30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: post@ciot.org.uk

Transfer pricing documentation requirements for UK businesses

Comments by the Chartered Institute of Taxation

1 Executive Summary

1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.

1.2 On 20 July 2022 the government published draft legislation for the new measure that will require the largest UK businesses to maintain a master file and a local file in a prescribed and standardised format, and to complete a summary audit trail. In our response to the consultation on these measures in 2021, we supported the policy aims of increasing certainty for businesses around transfer pricing documentation, and recognised the potential benefit to both HMRC and taxpayers from improved risk assessment by HMRC and, therefore, better focused enquiries. We were broadly supportive of the measures proposed, while also noting that they would inevitably increase the compliance burden for businesses.

1.3 Our stated objectives are for a tax system that includes a legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences and also provides greater simplicity and clarity, as well as certainty. As we noted in our response to the consultation, it is important that each of the measures is justified on the basis of the expected costs and benefits.

1.4 We set out below our initial comments on this draft legislation. However, we also note that detail around what will be relevant transfer pricing records is to be set out in secondary legislation. This, and also HMRC guidance, has not yet been made available, but is expected during the course of September. We look forward to discussing the full package with you in October 2022. We may have further comments on the draft legislation at this stage.

1.5 The structure of the draft legislation is that the requirement to keep transfer pricing records will apply to anyone within the UK's transfer pricing rules, and not just those within the Base Erosion and Profit Shifting Country by Country Reporting (CbCR) rules, although penalties would only be levied upon those companies within the CbCR rules. In our view this is the wrong approach. It seems odd that the government and HMRC would be effectively endorsing rule-breaking in respect of these requirements, whilst HMRC are generally trying to encourage voluntary tax compliance. We suggest that the better approach would be for the primary

legislation to apply only to those that are intended to have to comply and specifically carve non CbCR groups out of the requirement in the first place.

1.6 The change to the penalties for error rules is probably not necessary, however, we understand why it is being included and, on balance, the principle behind this suggested change, along with the record keeping changes in 1(1) and 1(2) seems reasonable. However, guidance will be required as to what will constitute a 'failure to comply', which we hope will also ensure that the obligations disproportionate and overly burdensome, and are commensurate with the size and complexity of the business and its transfer pricing arrangements.

1.7 In our view, the changes being made in relation to the restrictions on power regarding taxpayer notices following tax returns are not necessary or justified. As defined, the relevant transfer pricing records will automatically be part of the corporate's statutory records in respect of which taxpayer notices can be given, with the usual safeguards. The change proposed will mean that HMRC will be able to issue information notices in relation to transfer pricing records outside of an enquiry and we cannot see the justification for this, nor why the position in relation to transfer pricing records should be different from other records relevant to the company's tax position in this regard.

1.8 The draft legislation also proposes changes to the position with regard to documents in a taxpayers 'possession or power'. Whilst we understand the rationale for the proposed change, we are not convinced that they are necessary, nor that the administrative difficulties they seek to address justify undermining the principles underpinning the possession or power safeguard or Exchange of Information Agreements (EoIAs) as a whole.

2 About us

2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

2.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

3 Scope of the legislation

3.1 We note the structure of the draft legislation in that the primary legislation appears to apply the requirement to keep transfer pricing records to anyone within the UK's transfer pricing rules, and not just those within the CbCR rules, although penalties would only be levied upon those companies within the CbCR rules. This means that the legislation is saying to all companies 'you should do this but we are not going to penalise you if you do not'. In our view this is the wrong approach.

3.2 We are concerned that this may mean that many companies/businesses will want to comply with these requirements, even if there is no penalty on the basis that this is a responsible and 'safe' thing to do. Also, it seems to send the wrong message by bringing in rules, that apply, but without penalty for failure to comply.

It seems to encourage rule-breaking/non-compliance which is an odd position for the government and HMRC to be taking, given that HMRC are generally trying to encourage voluntary compliance.

3.3 It may be possible for this to be clarified in guidance on the basis that the draft legislation says that:

'records are 'relevant transfer pricing records' if the Commissioners for Her Majesty's Revenue and Customs reasonably consider [emphasis added] that the records may relate to the calculation of profits or losses in accordance with Part 4 of TIOPA 2010 (transfer pricing);'

HMRC could state in their guidance that they only reasonably consider that the documents are needed for groups within the CbCR rules, but this seems to be a strange distinction to make and also results in the unsatisfactory position of being 'taxed by legislation, relieved by guidance'. We suggest that it would be better for the primary legislation to apply only to those that are intended to have to comply and to specifically carve non CbCR groups out of the requirement in the first place.

4 Section 1(3) – penalties for carelessness

4.1 With regard to the change to the penalties for errors rule that would be made by section 1(3) of the draft legislation, on one view this is unnecessary because on current interpretations of 'carelessness' failing to keep proper records would contribute to the person's behaviour being careless (unless there was evidence that not keeping records was done intentionally as part of a tax fraud – in which case the behaviour is deliberate). However, we understand, tactically, why HMRC is inserting a new paragraph 3C into Schedule FA 2007 24, as it will make it very clear to all businesses that they must keep transfer pricing records, or be considered careless if more corporation tax is found to be due in relation to transfer pricing adjustments. On balance, therefore, the principle behind this suggested change, along with the record keeping changes in sections 1(1) and 1(2) seem reasonable.

