

Transfer pricing

Businesses with cross border transactions are recognising that transfer pricing is now an issue of significant importance to them. High profile targeting by tax authorities and new compliance rules mean that the risk of challenge has increased dramatically for large and small groups. In addition, as tax structured planning has declined in popularity, many multinationals are now considering the non-aggressive opportunities for cost control potentially offered by a well-conceived transfer pricing strategy.

Who does it apply to?

The UK transfer pricing legislation requires transactions between connected parties to be carried out on an 'arm's length' basis where these differ from the actual arrangements in place. This arm's length principle is common to the transfer pricing rules of virtually every country.

A connected party relationship exists where one party directly or indirectly controls the other or they are both controlled by another party. Control may be by way of participation in the management, control or capital of the other party.

The arm's length principle is applied to any relevant transaction by replacing the actual terms with hypothetical arm's length terms and recalculating the profits for tax purposes accordingly. The UK legislation relies on the OECD transfer pricing guidelines which set out a recommended approach and methodologies that can be adopted for setting the arm's length price. The OECD principles were significantly revised and expanded in 2017 and businesses need to ensure that their compliance documentation reflects this. The UK transfer pricing rules apply equally to UK transactions as they would to cross-border transactions.

When will it apply?

Transfer pricing will need to be considered for any transaction between connected parties. The scope of the legislation is wide and includes:

- intra-group services and support functions;
- the sale and purchase of physical goods;
- intra-group lending, financing and guarantees;
- valuation of intra-group payments for intangibles such as royalties;
- the provision of share options and share based payments to employees of subsidiaries.

Transfer pricing principles have wider applications, which will need to be considered in a number of other circumstances, including the allocation of profits to branches and permanent establishments, determining profits attributable under the Controlled Foreign Company rules and the attribution of relevant profits under the Patent Box regime.

By signing a tax return a declaration is made that the transactions in the return conforms with transfer pricing principles. HMRC has the power to issue penalties if it is found that a taxpayer was negligent or careless in respect of its transfer pricing position, so having suitable transfer pricing documentation in place is essential to ensure that penalties are avoided.

The OECD's review of existing transfer pricing principles and documentation requirements, as part of their Base Erosion and Profit Shifting project (BEPS), has resulted in the UK and many other governments implementing the OECD's recommended documentation model into legislation. This reporting requirement applies to relevant companies for accounting periods starting on or after 1 January 2016 and is a significant



change to previous requirements. In particular, many groups will need to compile a master file for the business plus local country files. Large groups will also have to compile a country-by-country report (CbCR); this applies to groups with a global turnover in excess of €750m. Both the master file and CbCR may be shared amongst tax authorities.

The BEPS project has triggered a mass of new compliance legislation around the world, however the use of transfer pricing as a cost control strategy remains relevant providing that the approach adopted reflects the creation of economic value within a business.

Many countries will allow a taxpayer to enter into an Advance Pricing Agreement (APA) which allows tax authorities to agree the arm's length price in advance and gives the taxpayer certainty of treatment.

How can we help?

Moore Stephens has considerable experience providing transfer pricing advice to clients across a broad range of business sectors. We work with our clients to ensure that:

- a strategy is adopted that complements the tax and commercial needs of the business;
- compliance documentation is compiled that meets the requirements of the countries involved;
- the risks of successful challenge are mitigated;
- the business is not paying more tax than it should be.

We work with our clients and our international network of member firms in over 100 countries to provide transfer pricing reviews, assistance in setting transfer pricing policies and preparing documentation and defending business that are under audit. Our insight into the strategies of tax authorities is of particular value in providing such advice.

This document provides a brief guide to the key issues, but specific advice should always be sought. For further information, please get in touch.

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