

Transfer pricing scope and documentation

Comments from Saffery LLP

1. Executive summary

1.1 We welcome the chance to comment on the proposals to amend the small and medium enterprise exemption from the UK's transfer pricing regime and introduce an International Controlled Transactions Schedule (ICTS).

1.2 In summary, our key points are as follows:

- We strongly support keeping the exemption for small and medium sized enterprises (SMEs) to avoid disproportionate compliance burdens, with thresholds simplified and applied at the UK entity level for small enterprises.
- Turnover, balance sheet total and staff headcount are appropriate metrics, but thresholds should be reviewed for inflation and applied more practically, with a “two out of three” test recommended.
- If the exemption is removed from medium sized enterprises, documentation requirements must be limited and subject to further consultation.
- Definitions around natural persons, investment funds and enterprise groupings need clearer legislation and/or guidance to reduce unnecessary analysis and compliance work.
- If introduced for all entity sizes, the ICTS should be proportionate to the size of the enterprise falling within transfer pricing. Aggregation rules and transaction classifications should be easier to apply, and permanent establishments should be excluded from scope for now.
- Financial thresholds should be reviewed over time. The £100k threshold is too low and aggregation rules should not combine income and expenses.
- Much of the data requested in the proposed ICTS is either already available to HMRC or not relevant for risk assessment, especially for SMEs. Requests should be streamlined to avoid duplication, cost and confusion.

1.3 Section 2 below makes some general comments on the proposals, and section 3 covers our responses to the specific questions raised in the consultation document.

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. General points

2.1 While the UK may be an outlier in having exemptions from transfer pricing, it does not automatically follow that most currently exempt medium sized UK businesses already need to apply the transfer pricing rules of another territory to their cross-border transactions with connected parties, because the majority of G20 countries have transaction limits.

2.2 In our experience it is not the case that many SMEs, exempt from preparing full transfer pricing documentation in the UK, are still liable to complete full transfer pricing

documentation for operations in other jurisdictions where exemptions don't apply. The UK is often the first place in which transfer pricing documentation is required, with some limited exceptions, such as the US.

- 2.3 Based on our experience we disagree that the additional burden of applying international standards on transfer pricing in the UK may therefore be limited.
- 2.4 Current transfer pricing compliance guidelines state that HMRC is of the view that an appropriate way to demonstrate that provisions between related parties adhere to the arm's length principle is to prepare documentation in line with the OECD's recommended approach where a UK enterprise is within transfer pricing, even where the MNE group test is not met, (although this is not required by legislation). This would need updating to confirm a lighter touch for any medium size enterprises now subject to transfer pricing.
- 2.5 Most businesses use transfer pricing principles to ensure profits are aligned with value creation and are allocated into the appropriate enterprise for commercial reasons (e.g. payments between group entities etc) and general corporation tax principles.

3. Specific consultation questions

3.1 Question 1: The government welcomes views on the proposal to maintain an exemption from transfer pricing for small enterprises.

- 3.1.1 We strongly support keeping an exemption from transfer pricing for small enterprises. Without it the compliance burden would be disproportionate to the size and resources of these businesses.
- 3.1.2 The current exemption thresholds based on the worldwide group can be difficult for SMEs to apply, particularly where the group structure is not straightforward. We suggest the government considers introducing UK entity/UK sub-group level specific thresholds that are simpler to apply.

3.2 Question 2: The government welcomes views on the proposal to continue to define small enterprises by reference to turnover, balance sheet total, and staff headcount. Views are also invited on whether alternative metrics or approaches would be preferable.

- 3.2.1 We agree that turnover, balance sheet total and staff headcount are the most straightforward metrics for defining small enterprises. These are familiar measures and businesses use the same financial metrics (albeit different thresholds) for determining their reporting and audit requirements.
- 3.2.2 However, we suggest the government considers simplifying the approach by applying these thresholds to the UK enterprises within the group only, without reference to the worldwide group.

