UNITED KINGDOM

Overview

Travers Smith LLP, Taxand United Kingdom

Travers Smith's Transfer Pricing team advises multinational clients on the legal aspects involved with complex cross-border pricing arrangements. We work seamlessly with partner firms and our Taxand network colleagues to deliver coordinated, practical, and commercially focused solutions that ensure alignment with global regulations and mitigate transfer pricing audit risk.

Our services include providing legal advice in connection with the structuring and documentation of intra-group transactions, mergers and acquisitions, and due diligence involving transfer pricing matters. In partnership with specialist firms, we can help facilitate benchmarking studies, economic analysis, and the design and implementation of transfer pricing policies.

Transfer Pricing Framework

For accounting periods ending on or after 1 April 2010, the UK's transfer pricing legislation is mainly governed by Part 4 of the Taxation (International and Other Provisions) Act 2010.

The UK's transfer pricing regime is based on the arm's length principle. The UK rules mandate that profits and losses should be calculated for tax purposes by substituting an 'arm's length provision' in place of an 'actual provision'. In broad terms, the UK's transfer pricing regime is triggered where:

- The actual provision differs from the arm's length provision, and
- The actual provision confers a potential 'UK tax advantage' on a person (or persons).

For these purposes:

- An arm's length provision means a 'provision' which would have been made between two independent enterprises (construed consistently with the expression of the arm's length principle in Article 9 of the OECD Model Tax Convention "OECD MTC");
- An 'actual provision' means a provision which has been made or imposed between the two 'connected parties' by means of a transaction (having a very wide definition) or series of transactions. The UK regime applies to both cross-border and UK-to-UK transactions (or series of transactions);
- A 'provision' is (broadly) equivalent to the phrase *"conditions made or imposed"* in Article 9 of the OECD MTC;
- Two parties are 'connected parties' if (broadly) one controls the other, or a third party controls both. However, the connection test satisfied in two additional scenarios:
    - Joint ventures "JV": such that a 40% participant in the JV will be deemed to control the JV if there is one other participant who also owns at least 40% of the JV – this is known as the 40% test; and
    - Financing arrangements: such that persons that have 'acted together' (widely defined) in relation to the provision of finance will also be connected; and
- A potential UK tax advantage includes any reduction of taxable profits, or any increase (or creation) of tax losses.

Where the regime applies, the advantaged party (or parties) must make a transfer pricing adjustment(s) in the tax return for the relevant period. HM Revenue and Customs "HMRC" also has the power to impose a transfer pricing adjustment in a tax return. When a transfer pricing adjustment has been by one party, if certain criteria are met, another party (who is not advantaged) may make a 'compensating adjustment'. Any 'balancing payments' made between the parties in such cases are treated as neither taxable receipts nor allowable expenses.

The UK regime exempts most transactions carried out by a business that is a small or medium sized enterprise "SME". A SME is currently a business (together with any group or associated companies) with:

- 250 or fewer staff, and
- Either:
    - Annual turnover of less than €50 million, or
    - Total balance sheet assets of less than €43 million.

However, the exemption for SME does not apply where:

- The business enters transactions with parties in a non-qualifying territory (i.e., a territory with which the UK does not have a double tax treaty with a non-discrimination article);
- HMRC has issued a transfer pricing notice to a medium sized enterprise;
- HMRC has issued a notice requiring the SME to apply transfer pricing in respect of a provision related to a claim made under the UK Patent Box regime; or
- The SME has made an election to remain subject to transfer pricing rules.

Special rules apply to entities that are life assurance companies or North Sea oil and gas companies.

Diverted Profits Tax "DPT"

The UK also operates a DPT introduced to counter perceived aggressive tax planning that diverts profits from the UK. The DPT is triggered in two circumstances:

- Arrangements lacking economic substance: where arrangements between related entities (including those at arm's length) lack economic substance or are intended to exploit a tax mismatch to obtain a tax benefit, and

- Avoided permanent establishment: subject to certain thresholds, where an entity is carrying on activities in the UK (in connection with the supply of services, goods, or other property) in a way that has been designed to avoid creating a UK permanent establishment.

