Uncertain times for the UK

Shiv Mahalingham of **Duff & Phelps** provides a roundup of the key changes to the UK transfer pricing landscape in recent months.

In recent months, there have been some important changes to the UK transfer pricing governance process:

1) Revised HMRC inspector guidance confirming that where a transfer pricing issue is neither suitable for an advance pricing agreement (APA), nor does it warrant an enquiry, Inspectors should not engage with the customer in discussions on that issue.
2) Revised APA statement of practice confirming the preference for multilateral APAs in most situations.

Initial experience of this revised process has shown that it is hampering the ability for businesses operating in the UK to obtain transfer pricing certainty and that it is leading to escalating transfer pricing compliance costs – particularly at year-end audit sign-off.

In examining the above changes and the impact on UK businesses, it is worthwhile revisiting some of the external factors that have brought about the changes:

- The European Commission has challenged several transactions in which 'aid' may have been granted (by a tax administration or ministry of finance) in a member state. Many of these challenges examine whether transfer pricing policy is in line with arm's-length standards. These challenges and the subsequent negative press surrounding them have created a preference amongst Tax Administrations to move away from unilateral advance pricing agreements (that may be subject to challenge) and toward multilateral agreements in which all relevant tax administrations reach an agreement on transfer pricing.
- Media pressure accusing tax administrations of 'sweetheart deals' with business (reference Google agreeing to pay £130 million ($158 million) in back tax to HMRC in January 2016 for the 10 years to 2015, saying this was "full tax due in law") has also created a preference to rein in any practices that may be construed to be informal deals as opposed to statutory rulings.
- Commitment to transparency and exchange information with treaty partners – the OECD global implementation of automatic exchange of information (AEOI) is "an essential step for stimulating the development of a global level playing field"; in other words, global implementation is essential to effectively tackle evasion as well as to ensure jurisdictions are on an even footing. Many jurisdictions have already announced their plan to implement the new standard (around 50 jurisdictions will work towards having their first exchanges by September 2017 with more to follow in 2018).

Shiv Mahalingham

Duff & Phelps

London
Tel: (44) 20 7089 4790
shiv.mahalingham@duffandphelps.com
www.duffandphelps.com

Shiv is a managing director in the newly established Duff & Phelps European Transfer Pricing Team. Shiv works across all industries and has built a strong reputation for the provision of measured and practical economic transfer pricing advice. He has been called as an independent expert witness in international transfer pricing cases, and has concluded dispute resolutions and APAs in jurisdictions including the US, UK, Japan, China, Australia, Singapore, France, the Netherlands and Germany.

Prior to joining Duff & Phelps, Shiv was a founding partner and the head of transfer pricing at Alvarez & Marsal Taxand UK and before that with Ernst & Young, where he led projects to include business restructurings for FTSE 100 groups; thin capitalisation studies for large private equity backed buyouts; and transfer pricing risk/opportunity assessments for FTSE midcap and fledgling groups. Shiv also spent two years with a fortune 500 company, establishing in-house transfer pricing risk controls, systems and planning structures.

Shiv brings a mix of academic skills, having studied economics and then taxation law before qualifying as a chartered accountant and a chartered tax adviser. He is a regular speaker at international transfer pricing conferences and has published well over 100 articles in international journals (including the International Tax Review, BNA Transfer Pricing, Taxation, Tax Adviser, Tax Journal, Tax Business, Tolleys Practical Tax, Finance Director, World Finance, and a case study in the Harvard Business Review). In addition, Shiv meets with UK tax authorities on a regular basis to consult on transfer pricing issues.

Shiv is often quoted on transfer pricing in the UK press, including mentions in the Financial Times, the Guardian, the Observer, the Times, the Telegraph, the Dow Jones Newswire and Accountancy Age. Some years ago, at the age of 26, Shiv was accepted as one of the youngest fellows in the history of the UK's Chartered Institute of Taxation (CIOT) for his thesis on modernising UK tax legislation, while maintaining the competitiveness of the UK economy.

Before embarking on a career in transfer pricing, Shiv played three seasons of professional basketball with the English Basketball League.

Duff & Phelps is the premier global valuation and corporate finance advisor with expertise in complex valuation, transfer pricing, dispute consulting, M&A and restructuring.

The transfer pricing governance process revisited

The three stage "gate" process

HMRC has a Transfer Pricing Group (TPG) to review each enquiry (or potential enquiry) in alignment with a three stage or 'gate' process:

- Making sure the selection of a case is appropriate;
- Ensuring there is effective progress in a case; and
- Reaching the appropriate conclusion in a case

The TPG includes specialists within HMRC who monitor transfer pricing and thin capitalisation enquiries. These personnel are drawn from the following directorates within HMRC: CTIAA Business International, Large Business Service, Local Compliance, Specialist Investigations, Knowledge Analysis and Intelligence.