- 3.2.3 In our experience, staff headcount is often the limiting factor. We suggest the test should require meeting any two out of the three criteria.
- 3.2.4 We also suggest that the thresholds are reviewed and increased for inflation, as they have not been updated since the European Union set them in the Annex to Commission Recommendation (2003/361/EC) of 6 May 2003.
- 3.2.5 The difficulty is often not with the numbers themselves but with the definitions. For example, how natural persons and investment funds are treated can create uncertainty (see our response to question 8).
- 3.2.6 Alternatively, a transaction-level threshold could be introduced, in line with the approach taken in many other jurisdictions.
- 3.3 **Question 3: The government welcomes views on the proposed amendment of the small enterprise threshold from €10 million turnover and balance sheet total to £10 million turnover and balance sheet total.**
- 3.3.1 We agree that amending the small enterprise threshold from €10 million to £10 million would be sensible.
- 3.3.2 There is no clear rationale for aligning with EU thresholds. In our experience, transfer pricing is the only area where this alignment is still used, with qualification criteria for R&D tax relief having diverged in 2008.
- 3.3.3 Using a euro-based threshold causes variation and uncertainty due to exchange rate movements.
- 3.3.4 If the threshold is amended from euros to pounds sterling, we suggest it is reviewed regularly to ensure it remains in line with inflation and sense checked to inflation trends since inception.
- 3.4 **Question 4: The government welcomes views on the proposal to only change the status of a small enterprise where the threshold is exceeded in two consecutive periods.**
- 3.4.1 We agree that requiring the threshold to be exceeded in two consecutive periods (subject to excluding periods of sale of the business and start up etc) before a small enterprise loses the exemption is a sensible approach. It would give businesses more time to prepare for the additional compliance requirements.
- 3.4.2 We would like clarification on whether the government also intends to require the threshold to be met for two consecutive periods before the exemption can be regained.
- 3.4.3 Any removal of the exemption must allow affected enterprises adequate time to prepare for the additional compliance requirements once they exceed the threshold.

3.5 Question 5: The government welcomes views on the proposal to remove the exemption for medium-sized enterprises from transfer pricing.

- 3.5.1 We disagree with the proposal to remove the exemption for medium-sized enterprises, unless this is replaced with substantial transactional thresholds.
- 3.5.2 The compliance burden would be very significant. For those medium-sized enterprises without existing documentation to support the arm's length nature of their cross-border transactions, the first period of compliance could easily double their annual tax compliance costs for that period. This is a disproportionate burden on these enterprises in the first year and in any future year where there are material changes in their business concerning cross border transactions. Annual compliance costs in other years are likely to increase by up to 25% due annual reviews and updates.
- 3.5.3 Payments made to overseas parties are already subject to being wholly and exclusively incurred in the performance of their business which carries arm's length implications and potentially mirrors the transfer pricing benefits test.
- 3.5.4 If the exemption is removed for medium-sized enterprises, the documentation burden for such enterprises must be substantially limited and subject to further consultation. This may delay implementation of changes to the SME regime.
- 3.5.5 Many SMEs already have technical obligations, because of non-qualifying territories, but with limited capability to comply. These businesses often rely on external advisors to comply, incurring further costs.
- 3.5.6 The consultation refers to the exemption creating a gap in the definition and protection of the UK tax base giving rise to a significant risk of cross-border profit diversion. However, this must be balanced against the disproportionate burden that would be placed on medium-sized enterprises if the exemption is withdrawn.
- 3.5.7 If the aim is to provide HMRC with more information to identify potential transfer pricing risk, this could alternatively be achieved through targeted disclosure. If exemption is removed for SMEs, they could be required to complete a shortened version of the ICTS, rather than full documentation requirements. This would strike a balance between HMRC's information requirements and easing administrative burdens on taxpayers.

3.6 Question 6: The government welcomes views on proposals relating to exceptions to the SME exemption, including whether the non-qualifying territory exception should be reviewed.

