

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

Comments from Saffery LLP

1. Executive summary

1.1 We welcome the chance to comment on the proposals to reform the UK's transfer pricing, permanent establishment and Diverted Profits Tax rules.

1.2 In summary, our key points are as follows:

- S148A(3) is unclear and unnecessary.
- Procedural guidance is needed on UK:UK transfer pricing exemption.
- Valuation alignment for transactions involving intangible fixed assets is helpful despite creating a misalignment with chargeable gains.
- Safeguards need adapting for the repeal of Commissioners' sanction.
- The changes create certainty around implicit guarantees.
- The acting together rules are potentially broader and still subjective.

1.3 We would also emphasise that where the government has committed to providing guidance, such as in relation to s147(3) and (5) TIOPA 2010, it is essential that this guidance be subject to proper consultation, in the same way as the legislation itself.

1.4 We would be happy to discuss the points raised here in further detail. If you have any questions, or would like any further information, please contact: Zoe Thomas, Partner - Head of Corporate Tax, on 0330 094 2698 or email zoe.thomas@saffery.com or Dawn Ross, Director - Transfer Pricing on 01733 306801 or email dawn.ross@saffery.com.

2. Specific consultation questions

2.1 **Question 1: The government welcomes views on the proposed amendments to the participation condition, particularly whether the draft legislation will create participation in the intended scenarios**

2.1.1 We note that while s148A(3) introduces a power for HMRC to issue a notice, it is not explicit within that subsection that such a notice can only be given where there is participation of the type envisaged by subsections (1) and (2). This limitation is, however, made explicit in the appeal provision in the amendment at subsection (4)(a), which may suggest an inconsistency in the drafting.

2.1.2 In our view, the power introduced by subsection (3) is unnecessary. Where HMRC considers that the participation condition is met under subsections (1) and (2), it can already open an enquiry and issue a closure notice through existing mechanisms.

2.2 **Question 2: The government welcomes views on the draft legislation relating to UK:UK transfer pricing. In particular, comments are invited on whether the proposed test will be simple to apply and the suggested exclusions (which include persons within the charge to income tax).**

- 2.2.1 We would welcome detailed HMRC procedural guidance on the application of the UK:UK exemption, which is a popular amendment to the current transfer pricing legislation.
- 2.3 **Question 3: The government welcomes views on the draft legislation which applies a single valuation standard to transactions involving intangible fixed assets, in particular whether the proposed changes will increase simplicity and certainty.**
 - 2.3.1 We note that while this change aligns the treatment of intangibles with transfer pricing, it may create a misalignment with the chargeable gains regime. In practice, this is unlikely to give rise to significant issues, but it is worth acknowledging the potential problems.
- 2.4 **Question 4: The government welcomes views on the proposed repeal of the requirement for HMRC's Commissioners to sanction transfer pricing determinations**
 - 2.4.1 The summary of responses to the original consultation said "The government will remove the legislative obligation for Commissioners' Sanction. HMRC will consider how existing safeguards and processes can or should be adapted and will look to provide expanded guidance on current governance processes. They will also consider the existing role of HMRC's central transfer pricing policy team in the review process".
 - 2.4.2 However, there doesn't seem to be any reference in the current consultation or the draft legislation to any such adaptations to safeguards. Further detail on how HMRC intends to maintain appropriate oversight and consistency in transfer pricing determinations would be welcomed.
- 2.5 **Question 5: The government welcomes views on the proposed amendments to the guarantees and compensating adjustments legislation. In particular, comments are invited on whether those changes increase clarity and alignment with Chapter X of the TPG, and whether any practical difficulties may arise from the changes to compensating adjustment claims, the election for section 192 claims, and the transitional provision.**
 - 2.5.1 The proposed amendments appear to address the uncertainties we have encountered in practice around implicit guarantees.
 - 2.5.2 We note that the use of the term "incidental benefit" aligns with the terminology used in Chapter X of the TPG, which is helpful for consistency.
 - 2.5.3 We would welcome further guidance from HMRC once the legislation is published, particularly on the application of implicit support. This area involves a degree of judgment and may raise complex issues and considerations.
- 2.6 **Question 6: The government welcomes views on the proposed changes to the acting together rules. Specifically, does the draft legislation clarify when borrowers and lenders are 'acting together'?**

