

Reform of UK law in relation to transfer pricing, permanent establishment and Diverted Profits Tax

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Sent to: dpt-tp-pe-reform@hmrc.gov.uk

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General Comments

We welcome the opportunity to respond to HM Revenue and Customs' ('HMRC') consultation on 'Reform of UK law in relation to transfer pricing, permanent establishment and Diverted Profits Tax' ('the Consultation').

We have set out below our comments, including highlighting instances where greater clarity or examples from HMRC would be useful.

Specific Questions

Transfer pricing

Question 2: The government welcomes respondents' views on the participation condition, and experiences of the application of other jurisdictions' laws in that regard.

It was unclear from the consultation sessions whether HMRC has seen examples in practice of the participation condition failing to catch transactions that realistically should be subject to Transfer Pricing rules.

In Members' experience the existing participation conditions already err on the side of caution, occasionally capturing situations where there is not in reality enough control to lead to non arm's-length pricing. It would therefore be important that any changes do not widen the scope of scenarios caught to a significant number of situations where one or more parties caught by the rules could not in reality influence pricing, making compliance difficult or impossible.

HMRC's only example of a situation, which is in its view not currently captured, was the influence of a major creditor over a debtor. This example raises issues of the distinction between influence in normal commercial relationships and the kind of entity control that forms the basis of current UK participation rules and whether the former really constitutes the kind of association envisaged by the treaties and TP guidance. Where an entity is heavily reliant on a single customer, supplier or creditor this will undoubtedly influence pricing, but this would generally be assumed as part of the conditions of normal arm's length arrangements.

At first glance it also seems unlikely that such a scenario could lead to manipulation of tax outcomes without a route such as dividends where income could be passed between entities without tax.

It would be helpful to have a clearer set of examples from HMRC, to illustrate the kind of situations where they have seen the participation condition fail to capture non-arm's length pricing arrangements in practice.

Question 4: The government requests respondents' views on UK:UK transfer pricing. Is it onerous and to what extent, and would providing a general exemption materially reduce the compliance burden? Do respondents have any views on the practical application of a general vs specific exception to the general exemption?

Our understanding is that in practice HMRC does not intend to devote resources to challenging arrangements with no impact on the overall tax base, but it would be helpful to have this codified in the legislation.

An example of a situation where the UK:UK transfer pricing rules present issues, but where there is no impact to the overall tax base, is that of dormant companies.

The rule that descopes dormant companies only if they were dormant pre 1 April 2004 can lead to situations whereby a post 1 April 2004 dormant company has an intercompany balance sheet entry, in relation to which a UK to UK imputation is strictly due, where the counterparty is an active UK company. To ensure that a 'net off' occurs across both companies, via UK to UK imputations of an equal and opposite amount, would require the filing of a CT return for the dormant company when otherwise no CT return would be due. This also raises questions such as whether there is then a need to include a tax note in the otherwise dormant company (even where group loss relief applies and no CT would be due), which then results in the reactivation of that company and the need for the cost and administration associated with an audit, purely to comply with UK:UK TP rules where there is no overall increase in CT payable.

It would be helpful if issues such as these could be addressed.

It would also be extremely helpful to have greater clarity on HMRC's view of when UK:UK transactions are in scope, either through a specific list of circumstances if amended legislation is introduced or otherwise through further guidance on their approach to compliance in such scenarios.

In particular it would be helpful to fully understand HMRC's expectations of the documentation to be maintained by taxpayers. For example, would the same degree of documentation and support as for a cross border transaction be expected if only the timing of tax paid was at stake or if the tax rate difference between the two UK entities was relatively small?

If you have any questions relating to this response, please contact Sabba Akhtar (sabba.akhtar@ukfinance.org.uk)

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