

# UK transfer pricing documentation: New law comes into force, guidance issued

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## In brief

The enactment in the UK of the Spring Finance Bill 2023 — which received royal assent in July to become Finance (No.2) Act 2023 (the Act) — brought to a formal conclusion a more than two-year process to update the UK's transfer pricing documentation requirements, which started in March 2021 with the release of a public consultation document. In response, various proposals have been put forward; some have been included in the new legislation, and others have been put on hold or noted for further consultation in the near future.

In essence, the new rules bring the UK transfer pricing documentation requirements more aligned with the Organisation for Economic Co-operation and Development (OECD) model for documentation, developed under Base Erosion Profit Shifting (BEPS) Action 13. The maintenance of OECD format Master File and Local File documents has been added to existing Country-by-Country Reporting (CbCR) requirements for large groups — i.e., those which meet the CbCR global turnover threshold of EUR 750 million (MNE CbCR threshold). The OECD Guidelines are directly referenced to establish the format and content of the records that now will be required by law.

The effective date is set by reference to the taxpayer's accounting period, with the new rules applying to accounting periods beginning on or after April 1, 2023 for corporation tax. For income tax, the rules will start to apply from April 6, 2024.

The Act itself is legislation which enables HMRC to specify specific transfer pricing recordkeeping requirements, the details of which are provided in a separate [Statutory Instrument](#) "The Transfer Pricing Records Regulations 2023" (the Regulations). The Act also sets out, among other things, the consequences for taxpayers of failing to comply with the new rules, including increased risk of substantial penalties, and additional powers for HMRC in relation to access to transfer pricing records and information.

Simultaneously with the release of the Regulations, HMRC issued accompanying [material](#) within the transfer pricing sections of their International Manual, which provides guidance to HMRC officers and taxpayers on the UK's application and interpretation of the aforementioned legislation and regulations.

**Action item:** Taxpayers should review their existing UK transfer pricing documentation (and underlying policies and processes as necessary) in light of the new regulations and guidance in order to analyze whether any action is needed to update and improve the outputs, as well as the underlying processes that underpin the preparation of such records, from transfer pricing policy setting through to implementation. This will be important in seeking to demonstrate that reasonable care was taken in determining a filing position, particularly given the presumption of

carelessness for penalty purposes if documentation is not prepared and made available in line with the Regulations and associated guidance. We expect HMRC, given its new information powers, to more regularly request transfer pricing documentation both during and in advance of a tax audit context.

## In detail

### Basic documentation requirements

#### Scope and effective date

UK entities are in scope of the new rules if they are part of an MNE Group that meets the 'MNE CbCR threshold' — i.e., greater than EUR 750 million global consolidated turnover in a given financial year. Guidance is given for determining whether the CbCR threshold is breached where the UK entity and MNE Group have non-coterminous year-ends.

Those UK entities that meet the MNE CbCR threshold in a given accounting period must keep specific transfer pricing records for that same accounting period, including a Master File and Local File, as per the 2022 OECD Transfer Pricing Guidelines, in relation to 'material-controlled transactions' (subject to certain exemptions). This requirement applies to periods beginning on or after April 1, 2023, for UK entities subject to UK corporate tax, and for the tax year commencing April 6, 2024, for UK entities subject to income tax.

#### Observations

While the UK was one of the first countries to introduce a requirement to prepare and file a CbC report intended to help HMRC with its risk assessments, to date there has been no formal requirement to follow Action 13 format and content for other components of a taxpayer's transfer pricing documentation. While the introduction of formal rules removes the degree of flexibility that previously existed in the UK legislation, the rules align the UK with many other territories that have adopted Action 13 Master Files and Local Files. The direct reference in the legislation to the OECD Guidelines should be helpful in promoting consistency, with the UK not following some other territories that have their own versions of the Action 13 requirements.

The limitation, to larger taxpayer groups, of the scope of the legal requirement to adopt the OECD standard and prepare annual documentation could be interpreted as meaning that the impact felt by many MNEs should be relatively limited, with Master Files and Local Files already being produced by a number of MNEs. However, in practice, there already is an increased importance and focus in transfer pricing inquiries by HMRC on underlying processes and behaviors of a taxpayer to adequately manage its transfer pricing from policy setting through to accurate implementation (the importance of which is endorsed in the new guidance).

