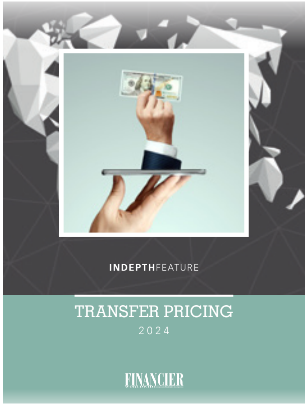

Price Bailey
CHARTERED ACCOUNTANTS

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TRANSFER PRICING

Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in transfer pricing.

UNITED KINGDOM

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Respondents

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Sarah Howarth is a director at Price Bailey. She has been with the firm for five years, having trained with EY. She is a corporate and international tax specialist, primarily focusing on advising large businesses that operate internationally. She is Price Bailey's transfer pricing specialist, but also advises on topics including the UK's interest restriction regimes, permanent establishment, corporate residence and tax governance. She is currently studying for her advanced diploma in international taxation.

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Q. What do you consider to be the most significant transfer pricing changes or developments to have taken place in the UK over the past 12 months or so?

A. The Finance Bill 2023 introduced two important new measures in relation to transfer pricing. With effect for accounting periods beginning on or after 1 April 2023, the largest taxpayers – those with a global turnover exceeding €750m – now have to prepare UK transfer pricing in the Organisation for Economic Co-operation and Development's prescribed 'master file and local file' format. Prior to that, UK domestic legislation had not dictated the format of transfer pricing documentation, requesting only that it was sufficient to support the filing position adopted in UK corporation tax returns regarding related-party transactions. His Majesty's Revenue and Customs (HMRC) also increased its information powers, and its scope to charge tax-geared penalties. HMRC can already acquire information from group companies in other territories from treaty tax authorities, but having the power to demand this of a UK group company via its international associates will undoubtedly speed up the process. HMRC will also be able to request transfer pricing documentation outside of an enquiry context. If transfer pricing documentation cannot be produced or is insufficient, there is an automatic presumption of 'carelessness', with the associated repercussions from a tax-geared penalties perspective.

Q. In your opinion, do companies pay enough attention to the challenges and complexities of maintaining compliant transfer pricing policies? What challenges do chief financial officers (CFOs) face when considering transfer pricing?

A. The largest companies, those with an in-house tax team, and possibly even internal transfer pricing specialists, either within the UK or at group level, will likely have a good handle on their intragroup transactions and compliance obligations. For smaller taxpayers, transfer pricing is often less of a priority. In particular, as the UK does not require any mandatory annual filing of transfer pricing documentation, other than data via country-by-country reporting, for those larger entities which are in scope. When chief financial officers (CFOs) do come to consider transfer

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pricing, it is a niche area which many have little knowledge of. Therefore, CFOs must balance their obligations to comply with the UK's transfer pricing rules against other priorities. The UK's exit from the EU in 2021 presented many finance and operations teams with huge issues in terms of maintaining efficient cross-border movement of goods, which has consumed considerable management time, at the expense of other matters.

Q. To what extent have the tax authorities in the UK placed greater importance on the issue of transfer pricing in recent years, and increased their monitoring and enforcement activities?

A. HMRC has a dedicated and well-established transfer pricing group (TPG), which was formed in 2008. The TPG consists of dedicated transfer pricing specialists as well as economists and systems analysts. HMRC's recently released 'Transfer Pricing and Diverted Profits Tax statistics 2022 to 2023' highlights a couple of interesting points. The yield from transfer pricing enquiries is up 10 percent compared to the previous year, despite the number of HMRC staff working on international tax issues remaining static, and the number of cases closed in 2022-23 was 13 percent fewer than in the previous period. This would suggest the TPG is continuing to hone its case selection skills in targeting taxpayers where the perceived loss to the Exchequer is greatest, and the likelihood of a successful outcome for the UK tax authority is highest.

Q. How should companies respond if they become the subject of a tax audit or investigation? What documentation needs to be made available in this event?

A. For HMRC to open a transfer pricing enquiry, its internal procedures require that a risk assessment is undertaken and there is a robust business case for investigating the taxpayer. Taxpayers should therefore assume they have not been randomly targeted, but that HMRC has identified one or more risk factors. HMRC may only request documentation that is part of the mandatory transfer pricing records or the general statutory records or else that is 'reasonably required' to check the tax position. However, taxpayers are advised to cooperate as far as possible in terms of provision of information and explanations. This will work in their favour should penalties be enforced. The HMRC penalty framework is based in part on the taxpayer's willingness to 'tell, help or give'. Additionally, taxpayers should endeavour to stick to HMRC's deadlines.

Q. In general, what advice would you give to companies on reviewing and amending their transfer pricing policies and structures?

A. Reviewing transfer pricing policies should not be an ad hoc process – HMRC guidance recommends that functional and economic analysis is reviewed annually to confirm it is accurate. Where significant changes to the business' operating model are identified, finance teams will need to establish whether they have the in-house expertise to consider the transfer pricing implications or to what extent they will need to outsource this exercise. Regardless of the approach taken, there must be an acceptance that any such review will need to include personnel beyond the finance team. Those involved in, for example, managing the business' intellectual property will need to be made available to

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allow for an accurate functional analysis to be undertaken. Any amendment to transfer pricing policies needs to consider the wider impact – indirect tax and withholding tax consequences, for instance. There may also be the need to revisit profit-based remuneration models for certain staff if the change in transfer pricing may now produce an uncommercial outcome for either employer or employee.

Q. What are the key changes expected in the UK over the next 12 months or so?

A. The Pillar Two rules came into effect in the UK for accounting periods beginning on or after 31 December 2023, as the first stage of the UK's implementation. Therefore, in-scope entities are beginning their first accounting period within the regime. While some may have undertaken significant preparation in advance, many will still be grappling with the rules and how they apply to their business. In addition, some taxpayers will still be identifying the best technology solution to obtain the higher quality information required for Pillar Two, and in a timely fashion. In the meantime, HMRC's focus is likely to be on providing technical training to its inspectors, as well as finessing, and issuing guidance on, the second phase of the implementation. On a purely domestic level, following a consultation period in the summer of 2023, HMRC has now published a summary of responses regarding its proposed reforms to the UK's transfer pricing rules, including certain simplifications.

Q. How will the Pillar Two approach interact with transfer pricing rules? Is there a risk of double taxation?

A. The transfer pricing rules are concerned with providing each entity with arm's length return for its contribution, whereas Pillar Two addresses the rate at which those profits are taxed, topping that rate up to 15 percent where, for example, group entities are in low tax jurisdictions, or enjoy certain tax 'holidays'. The first observation to make, therefore, is that Pillar Two may render many transfer pricing-driven structures less effective. It will also shine a light on situations where a group's transfer pricing policy is inconsistent, for example where group entities with similar functionality are not being rewarded in the same way. Double

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taxation may arise where territories implement Pillar Two inconsistently. Equally, double taxation may arise due to timing issues; where, for example, the Pillar Two top up is based on the figures used for consolidated financial statements, but transfer pricing adjustments are not posted until later, and for the purposes of the local statutory accounts on which the actual tax charge is based. ❑

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