- 2.6.1 The draft legislation does provide further definition of when borrowers and lenders are considered to be ‘acting together’, but in doing so, it arguably broadens the definition.
- 2.6.2 For example, a senior lender may require an equity holder to be party to an inter-creditor agreement. This is a financing agreement that “relates to the exercise of any of U’s or Q’s rights in relation to B,” which could bring such arrangements within the scope of the acting together rules, even where there is no intention of co-ordinated control.
- 2.6.3 The wording “it is reasonable to suppose is designed to affect the value of any of U’s or Q’s rights or interests in relation to B” is also quite broad. In practice, no shareholder would permit a company to take on borrowing unless it was in the financial interests of the company and potentially increased the value of their shareholding.
- 2.6.4 There remains a degree of subjectivity in assessing whether one party “typically acts” in accordance with another’s wishes. In joint venture situations, for example, a junior partner may choose to be passive and follow the lead of a senior partner, not because of any obligation, but simply because they don’t disagree with the senior partner’s view. It is unclear whether such behaviour would fall within the scope of the revised rules.
- 2.7 **Question 7: The government welcomes views on the draft legislation relating to the loan relationship and derivative contract rules.**
 - 2.7.1 No comments.
- 2.8 **Question 8: The government welcomes views on the draft legislation relating to exchange gains and losses, including the new matching rules and the proposed documentation requirements.**
 - 2.8.1 No comments.
- 2.9 **Question 9: The government invites comments on how the OECD guidance on the attribution of profits to permanent establishments has been incorporated into the draft legislation at Part 2, Chapter 4 CTA 2009 and section 1140A CTA 2010.**
 - 2.9.1 No comments.
- 2.10 **Question 10: The government invites comments on the changes to section 1141 CTA 10 in the draft legislation, including any practical or administrative consequences that are expected to arise from the proposed change to the definition of a DAPE.**
 - 2.10.1 In practice, non-resident companies with a potential permanent establishment risk, where all attributable profit is paid away (eg as commission to a dependent agent), often do not register a permanent establishment, as there is no tax at stake.
 - 2.10.2 If the government does not intend to provide relief for the large number of “small PEs with little or no tax arising”, it should recognise that this practice is likely to continue.

2.11 Question 11: The government invites comments on the repeal of the specific exemption for Lloyd's agents at section 1151 CTA 2010.

2.11.1 No comments.

2.12 Question 12: The government invites comments on the extension of the exclusion from Income Tax to the UK trading income of non-resident companies which do not have a permanent establishment.

2.12.1 The proposed extension appears sensible.

2.12.2 We are not aware of any situations where this change would inadvertently take income outside the scope of UK taxation.

2.13 Question 13: The government invites comments on the definition of "investment transaction" in the draft legislation, including whether any transactions or persons which would previously have been in scope have been omitted and whether any practical difficulties in applying the definition are anticipated

2.13.1 We note the proposed changes to the Investment Management Exemption (IME) and their potential impact on family offices, a sector in which we have significant experience.

2.13.2 In our experience, most family offices are not 'trading', and therefore do not typically have any permanent establishment risk, even where UK staff may be considered dependent agents.

2.13.3 However, we acknowledge that in some cases the distinction between trading and investment activity can be unclear. While the removal of the 20% test is unlikely to affect most family office structures, given that they fail the independence test, the government should consider the specific characteristics of these structures.

2.13.4 We suggest the government engage with professional firms to better understand the nature and structure of family offices. In many cases a trust will be involved introducing a form of quasi-independence that may be comparable to wide holding.

2.14 Question 14: The government invites comments on the proposal to repeal the 20% test (formerly Condition D) and the charging provision in section 1152, including whether this would cause any practical difficulties to businesses previously in scope of the Investment Manager Exemption

2.14.1 No comments.

2.15 Question 15: The government invites comments on the draft amendments to Statement of Practice 1/01, including whether it is consistent with the draft legislation and whether businesses foresee any difficulties in applying the revised guidance in respect of Condition C.

2.15.1 No comments.

2.16 Question 16: The government invites comments on the draft amendments to the capital gains rules for permanent establishments.

2.16.1 No comments.

2.17 Question 17: The government invites comments on the consequential changes to other parts of the Taxes Acts in the draft permanent establishment legislation including any anticipated changes which appear to have been overlooked.

2.17.1 No comments.

2.18 Question 18: The government invites comments on the interaction between Part 4A TIOPA 2010 and transfer pricing in the draft legislation.

2.18.1 No comments.

2.19 Question 19: The government invites comments on the interaction between Part 4A TIOPA 2010 and the CT framework in the draft legislation.

2.19.1 No comments.

2.20 Question 20: The government invites comments on the operation of the UTPP assessment process in the draft legislation.

2.20.1 No comments

2.21 Question 21: The government invites comments on the functioning of the ETMO in the draft legislation.

2.21.1 No comments.

2.22 Question 22: The government invites comments on whether the legislation provides sufficient time for representations where the other party is a partnership.

2.22.1 No comments.

2.23 Question 23: The government invites comments on the operation of the Tax Design Condition in the draft legislation.

2.23.1 No comments.

3. About Saffery LLP

3.1 At Saffery, we're more than just chartered accountants and tax and business advisers. We're a partner-led and people-focused firm, committed to our clients and honouring our heritage.

3.2 Since 1855, we've evolved in size and scope, but our unwavering dedication to exceptional client service remains the same.

- 3.3 As a proud member of Nexia, a worldwide network of trusted member firms, we've got access to local insight on a global scale.
- 3.4 In the UK, Saffery LLP is the 15th largest accountancy firm by fee income, with 90+ partners and 1,200+ staff across nine offices. Overseas, Saffery is represented in Cayman, Guernsey, Geneva, Zurich, Dublin and Dubai.