This development is in addition to the requirement for the provision of specific facts and supporting evidence to underpin the analysis and policies adopted by the UK business and this therefore should be actively factored into any assessment of achieving current compliance in the UK. This will be critical not only to substantiate the transfer pricing position but in seeking to show that "reasonable care" has been taken, which is instrumental in the penalty position and statute of limitations as detailed below.

Where a UK entity is part of an MNE Group that does not meet the CbCR threshold, HMRC has emphasized that to the entity still must keep appropriate books and records to file a correct and complete tax return. Additionally, while legally such UK entities are not formally required to prepare a prescribed Master File and Local File, HMRC is of the view that such formats can provide an appropriate way in seeking to demonstrate adherence to the arm's-length principle and the requirement to prepare and retain adequate books and records to substantiate this. This view also is aligned with the position and expectation for the periods prior to the enactment of the new legislation.

## Available exemptions

### UK-to-UK transactions

As a general rule, transactions between UK entities within the same MNE Group may be excluded from the Local File. However, this exemption does not apply where one or both of the entities (1) has made a patent box claim, or (2) is carrying on a ring-fenced trade (oil-related activities).

### Existing APAs

Under all APA exemption where a UK entity has an APA in place prior to the date of commencement of the specified transfer pricing records, the details of controlled transactions do not need to be included in the Local File. However, for any APAs concluded on or after the date of commencement of these new rules, full details of the controlled transactions need to be included in the Local File.

### Observations

Taxpayers need to document why and how they have met the above exemptions. Where a UK entity meets either or both of the aforementioned exemptions, there is no obligation to keep and preserve the specified transfer pricing records, but taxpayers still will need to be able to document that the returned position is accurate.

## New guidance

HMRC has issued accompanying [material](#) within the transfer pricing sections of their International Manual, which provides guidance to HMRC officers and taxpayers on the UK's application and interpretation of transfer pricing requirements. The guidance is helpful and should be considered in full, but some key points are outlined below.

### Frequency of review

HMRC has specified in its guidance that records should be reviewed annually at a minimum and updated where necessary, in particular the functional and economic analyses. Where these have not 'changed significantly,' they can be carried forward.

In relation to benchmarking, HMRC has referred to paragraph 3.82 of the 2022 OECD Transfer Pricing Guidelines (Chapter III Comparability Analysis) as helping taxpayers determine whether a new benchmarking study is required. HMRC has indicated that financial data for the accepted comparables should be updated annually to confirm reliable application of the arm's-length principle. For controlled transactions covered by an APA, there is no requirement to update the comparables.

### Local File - proportionality and a 'UK Local File'

HMRC emphasizes the importance of presenting information that is proportionate to the complexity and materiality of a particular controlled transaction.

While the Local File is an entity-specific document that should be prepared on an entity-by-entity basis, HMRC has stated that an amalgamated UK country specific Local File (UK Local File) may be prepared. Taxpayers should undertake a cost benefit analysis of both approaches (or combinations thereof).

### Controlled transactions - categories, aggregation, and materiality

In terms of materiality:

- HMRC has indicated that where a category of controlled transactions (aggregate of all transactions with counterparties for the same category) is less than £1 million (the de minimis threshold), the category of controlled transactions can be excluded from the Local File.

- Where a category of controlled transactions is above the de minimis threshold, materiality should be considered on a case-by-case basis. HMRC has not set out a single rule, but instead set out factors to consider when determining whether a category of controlled transactions is material.
- HMRC also has set out a specific list of categories of transactions that it considers always to be material due to their nature and complexity, and that therefore should always be included in the Local File irrespective of value. This list includes:
  - transactions priced using a profit split methodology
  - transactions concerning the transfer or license of intangible assets
  - transactions concerning Hard to Value Intangibles
  - transactions concerning the transfer, use, or right to use key or strategic assets that are required for the entity to carry on its business
  - transactions concerning global or regional strategic or leadership services
  - transactions concerning Cost Sharing Agreements or Cost Contribution Agreements
  - transactions concerning business reorganizations, including where functions, assets, or risks have been moved into or out of the UK during the relevant period
  - commencement or cessation of transactions in the relevant period.
- Where a transaction is deemed to not be material, HMRC has emphasized that it still must be priced in accordance with the arm's-length principle. Taxpayers will also need to clearly document how they have determined what is considered to be material.