The selection stage requires a business case file (in a specific and predetermined format) to be prepared and approved before an enquiry is commenced and INTM481030 confirms that "each directorate will decide the best method for checking effective progress within their business area. This will allow each directorate to tailor the progression stage to its own systems. The progression reports, in the system adopted, should continue to be submitted to the TP Panels as previously". It remains possible for businesses to engage in a regular dialogue with customer relationship managers (CRM) about transfer pricing policy to ensure that the process does not reach stage one.

Business case files where there is no enquiry

Stages two and three will require the preparation of a business case file. If the conclusion at stage one is that an enquiry is not justified, there is no requirement on the HMRC case team to prepare a business case. However, it is recommended practice in the inspector guidance to record the results of the research carried out and the conclusion reached to inform future risk assessments. It may be possible for businesses to request sight of these business case files as these may include important information on the different levels of risk associated with transactions (e.g. a transaction may be flagged in one financial year but not pursued until it become more material in later years but an early indication of this would be useful in stopping the enquiry process). This risk assessment process will be important for businesses in assessing year end provisions for potential transfer pricing adjustments in current and future years (or to support the fact that no such provisions are necessary).

Revised inspector guidance INTM480540

Informal discussions and agreements with CRMs have been useful in the past to provide taxpayers with certainty and protect them from overselling/overengineering in the market place. We have revisited a number of informal agreements in the past few months and the common theme is that

they all apply a practical and commercial risk-based approach to transfer pricing policy.

It is important to note that the HMRC CRM will still engage with businesses about a wide range of potential transfer pricing risks and policies to inform the annual risk review processes – however, informal agreements on transfer pricing matters will no longer be provided (and more importantly, existing agreements may no longer be relevant). As discussed in the above governance section, businesses will still be able to manage risk with transparency and communication with the CRMs – it is recommended that all meetings and discussions with CRMs be documented by businesses as audit evidence and risk management. However, businesses are faced with having to undertaken onerous transfer pricing reviews to appease financial auditors when an existing and valid CRM agreement may already be in place.

Changes to the APA statement of practice

The (November 2016) revised statement of practice confirms that:

"HMRC expects that APA applications are bilateral rather than unilateral except where:

- The other party to the transaction is resident in a jurisdiction with which HMRC has no treaty or where HMRC is aware that the treaty partner has no APA process; or
- HMRC considers there is little extra to be gained by seeking a bilateral agreement. For example where the UK is at the hub of arrangements with associated enterprises in many different countries and where the trade flows involved with any one particular country are relatively modest in scale".

The statement of practice further confirms that unilateral APAs are considered to be of less value to both HMRC and potential applicants and provide less transparency – therefore, applications for unilateral APAs are less likely to be accepted into the APA programme and recent experience has shown that this is very much the case. Businesses are aware that a multilateral process will be a three-year time commitment and significant resource drain and are less willing to utilise this process than may have been the case for unilateral APAs which could be agreed in a shorter timescale. The commitment to a multilateral APA is a three-year one (compared with unilateral rulings which could be obtained within three to six months) and that is not palatable to most businesses with limited tax spend budgets in the current climate.

The expression of interest (EoI) stage may still be considered by businesses looking for certainty of transfer pricing treatment – HMRC prefers that such discussions are on a named basis to maximise the benefit of discussions. The outcome of such a discussion may be that the transactions are not considered to be high risk and a documentation of that discussion may be a helpful risk management tool.

Compliance burden

It is unfortunate that the above changes are already increasing the compliance burden on businesses at a time when more transfer pricing certainty is required although the political and media backdrop discussed at the outset of this article provides the author with sympathy as to why the changes have been implemented. The ability to enter a dialogue with HMRC inspectors on transfer pricing matters (formally and informally) once put the UK above most tax jurisdictions in terms of transparency and management of business resource; however, the above changes and experience in recent months has seen this ebb away to leave businesses with reduced certainty options unless they are prepared to spend a number of years engaged in discussions with multiple tax authorities at significant cost. The changes are already leading to an increase in audit and advisory fees for many businesses who can no longer rely upon a valid CRM agreement and they are likely to lead to a decline in APAs being submitted in the UK (HMRC has not released APA statistics since 2014) as businesses opt for preparing robust documentation in alignment with the revised OECD transfer pricing guidance instead of engaging with HMRC.

However, having discussed this trend with a handful of CRMs, it is clear that a regular and transparent risk assessment discussion or process with the CRM should still help to stave off a transfer pricing enquiry in the early gate stages rather than having to reinvent the wheel on documentation.