Report On The Attribution Of Profits To Permanent Establishments is not part of the OECD Transfer Pricing Guidelines for these purposes, although HMRC will consider the Report to be highly persuasive. There has been little transfer pricing case law in the UK with many taxpayers preferring to settle. The most notable case was DSG Retail Ltd & Others v HMRC [2009], which was the first case to move away from the old OECD hierarchy of transfer pricing methodologies. Whilst there is no longer a hierarchy as to which methodology to apply within the OECD Transfer Pricing Guidelines, this is still an important case as it examines how to apply the profit split method, a method that we expect to be more commonly used in light of the UK's new Diverted Profits Tax and the OECD BEPS initiative. Finance (No.2) Act 2015 brought in the new Diverted Profits Tax (DPT), effective 1 April 2015 levied at 25% on profits that are assessed as having been diverted from the UK. This legislation has been born out of the UK government's frustration that transfer pricing rules do not go far enough in protecting the UK tax base, with taxpayers taking steps to artificially avoid creating a UK taxable presence or charging for the use of royalties or other services that result in such income flowing through convoluted structures to entities and territories lacking economic substance. The key point to note is that the legislation looks beyond the

UK/foreign transaction at hand and to the substance of an onward transaction and wider group supply chain structure. The DPT effectively overrides UK transfer pricing rules (and permanent establishment definition) by seeking to arbitrarily restrict fees paid to non-UK connected parties as well as seeking to allocate profits to artificially avoided UK PEs on a 'just and reasonable' basis as opposed to an arm's length basis. The concept of 'just and reasonable' is not defined. The DPT is deliberately outside of the UK's DTC network. No protection is therefore available under those DTCs in the UK to any non-UK entity charged to DPT. The DPT will apply if one of two Charging Provisions is met: 1. where a UK resident company (or the UK permanent establishment (PE) of a non-UK resident company) has entered into transactions with entities lacking economic substance (Charging Provision 1); or 2. where a non-UK resident company has taken steps designed to avoid creating a UK PE (Charging Provision 2). The legislation is complex and groups must undertake a full assessment as to the application of the rules. If a group considers the rules do not apply it should retain documentation evidencing how this conclusion was drawn.

The UK government has chosen to move through with the proposed Master file and Local file requirements for enterprises subject to CbC reporting standards. The necessary content of the Master file and Local file is intended to be closely aligned with OECD standards outlined in BEPS Action 13 as in the 2017 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

## b) Definition of Related Party

The related party requirement is applied by reference to body corporates or partnerships which are controlled by a person.

The term "Person" can cover individuals as well as corporates or other legal entities.

"Control", in relation to a body corporate, means the power of a person to secure:

- by means of the holding of shares or the possession of voting power in or in relation to that or any other body corporate; or
- by virtue of any powers conferred by the articles of association or other document regulating that or any other body corporate, that the affairs of the first-mentioned body corporate are conducted in accordance with the wishes of that person and, in relation to a partnership, means the right to a share of more than one-half of the assets, or of more than one-half of the income, of the partnership.

There are two important additions to the control definition:

- the 40% test (section 160(3) TIOPA) that applies to joint venture companies where each party has an interest of at least 40 per cent; and
- attribution rules (section 160(5) TIOPA) that trace control relationships through a number of levels in determining whether parties are controlled.

## c) Nature of Transfer Pricing Documentation

As previously noted, the UK government has recognized that the best practice for TP documentation is the local and the Master file. Therefore, it encourages, even at the moment that all UK businesses subject to UK TP rules take this documentation approach. Moreover, the UK will implement a new International Dealings Schedule (IDS) reporting requirement that will accompany the annual tax return. This will be applicable to all cross-border transactions within the scope of UK TP rules.

#### d) Tax Havens & Blacklists

The UK does not have a list of tax havens or blacklist. Nevertheless, it is necessary to note that overseas territories of the UK, such as the Virgin Islands are considered by many countries to be Tax havens, where tax avoidance schemes occur more often than not.

#### e) Advance Pricing Agreement (APA)

APAs are written agreements between the Tax Authorities and a taxpayer that have as their scope to govern the most appropriate TP method for a specific period of time. Generally, there are around 30 cases every year, however the time to negotiate APAs may take up to 33 months. In case an agreement cannot be reached the UK legislation provides other for arbitration, according to the OECD Multilateral Instrument (MLI). Subsequently, when a treaty partner country has also agreed, arbitration should be available to eliminate double taxation.

#### f) Audit Practice

As noted before, the HMRC performs audits to ensure that the taxpayer is compliant with the TP rules. It shall be noted that the HMRC employs risk assessors and economic specialists to consider which MNEs shall be audited and to collect enough evidence on whether an audit is needed.