The DPT does not apply to a SME or in circumstances where (absent a a tax avoidance motive) non-UK tax is being paid on the diverted profits (as defined) equal to at least 80% of the UK corporation tax that would otherwise have been payable.

The current general rate of DPT is 31%. The rate of DPT applicable to banking companies' profits subject to the corporation tax surcharge is 33%. The rate of DPT applicable to ring fence profits of oil and gas companies is 55%.

HMRC currently conisder that the DPT is seperate and distinct from UK corporation tax. DPT liability is not self-assessed but a company must notify HMRC if it is potentially in scope within three months after the end of the relevant accounting period. Failure to notify may result in a tax-geared penalties. HMRC also currently consider that DPT is not a tax covered by double tax treaties.

Profit Diversion Compliance Facility "PDCF"

Since 2019, HMRC has operated a voluntary disclosure system, the PDCF. The PDCF is intended to encourage MNEs to review the design and implementation of their transfer pricing policies (including, but not limited to, any arrangements targeted by DPT) to ensure:

- They are aligned with factual operations;
- Accordance with the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations "OECD TPG"; and
- The MNE can make amendments where necessary or appropriate.

The PDCF process can be onerous and requires MNEs to submit a detailed report (supported by evidence and signed by a senior responsible officer) outlining proposals to correct transfer pricing irregularities, pay any additional tax owed (plus interest) and any applicable penalties due. However, using the PDCF can help protect the MNE against HMRC action in relation to the DPT and mitigate the scale of any penalties for non-compliance.

Accepted Transfer Pricing Methodologies

The UK's transfer pricing regime must be interpreted in a way that ensures consistency with OECD principles, the OECD MTC and the OECD TPG (whether there is a treaty in force between the UK and the other country or not). This requirement includes ensuring the arm's length principle applies to a controlled transaction by replacing the actual terms of the transaction with arm's length terms and, for tax purposes, recalculating the profits accordingly.

HMRC's view is that the OECD TPG explain how to choose and apply the most appropriate transfer pricing methodology in any given case. As a result, any of the three tradtional transaction methods (Comparable uncontrolled price "CUP"; Resale minus; and Cost plus), or either of the transactional profit methods (Profit split; and Transactional net margin method) may be used, provided that it is the most appropriate method to achieve the necessary degree of acceptable comparability with the transactions being tested in that case.

Although HMRC do not enforce any absolute hierarchy, their guidance states that the traditional transactional methods are the most direct way of establishing whether arrangements are at arm's length, and (consistently with the OECD TPG) where the CUP and another pricing method can be applied equally reliably, the CUP method should be preferred.

Transfer Pricing Documentation Requirements

Unless benefitting from an exemption, under normal self-assessment rules entities within the charge to UK tax must keep sufficient records demonstrating that the results of their transactions with connected parties are determined according to UK transfer pricing rules and the application of the arm's length principle. Failure to keep or to preserve adequate records can result in penalties being charged.

HMRC can request transfer pricing records informally, or to support risk assessment activity, or as part of a formal enquiry. HMRC's formal information powers require entities to provide specified transfer pricing records within a reasonable period, typically 30 days. Failure to comply with requests can result in penalties being charged.

It should be noted that maintaining the specified transfer pricing records forms part of the responsibilities imposed by the UK's Senior Accounting Officer "SAO" regime. Failure to keep the records may, therefore, be interpreted by HMRC as being an indication of not establishing and maintaining adequate accounting processes and arrangements for the purposes of SAO (and result in penalties being applied).

Multinational entity "MNE" groups

Entities that are part of a MNE group that meets the Country-by-Country Reporting "CbCR" threshold, and have at least one 'material controlled transaction', must create and preserve both a 'Master File' and a 'Local File'.

The CbCR threshold is met when the group:

- Includes two or more enterprises that are tax resident in different jurisdictions; and
- Has consolidated revenues of at least €750 million in a given period (whether the group is UK headquartered or not).

