

# Changes ahead for UK transfer pricing documentation

April 19, 2021

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## In brief

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Her Majesty's Revenue and Customs (HMRC), the UK's tax authority, has asked for comments on proposed changes to its transfer pricing documentation rules. While these proposals would align the UK's current rules more closely with the documentation requirements of other jurisdictions and with the [BEPS Action 13 Report](#), they also contain some novel features.

Three main changes are being considered:

- The introduction of mandatory master file and local file requirements (in line with the BEPS Action 13 Report) for UK multinational enterprises (MNEs) within the scope of Country-by-Country (CbC) reporting requirements;
- The introduction of additional disclosures about cross-border transactions with associated enterprises to be included in an International Dealings Schedule (IDS) as part of the annual tax return for all businesses within the scope of UK transfer pricing rules; and
- The potential use of an "evidence log" or similar document as a means of identifying key facts and evidence.

**Action item:** If adopted, these proposals could substantially increase the reporting obligations for many UK taxpayers. HMRC has invited contributions by June 1, 2021 from businesses, advisers, and representative bodies on "possible options and design ideas which could benefit UK business and HMRC." (Please find the public consultation document [here](#)).

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## In detail

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### Introduction of master file and local file requirements

#### *Summary of consultation proposals*

HMRC is considering the introduction of a mandatory requirement for UK MNEs within a CbC reporting group (i.e., a group with consolidated group revenues over EUR 750 million) to obtain or prepare a Group master file, as well as a local file, which would have to be provided to HMRC within 30 days after a request.

HMRC says that its discussions with other tax authorities have provided positive feedback about how "availability and access to the master file and local file improves tax compliance interventions and risk assessment." HMRC's expectation is that the majority of groups that meet CbC thresholds and

requirements routinely will create a master file and should be able to provide it to HMRC without additional effort. In respect of local files, HMRC sees this as the compilation of records that already are maintained but in a prescribed format.

### **Observations**

The UK was one of the first countries to introduce a requirement to prepare and file a CbC report that would help HMRC with risk assessment. While the BEPS Action 13 Report generally is considered a best practice approach to documentation in the UK, to date there has been no formal requirement to follow Action 13 format and content.

While bringing in formal rules for Action 13 master and local files would align the UK with many other countries, the United States and some other countries have not adopted this approach, and even those that do often have their own version of the Action 13 requirements.

For some MNEs already producing master files and local files, any change to an Action 13 approach by the UK may not create concerns, but for other MNEs this may not be the case. HMRC has asked for comments on this detail of this proposal, including restricting the need for a master and local file to MNEs within the scope of the CbC reporting regime, *de minimis* thresholds for transactions, and a 30-day time limit for submission.

## **Introduction of the International Dealings Schedule (IDS)**

### **Summary of consultation proposals**

The consultation also proposes introduction of an IDS to report transactional data about intragroup cross-border transactions in a structured format which would be used by HMRC to identify transfer pricing risks more accurately.

All UK businesses within the scope of UK transfer pricing legislation which generally excludes small and medium-sized enterprises, would be required to file an IDS under the current proposals, but with materiality limits being considered to exclude certain transactions and reduce the potential administrative burden.

The consultation document includes the following types of information that could be within the scope of reporting via an IDS:

- the nature and amount of specific types of transactions
- details of financial dealings
- compensation, receipts, or payments of a non-financial nature
- information on restructuring activity
- information on the TP methodologies applied
- information on the level and type of supporting documentation for the TP methodology selected and applied
- counterparty details for transactions including identity and country location
- information on activities
- corporate group information (to enable entity-level data to be combined and attributed to a particular MNE group).

### **Observations**

As noted above, the UK was one of the first tax authorities to implement CbC reporting and already uses this data in its risk profiling of MNEs. The introduction of an IDS, as in some other countries, would provide HMRC with additional information on all MNEs subject to the UK TP legislation, not just those subject to CbC reporting. This is seen as a way of improving HMRC's risk profiling activity and enabling it to better target its audit activity.

The suggested list of data that might be required by HMRC is extensive and raises concerns about the potential burden on MNEs as well as the subjective nature of some of the data requested and its relevance to risk profiling.

The ability to analyze data from IDS returns by sector, by size of company, profitability etc. could create many profiling opportunities for HMRC and could cast a light on those MNEs that are at the bottom of the range.

## Introduction of the “evidence log”

### *Summary of consultation proposals*

As part of the proposals covering master file and local file, HMRC has suggested that it would like “to explore the benefits of requiring the local file to be supported by some form of evidence log setting out key facts, potentially as an appendix to local file documentation.” In HMRC’s view, this would help with a common problem in transfer pricing enquiries of distinguishing underlying facts and evidence from technical opinions.

It is suggested that including an evidence log, potentially as an appendix to local file documentation, would result in better-focused enquiries and faster resolution by reducing long periods of fact-finding. There is precedent for an evidence log as it is a fundamental part of the approach adopted in the [Profit Diversion Compliance Facility](#) (PDCF); HMRC’s PDCF guidance provides an example of what might be included in such a document.

### **Observations**

Recent enquiry experience in the UK, coupled with the introduction of the PDCF, has led to a marked increase in the level of evidence that HMRC is asking to see, such as copies of emails, notes of interviews with employees, and evidence from customers. HMRC typically will want to check whether there is evidence to support the transfer pricing and if this aligns with the facts on the ground. If it does not, HMRC increasingly has been challenging whether sufficient care has been taken by MNEs, and, if not, has sought to impose penalties.

The introduction of an evidence log for all MNEs would be a novel step beyond the scope of the Action 13 proposals. With this requirement, HMRC in effect would be asking MNEs to confirm that the transfer pricing analysis is based on a detailed fact pattern supported by documentary evidence that could be provided to them on request.

This is one aspect of these proposals that merits further detailed consultation. Our experience with the PDCF is that compiling and maintaining an evidence log for UK-related transactions could create significant compliance burdens for many MNEs, both those based in the UK and inbounds. Clarity and balance on the part of HMRC would be essential to making such a proposal effective.

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## **The takeaway**

To date, the UK’s approach to transfer pricing documentation has been to rely on general requirements for taxpayers to support the completeness and accuracy of their tax returns. Although this guidance is broad in nature, it would appear that, in many instances, HMRC does not consider the interpretation of this guidance by MNEs meets its expectations.

With this consultation, HMRC has given a clear indication that the future of UK transfer pricing documentation is likely to be far more structured and detailed. The introduction of BEPS Action 13 master file and local file requirements would more closely align the UK with many other countries and enhance the benefit of a globally coordinated and consistent approach. But the proposal for an evidence log sends a clear signal that the information in master and local files may not be considered enough to support an MNE’s transfer pricing policy.

The potential additional requirement for a data return such as the IDS also could move the UK toward the more burdensome end of the global compliance spectrum.

Overall, MNEs need to be aware of and prepare for changes in the UK rules that could be wide-ranging and could require significant additional compliance resources on an on-going basis.

The consultation period is relatively short — with a June 1 deadline — but provides businesses and other interested parties with the opportunity to address the nature and degree of these changes.

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## Let's talk

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If you would like to know more on how these changes might affect you, please speak to your usual transfer pricing contact or any of the PwC specialists named below:

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