- 3.6.1 We agree that removing the ability to issue a transfer pricing notice, except to small businesses where the relevant provision contributes to the calculation of profits eligible for the Patent Box, would be sensible. In our experience, we haven't seen a transfer pricing notice used but it can introduce uncertainty, particularly in due diligence situations.

- 3.6.2 The non-qualifying territory exception equates non-qualification with a “high risk of profit diversion”, which we do not believe is accurate. It more often reflects gaps in the UK’s treaty network. For example, territories such as the United Arab Emirates and Georgia are qualifying territories despite low corporate tax rates.
- 3.6.3 There are also anomalies where there are full treaties but not with ‘territories’, such as Hong Kong and the Channel Islands. Removing the exclusion would remove these anomalies.
- 3.7 **Question 7: The government welcomes suggestions of alternatives to the non-qualifying territory exception, and comments on the potential alternative approaches outlined in this document.**
 - 3.7.1 We believe the non-qualifying territory exception should be removed.
 - 3.7.2 The use of HMRC directions (albeit with the ability to self-assess) to qualify for relief from withholding tax on interest under treaties provides a lower-risk framework, and HMRC would retain the ability not to issue directions if it had concerns.
 - 3.7.3 Small companies are also likely to fall within the scope of other anti-avoidance rules such as the transfer of assets abroad (TOAA) provisions, which should be the primary counteraction rather than imposing further obligations on the companies.
 - 3.7.4 Headline tax rates are not a reliable measure of risk, as they do not reflect deductions and exemptions. This is reflected in the approach taken under the CFC rules. Although we do not suggest the same approach here, with most small companies relying on the de minimis exemption rather than tax rate exemptions.
 - 3.7.5 A more balanced approach may be to require reporting rather than full compliance, potentially through the ICTS, which would require consequential changes.
- 3.8 **Question 8: The government welcomes views on whether aligning the definition of enterprise with the scope of the participation condition would make the SME exemption easier to apply.**
 - 3.8.1 There are particular issues with how natural persons and investment funds are treated under the current definition of enterprise. If this definition is retained, clearer legislation or guidance is needed.
 - 3.8.2 In practice, these relationships are often ignored, but analysing them creates unnecessary work resulting in a disproportionate compliance burden.
 - 3.8.3 A 25% relationship rarely reflects two entities being part of the same economic group.
 - 3.8.4 Aligning the definition with the participation condition in s148 TIOPA 2010 would be sensible, as it would mean testing the size threshold against the entities actually in scope.
 - 3.8.5 However, the participation condition alone would not resolve the issues with natural persons and investment funds, as these can still meet the condition.

- 3.8.6 S148 does not define “enterprise”, only control thresholds. A carve-out would be needed in the size test, similar to the EU definition, but with clearer definitions and guidance.
- 3.9 Question 9: The government welcomes views on whether removing partner enterprises from the definition of enterprise would simplify the application of the SME exemption.**
- 3.9.1 We believe that removing partner enterprises from the definition of enterprise would help reduce some of the uncertainties around natural persons and investment funds.
- 3.10 Question 10: The government welcomes any other comments, suggestions, or feedback on the proposed amendments to the SME exemption.**
- 3.10.1 The amendments should focus on simplification and ease of application for non-tax specialists. Clear and concise guidance is needed to reduce taxpayers’ reliance on tax specialists, particularly where structures are more complex and could otherwise lead to disproportionate costs.
- 3.11 Question 11: The government welcomes views on the suggested scope of the ICTS requirement. In particular, the government welcomes comments on the proposed application of the requirement to PEs.**
- 3.11.1 We cautiously support the proposed scope of the ICTS requirement.
- 3.11.2 HMRC must be cautious about using ICTS data to open enquiries, as this could create a lot of unnecessary work for both HMRC and taxpayers. This risk is similar to what has been seen with CRS reporting.
- 3.11.3 ICTS data must not be used in place of widely available benchmarks, which are expected to improve with the publication of small company profit and loss accounts.
- 3.11.4 HMRC should work with industry specialists to identify relevant risk factors, be transparent about its approach, and remain open to adapting it.
- 3.11.5 HMRC’s capacity to review the information submitted should be considered.
- 3.11.6 Many SME systems are not currently capable of producing the required data. The cost of implementation should not be underestimated where medium size enterprises are brought into transfer pricing, and HMRC should work with software providers and allow sufficient time.
- 3.11.7 Excluding transactions reported in the ICTS from the local file requirement should reduce compliance burden, but the underlying transfer pricing work would still be needed.
- 3.11.8 The application of the ICTS to PEs needs further thought. The authorised OECD approach is based on allocation rather than transactions, but assuming the PE is dealing at arm’s length with the head office. Including PEs could result in deemed transactions for reporting purposes, which would not reflect how PEs are typically viewed, and most enterprises do