4.2 However, we are concerned that the changes being introduced section 1(3) do not make it clear what would constitute a 'failure to comply' with the requirements to keep and preserve the specified relevant transfer pricing records. In some cases (probably rare ones), it may be the case that neither the master file or local file has been prepared. But in others, we imagine that the question is more likely to be about the content and adequacy of these files. The threshold for a 'failure' is not addressed. As a minimum, guidance will be required on this, including in relation to what is commensurate with the size and complexity of the business and its transfer pricing arrangements. This question has been part of litigation in other jurisdictions, albeit not in relation to penalties.

4.3 In particular, in regard to the proposed requirement for taxpayers to complete a questionnaire detailing the main actions undertaken in preparing the local file, it is not clear how this interacts with the penalty regime. Specifically, will there be a threshold below which a taxpayer might be considered by HMRC not to have done enough to have taken reasonable care if there is an error in the tax return (for example the transfer pricing is found to be non-arm's length)? How would this threshold reflect the size and complexity of the business and its transfer pricing arrangements? Again, additional guidance and clarification will be important. More generally, it will be important for businesses and their advisers to understand the expectations of HMRC for what work is required, and that these expectations are not disproportionate and overly burdensome. It is also unfortunate that the requirement for the questionnaire is a step away from consistency of requirements internationally, which may result in either a levelling-up or more 'tailored', and inconsistent, approaches country-by-country.

5 Section 1(4)(a) – restrictions on power re taxpayer notices following tax returns

5.1 In our view, the changes being made by section 1(4)(a) to paragraph 21 of Schedule 36 FA 2008 are not necessary or justified. Earlier in the draft legislation the rules on record keeping are changed to insert the new

transfer pricing records. This means that the transfer pricing records will automatically fall within paragraph 62 of Schedule 36 FA 2008 and they will be part of the corporate's statutory records. The corporate will not be able to appeal against being required to provide them (see paragraph 29(2) of Schedule 36).

5.2 Paragraph 21 already allows HMRC to issue an information notice to get hold of information and documents where HMRC opens an enquiry (Paragraph 21 Condition A). Most transfer pricing checks are done within such an enquiry.

5.3 By inserting the new wording into paragraph 21 and introducing a new Condition E, HMRC are effectively being permitted to issue an information notice to obtain 'specified relevant transfer pricing information or documents' outside of an enquiry, even where it has no reason to suspect there is anything wrong with the return. The new condition means that for transfer pricing the main safeguard of Condition B in paragraph 21 would be removed where there is no statutory enquiry.

5.4 Arguably, the 'reasonably required' element in paragraph 1 of Schedule 36 may help the taxpayer contest the information notice, but there is not a settled case law position on whether that requirement would apply in priority to the more general 'cannot appeal requests for statutory records' rule. On balance, we cannot see the justification for this change, nor why the position in relation to transfer pricing records should be different from other records (here are no other aspects of taxation (income tax or corporation tax) where HMRC are able to disregard the Condition B in this way).

6 Section 1(4)(b) - changes to Schedule 36 to FA 2008 re possession or power

6.1 The new paragraph 37C which will be inserted into Schedule 36 FA 2008 removes the 'possession or power' safeguard in relation to 'specified relevant transfer pricing documents'. At present the recipient of an information notice cannot be required to give a document to HMRC if it is not in their possession or power, so they cannot be penalised for failing to comply with the part of the notice which relates to documents not in their possession or power.

6.2 There has been some litigation on the meaning of possession or power and how it applies for groups of companies (See for example *Meditor Capital Management v Feighan* [2004] STC (SCD) 273). Possession essentially means that the document is held by the person to whom the notice is addressed. Power essentially means '*a presently enforceable legal right to obtain from whoever actually holds the document inspection of it without the need to obtain the consent of anyone else'*. Therefore, currently, if an information notice goes to a subsidiary seeking a document which is in the possession of its holding company, but not the subsidiary, then whether or not the subsidiary has to give the document to HMRC depends on whether the subsidiary has the power to get the document from the holding company.

6.3 The change being made by the new paragraph 37C would remove this distinction with regard to transfer pricing documents. Whilst we can understand why HMRC may be frustrated if a subsidiary with a UK taxable presence is unable to provide key transfer pricing documents, because they are held by the parent company, we are not convinced that this change is necessary or justifiable.

6.4 One view, the new paragraph 37C should circumvent the time that can be taken by all parties debating what is and what is not in the 'possession or power' of a UK entity, especially if HMRC can potentially obtain documents via an EoIA anyway, although this also takes time. But we are not convinced that these administrative difficulties justify undermining the principles underpinning the possession or power safeguard or EoIAs as a whole.

6.5 Is this change necessary in reality? The new rules will specify the relevant transfer pricing records that must be kept by a corporate. We suggest that a better way forward might be to ensure that the scope of the transfer pricing records (which will be specified in the record keeping regulations referred to earlier in this draft

legislation) is broad enough so as to ensure the UK taxable entity keeps all the records that HMRC would want to see, thus making this change with regard to possession and power unnecessary.

6.6 This would avoid legislation that would effectively mean that a UK taxable company could find itself in the position of being incapable of extracting the documents sought by HMRC from other group companies (as they have no legal right to obtain them and are refused when they ask for the document), and facing penalties in this situation. No doubt HMRC hopes that this law change would cause multinational groups to reflect and ensure that subsidiaries are given documents that HMRC wants to have. Only time will tell what actually happens if this legislation is enacted, and whether other jurisdictions may move to enact similar provisions, independently of the current EoIAs.

7 Acknowledgement of submission

7.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation
13 September 2022