In addition to providing guidance and examples for determining what constitutes a 'material category' of controlled transactions for the purposes of the Local File documentation (including separate guidance relating to financial transactions), HMRC has specifically called out Low Value-Adding Services. Where conditions per paragraph 7.45 of the 2022 OECD Transfer Pricing Guidelines are met, HMRC has stated that this may be considered as a single category of controlled transactions. Furthermore, HMRC further endorsed the simplified approach for Low Value-Adding Services, referring to its [International Manual](#) on the matter.

HMRC states that provisions are not considered 'controlled transactions' if the participation condition is met only because of the acting together conditions at sections 161 and 162 of Part 4 TIOPA 2010 relating to financing cases. In such circumstances, such provisions do not need to be included in the Local File.

### **Observations**

HMRC's guidance is practical and provides useful examples and considerations when undertaking transfer pricing compliance processes. The guidance highlights the need for having a timely and robust compliance process for filing tax returns correctly and accurately on the basis of complete transfer pricing records.

Taxpayers need to establish a framework for contemporaneously reviewing their business and for determining what are 'significant' changes within the context of their business and industry. It also is important for taxpayers to document their processes and logic for assessing complexity and materiality. The guidance identifies some specific areas which HMRC considers to be 'material' (i.e., high risk) due to their inherent nature and complexity — see [INTM450104](#). Taxpayers should review any arrangements that fall into these categories and assess whether the associated transfer pricing analysis and documentation is robust.

## Other changes to the law

### Penalties and the failure to keep and preserve the specific transfer pricing records

The most material potential impact if a taxpayer fails to do the work necessary to maintain or to produce relevant records on request would be on the assessment of behaviors should HMRC later identify an inaccuracy in a return that relates to transfer pricing, i.e., where an enquiry results in an adjustment.

Where a tax return is submitted that contains an inaccuracy and the specific records required by law (including the transfer pricing documentation report) have not been kept and/or the processes for managing the taxpayer's transfer pricing positions (including setting and implementing transfer prices) are inadequate, "careless" behavior will be presumed. Similarly, careless behavior will be assumed if HMRC finds an underassessment of tax relating to transfer pricing and the specified records have not been kept or preserved. This will have ramifications for penalties geared to the amount of any transfer pricing adjustment, and on how far back HMRC can issue assessments in the event of a discovery.

Failure to keep or to preserve the records also may result in a fixed penalty of up to £3,000 being charged to the relevant person. HMRC's guidance also indicates that maintaining the specified transfer pricing records is part of the Senior Accounting Officer (SAO) responsibilities.

### When to provide specific transfer pricing records

As well as requesting the specified transfer pricing records as part of a formal enquiry, HMRC in the past has requested such records informally (e.g., as part of a risk assessment for a collaborative approach to tax compliance), but without an obligation on the taxpayer to provide them. The new rules give HMRC the power to issue a formal notice requiring relevant transfer pricing documents to be provided outside an inquiry. This is a major change in long-standing legislation on information requests and demonstrates the focus HMRC is putting on transfer pricing as a key strategic risk area.

It is expected that taxpayers will have 30 days upon issuance of an information notice to provide the specified transfer pricing records. An information notice for a given accounting period can be issued from the date of filing of the tax return relating to that accounting period, given the expectation that such records will have been prepared in order to accurately and reasonably file the tax return. Failure to comply with an information notice may result in monetary penalties, i.e., a £300 initial penalty and daily penalties of up to £60 a day.

### Possession or power

The legislation on HMRC's information powers states that an information notice only requires a taxpayer to produce a document if it is in the taxpayer's possession or power. The new rules introduce a significant exception to this rule in relation to transfer pricing records, with the possession or power limitation no longer applying where a specified document is in the power or possession of another person who is part of the same MNE group. The information notice therefore may require the taxpayer to produce a transfer pricing document even though it is held elsewhere within the group and not by the taxpayer itself.

### Observations

The penalties legislation makes clear that the failure to create and maintain complete transfer pricing documentation, as well as having adequate transfer pricing management processes from policy setting through to implementation, has penalty implications for taxpayers, with the burden of proof to rebut penalties resting with the taxpayer. This is an important shift, as usually in UK tax legislation the burden of proof is on HMRC to demonstrate carelessness. There is a significant risk that UK taxpayers determined not to have complied with the new requirements will be penalized in the event of a transfer pricing adjustment unless they can clearly demonstrate that they have taken reasonable care. The amounts may be significant, and can have real outward cash implications, so the need to document and demonstrate compliance with the new requirements is of critical importance.