not always have accurately delineated transactions with their PEs. We suggest omitting PEs from scope for now.

- 3.11.9 There is a low risk of mischief through the use of PEs, as enterprises are unlikely to set up a PE instead of a subsidiary to avoid reporting.
- 3.11.10 Alternatively, the ICTS requirement could be limited to cases where a branch exemption election has been made, as otherwise profits are already within the charge to UK tax.
- 3.12 **Question 12: The government welcomes views on the proposed exemption from the ICTS requirement where the total aggregated value of relevant cross-border related-party transactions is below £1 million. Views on whether multiple or alternative thresholds would be preferable are invited.**
 - 3.12.1 We support the use of financial thresholds, but suggest they are reviewed after the first years of operation to ensure they are appropriate.
 - 3.12.2 We do not agree that transactions with non-qualifying territories automatically represent a high risk of profit diversion. On that basis, we do not support applying a £nil threshold in these cases.
 - 3.12.3 The aggregation criteria should be simple and absolute. The additional aggregation factors proposed introduce unnecessary complexity.
- 3.13 **Question 13: The government welcomes any comments or suggestions on the proposed tabular analysis, including both the transaction analysis in Section A and the loan relationship disclosure in Section B.**
- 3.14 **Question 14: The government welcomes any comments or suggestions on whether the items of information requested appear reasonable and proportionate, in light of the policy intention to improve risk identification and risk assessment. In addition, are there any other items of information which would be useful for HMRC to have at the time of risk assessment?**
- 3.15 **Question 15: The government welcomes views about the ability to extract the information suggested from businesses' existing records and systems. Could any changes be made to the template to make collation of data easier, while still extracting fundamentally similar data?**
- 3.16 **Question 16: The government welcomes any comments or suggestions on the proposed approach to aggregation.**
- 3.17 **Question 17: The government welcomes any comments or suggestions on whether the de minimis thresholds suggested appear reasonable.**
 - 3.17.1 Combined response to questions 13 to 17.

- 3.17.2 Aggregation may need to be simplified if the ICTS is intended as an initial risk assessment tool. For example, aggregation could be based only on jurisdiction or transaction type. This would (for example) identify all transactions a company has with a particular country, or all transactions of a particular type (eg sales only of manufactured goods) regardless of destination, which could give HMRC sufficient information.
- 3.17.3 SMEs may struggle to identify and classify certain transaction types, for example they may have a cost contribution arrangement but not realise what it is.
- 3.17.4 There may be lessons to learn from confusion around transaction types in CbCR reporting.
- 3.17.5 A shorter form for SMEs and a longer version for very large companies could help reduce the compliance burden.
- 3.17.6 The proposed de minimis threshold of £100,000 is very low for SMEs, some of which may have turnover of more than £100 million. More appropriate materiality limits could be:
 - a. Intra-group purchases **or** sales of goods and products not exceeding £1 million per fiscal year, or
 - b. Intra-group service remuneration not exceeding £500,000 per fiscal year.
- 3.17.7 Aggregating purchases and sales within a category removes the benefit of simplification of aggregation. Aggregation limits should also be adjusted periodically for inflation.
- 3.17.8 The £1 million de minimis for large companies is sensible and aligns with existing transfer pricing documentation thresholds.
- 3.17.9 For related party financing, the proposed de minimis does not sufficiently capture key risk areas. For example, there may be a non-arm's length interest-free (or low interest) loan issued part way in the financial period and settled before the end of the financial period. This would not be required to be reported in the current form ICTS as the opening and closing balance is less than £5 million and the in-year impact on profits and losses was less than £100,000. We suggest a de minimis based on average balance throughout the year (or active loan period if settled during the year) should be considered.
- 3.17.10 This issue also applies to companies under the Transfer Pricing Records Regulations 2023 (on higher thresholds), though these should already be supported by local file documentation and should theoretically present low risk in practice.
- 3.17.11 The two-part de minimis approach otherwise appears reasonable and relatively straightforward to apply.
- 3.17.12 Regarding questions 7 and 8 of the ICTS, we do not see the benefit of requiring this information. Any material financing arrangements are already disclosed under question 6, which is based on profit and loss impact and excludes interest-free or low-interest loans.