### 3. Transfer Pricing Documentation

#### a) Level of Documentation

The UK's transfer pricing legislation does not require that specific documentation be kept to support the positions taken. Instead, the normal record-keeping requirements apply. These are that the person must keep sufficient records to enable them to deliver a correct and complete Return. The HMRC guidance recommends a business:

- should, on request, make documentation available and accessible to HMRC (including, where appropriate, translation from another language). The form in which the documentation is stored should be at the discretion of the business;
- should maintain documentation for a permanent establishment on the same basis as for a legal entity; · should identify the associated businesses with which the relevant transactions took place and the nature of the association;
- should describe the nature of the business in the course of which the relevant transactions took place and the property (tangible and intangible) used in that business;
- should set out the contractual or other understandings between the associated businesses and the risk assumed by each party;
- should describe the method used to establish an "arm's length" result and explain why that method was chosen;
- need not provide evidence about associations or transactions between businesses where those associations or transactions are not within the scope of UK transfer pricing rules;
- need not provide evidence related to each relevant transaction, but may provide aggregated evidence related to a class of similar transactions;
- need not create new evidence for transactions that occur after evidence has been created in respect of transactions that are similar and there have been no material changes in the circumstances for determining an "arm's length" result;
- need not commission the production of evidence from a professional adviser if the business is able to produce appropriate evidence itself;
- may choose to explain its general commercial and management strategy, or that of the group of businesses and technological environment, competitive conditions, and regulatory framework; and

- may choose to make documentation on relevant transactions available to HMRC before the tax return in which those transactions are reflected is due to be made

#### b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

#### c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

#### d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

#### e) Choice of Transfer Pricing Method

The OECD Guidelines are applied by the UK legislation. Therefore, all methods outlined in the OECD guidelines may be accepted.

#### f) Economic Analysis – Benchmark Study

The UK TP rules stipulate that a Benchmark study is required to determine the arm's length principle. An external database is to be used for such purposes and generally, regional comparables are preferred. EMEA comparables can also be accepted in certain cases.

#### g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the "conduct of parties" the prevailing concept.

#### h) Financial Statements

The taxpayer has to disclose their financial statements for intra-company transactions

#### i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. This information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

	Prepare or File?	Format	Deadline	Notification Deadline*	Threshold* (Yes/No)	Local Language (Yes/No)* (If "No", it can be filed in English)
<b>Corporate Income Tax</b>	File	iXBRL (digital form); CT600 (paper form)	March, 31 <sup>st</sup> . (it is 12 months from the broken year - ending March)	N/A	N/A	No
<b>Master File</b>	Prepare	OECD Guidelines	To be prepared when requested in Tax Audit (mandatory in FY 2023 cycle)	N/A	N/A	No
<b>Local File</b>	Prepare	OECD Guidelines	To be prepared when requested in Tax Audit (mandatory in FY 2023 cycle)	N/A	N/A	No
<b>CbCR</b>	File	OECD XML Schema	December, 31 <sup>st</sup> .	Yes	Yes	No
<b>Local form</b>	File	Diverted Profit Tax	TBC	TBC	TBC	No
<b>Annual Accounts</b>	File	Local IFRS	September, 31 <sup>st</sup> .	N/A	N/A	No
<b>Segmented P&amp;L</b>	N/A	N/A	N/A	N/A	N/A	N/A
* The United Kingdom has signed the MCAA agreement for the filing of CBCR.						
* The United Kingdom does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises.						

#### j) Mandatory Language

TP documentation must be provided in the English language.

#### k) Notification Requirement

The Tax Authorities need to notify the taxpayer 30 days in advance, in case an audit is performed.

#### l) Record Keeping

Transfer pricing falls within the UK self-assessment rules. As such, the records kept must be sufficient to enable the taxpayer to deliver the correct tax return.

Documentation must, in general, be kept for a period of 6 years from the end of the chargeable period to which it relates. HMRC guidance set out that the following documentation must be kept: 1. primary accounting records; 2. tax adjustment records; and 3. records to demonstrate an arm's length result, as is reasonable to the size of the business (HMRC INTM483030). HMRC will also accept documents prepared in accordance with the EU's Code of Conduct on transfer pricing documentation. Businesses who intend using the Code are asked to notify HMRC of this although there is no legal requirement to do so.

#### m) Penalties and Interest Charges

A tax related penalty can be imposed under Schedule 24 of Finance Act (FA) 2007 on a company of up to the amount of the tax understated, where:

- a return is made that is not in accordance with the arm's length principle;
- the inaccuracy was either careless or deliberate; and
- United Kingdom tax is lost as a result.

Where the inaccuracy was deliberate the level of penalty will depend on whether the inaccuracy was concealed or not. The penalty may be reduced if the taxpayer brings the error to HMRC's attention and also for the amount the taxpayer assists HMRC during the enquiry.

In addition, where a transfer pricing assessment is raised on an individual (for example where an individual is providing services to a related company and the service fee is not arm's length), FA 2010 introduced paragraph 4A of Schedule 24 FA 2007 under which the penalty for understated tax can be up to twice the amount of the tax where:

- the inaccuracy was deliberate and concealed;
- it involves an "offshore matter"; and
- the offshore territory in question falls within a list of designated offshore jurisdictions (so called Category 3 territories).

In determining whether a jurisdiction is a Category 3 territory the UK Treasury considers the existence and quality of information exchange agreements. A list of Category 3 territories is published on the HMRC website 1 and includes jurisdictions such as Brazil and United Arab Emirates. In addition, all other corporate tax penalties can apply and in particular:

- Paragraph 23 of Schedule 18 of the FA 1998 imposes a penalty on a company of up to £3,000 for a failure to keep and preserve records;
- Paragraph 39 of Schedule 36 of the FA 2008 imposes a penalty of £300 for a failure to produce documents and other information plus £60 for each day during which the failure continues.