These records will need to be provided to HMRC within 30 days of a request, so they must be in place by the time a return is filed. Failure to do so can bring increased scrutiny, including the assumption of careless behavior which again also impacts the number of years HMRC is able to assess, and (at a minimum) an increased risk of monetary penalties from the outset.

HMRC's new power to require the production of transfer pricing documents outside of a formal inquiry could significantly accelerate the point at which HMRC asks for the documents once a tax return has been filed, and the extension of the "possession or power" criterion to other members of the MNE group will increase the level of coordination and collaboration needed between the UK taxpayer and its overseas affiliates.

## Future developments

Although the finalized Act and Regulations bring into force much of the outcome of a consultation process which started over two years ago, there is likely to be more to come. The regulations also provide HMRC with the power to introduce the requirement for affected businesses to produce a Summary Audit Trail (SAT), which HMRC initially described as "a short, concise document summarizing the work already undertaken by the customer in arriving at the conclusions in their transfer pricing documentation." This description subsequently has been replaced by an SAT measure "requiring businesses to complete a questionnaire detailing the main actions they have taken in preparing the local file," although no further details on either approach have been made public.

HMRC sees the SAT as a way of encouraging businesses to undertake sufficient work to support their transfer pricing policies and, ultimately, assisting HMRC with its risk assessments. HMRC is not implementing the SAT at this time, but has noted that it intends to undertake a public consultation on this additional measure later in 2023.

The requirement for an International Dealings Schedule (IDS) — a document which would report transactional data about intragroup cross border transactions in a structured format — also is being kept under review.

### **Observations**

It remains to be seen what the format and content of the SAT will be, and HMRC previously has stated that it wants to design something that would achieve the stated aims without imposing a disproportionate burden on businesses. The format may revert from a questionnaire to a more free-form document, along with guidance on appropriate content. HMRC has shown a willingness to consult meaningfully on the development and enactment of the new rules, and the SAT consultation provides another opportunity for taxpayers to provide input into any additional requirements.

Although the descriptions of the SAT provided to date put emphasis on the preparation of the Local File, this will in turn depend to a large extent on the underlying processes for and management of the setting and implementation of transfer pricing policy.

## The takeaway

All taxpayers that must apply transfer pricing are encouraged by HMRC to take the same approach to documentation, reflecting HMRC's view that the Master File and Local File approach represents best practice. In practical terms, the new rules set the standard for HMRC expectations for transfer pricing documentation for all UK businesses within the scope of transfer pricing, not just for those groups that meet the legal requirement threshold.

The changes to a variety of tax administration aspects send a message that HMRC expects taxpayers to comply with the new legislation, reflecting HMRC's tougher position in terms of the minimum standards it expects taxpayers to adhere to in relation to their transfer pricing management, including documentation, and that there will be consequences for those who do not.

Businesses should continue to comment, where appropriate, in particular in relation to any additional SAT requirement, with the goal of obtaining guidance on expectations with regard to the "sufficiency" of process and the

documentation of the audit trail itself. Any SAT requirement should be able to satisfy in a pragmatic and cost-effective manner, especially given the new presumption of carelessness and its impact on the amount of any penalties.

## Let's talk

For a deeper discussion of how the UK's new transfer pricing documentation requirements might affect your business, please contact:

### Transfer Pricing - UK

Yvonne Cypher  
+44 (0)7957 296907  
[yvonne.cypher@pwc.com](mailto:yvonne.cypher@pwc.com)

David Oak  
+44 (0)7715 484263  
[david.oak@pwc.com](mailto:david.oak@pwc.com)

Steve Lord  
+44 (0) 7764 989025  
[steve.lord@pwc.com](mailto:steve.lord@pwc.com)

### Transfer Pricing Global and US Leaders

Horacio Peña, *New York*  
Global Transfer Pricing Leader  
+1 917 478 5817  
[horacio.pena@pwc.com](mailto:horacio.pena@pwc.com)

Paige Hill, *New York*  
US Transfer Pricing Leader  
+1 917 923 8412  
[paige.hill@pwc.com](mailto:paige.hill@pwc.com)

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