3.18 Question 18: The government welcomes views on the proposed question list in Section C, including any suggestions of additional information which would be useful for HMRC to have during risk assessment.

- 3.18.1 All of the proposed questions in Section C are either unnecessary for determining taxable profit or transfer pricing risk, or the information is already available to HMRC from other sources. Requesting the information again will increase the compliance burden, particularly for SMEs.
- 3.18.2 The UTR may be relevant if the ICTS is filed on a standalone basis, similar to the AIF.
- 3.18.3 Global Ultimate Owner (GUO) is not relevant.
- 3.18.4 Industry codes (SIC/NACE) are often not relevant to the current business and are usually available from Companies House.
- 3.18.5 Functional currency is disclosed in the statutory financial statements.
- 3.18.6 Transfers of intangibles would be shown as disposals or acquisitions on the tax return.
- 3.18.7 Business restructurings would also be shown as disposals if relevant, otherwise they are not relevant.
- 3.18.8 Changes to transfer pricing policies are not relevant and SME policies are more fluid anyway, exempt this query for SMEs. This information would be available in the enterprise's local file for those already within transfer pricing if other factors of HMRC's review of the ICTS flagged it for further review. Further, this may be considered subjective as to what would constitute a change in transfer pricing policy, is this a change in mark-up to align with latest benchmarking or a change in transfer pricing method applied. This could lead to unnecessary scrutiny and confusion.
- 3.18.9 Transfer pricing adjustments would be included in the company's tax computation.
- 3.18.10 Elections to exempt profits would be made on the tax return and we assume already be visible to HMRC.

3.19 Question 19: The government welcomes any other comments, suggestions, or feedback on the proposed scope of the ITCS requirement and template.

- 3.19.1 Questions 1 and 2 of the ICTS reference legislation. If the form is intended for completion by taxpayers, including medium-sized enterprises, references to HMRC's manuals would help reduce compliance costs by supporting self-completion.
- 3.19.2 Similarly, the reference to qualifying territories in question 4 would benefit from clear guidance.
- 3.19.3 Further consultation is recommended on the aggregation factors in lines 31 and 32 of the spreadsheet, as they appear complex.

- 3.19.4 In question 5, aggregating income and expense transactions within a transaction category increases complexity and the compliance burden and cost for taxpayers. We recommend applying the aggregation criterion separately to income and expense for each transaction type.
- 3.19.5 We believe the list of transaction types from line 43 onwards is too detailed. This level of information may be appropriate for large businesses but adds unnecessary complexity for medium size enterprises or SMEs with transactions in non-qualifying territories. A simpler approach should be adopted for them.

4. About Saffery LLP

- 4.1 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.
- 4.2 Since 1855, we've evolved in size and scope, but our unwavering dedication to exceptional client service remains the same.
- 4.3 As a proud member of Nexia, a worldwide network of trusted member firms, we've got access to local insight on a global scale.
- 4.4 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.