The Master File and the Local File must be prepared in accordance with the OECD TPG. HMRC expect both Master File and Local File to be reviewed annually to determine that the functional and economic analysis remains accurate, and that necessary updates are made.

The country-by-country "CbC" report (containing information relating to the global allocation of the MNE group's income and taxes paid) must be submitted for the period immediately following that in which the threshold requirement is met. A CbC report must be filed within 12 months after the end of the period to which it relates by:

- Any UK resident ultimate parent entity "UPE" of the group; or
- The top UK entity in the group (if the the non-UK UPE has not filed, does not need to file, or authorises the UK entity to file on its behalf)

Even where entities are not required to maintain a Master File and Local File, HMRC guidance states that preparing documentation in line with the OECD's recommended approach is an appropriate way to demonstrate that provisions between related parties adhere to the arm's length principle.

Local File: Preparation and materiality

For the purposes of preparing the Local File, controlled transactions are aggregated by category to assess materiality. A *de minimis* threshold of £1m applies to each category of controlled transaction such that, where the aggregate value of transactions is no more than £1m, those transactions do not need to be included in the Local File (but, for the avoidance of doubt, must still be priced in accordance with the arm's length principle).

HMRC guidance emphasises that because the Local File is an entity-based document, materiality must be assessed from the perspective of the UK entity preparing the Local File (rather than the MNE group as a whole).

However, certain categories of transactions are always material due to their nature and complexity, regardless of value. These are transactions:

- Priced using a profit split method;
- Involving the transfer or license of intangible assets;
- Concerning Hard to Value Intangible assets;
- Relating to the transfer of, use of, or right to use, key or strategic assets required by entity to carry on its business;
- Concerning global or regional strategic or leadership services;
- Involving Cost Sharing Agreements or Cost Contribution Agreements;
- Relating to business reorganisations (including where functions, assets, or risks have been moved into (or out of) the UK during the relevant period); and
- That commence or cease in the relevant period.

For other transaction categories, materiality should be determined on a case-by-case basis considering all relevant facts and circumstances, including factors such as the size of the UK entity, the nature of the transaction, risk level, impact on profit or loss, and industry context. Entities are required to set out their approach to assessing materiality in the Local File.

Local File: UK-to-UK Exemption

Subject to certain specific exceptions, information relating to controlled transactions does not need to be included in the Local File if both entities meet one of the following criteria:

- A company UK resident for tax purposes;
- A trust (where the trustees are UK resident for tax purposes); or
- A partnership (where the partners are UK resident for tax purposes).

Local Jurisdiction Benchmarks

Comparability is of critical importance. HMRC emphasise that whatever transfer pricing methodology is employed, the uncontrolled transactions used must show an acceptable degree of comparability with the transactions being tested.

Since the UK legislation must be interpreted consistently with the OECD TPG, the nine-step process outlined there can be followed when performing a comparability analysis in the UK. The process envisages reviewing existing internal comparables (if any) before assessing available sources of information on external comparables.

HMRC state that internal comparables can be the best source of comparables. Entities should make efforts to identify if any suitable internal comparables are available (making appropriate adjustments if helpful) to ensure that the best available comparables have been reviewed. HMRC may challenge the work done by the entity if they do not think it has been sufficiently thorough.

For external comparables, the UK emphasizes the importance of assessing the market that the entity operates in. For UK companies, the starting point will normally be to consider UK market comparables first. However, where acceptable UK comparables cannot be found, using comparables from overseas markets (making appropriate adjustments as necessary) is acceptable.

Entities should update their transfer pricing comparability analysis 'regularly' (but not necessarily annually if the relevant operating conditions remain unchanged). The actual review cadance will depend on the factors set out in the OECD TPG (namely, the size of the transactions, complexity, level of risk involved, and the stability of the environment), but HMRC state that any functional change will mean a new benchmarking analysis is required.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

The UK transfer pricing legislation provides for APA. An APA will normally determine an agreed pricing mechanism. APA are normally only used for more complex transactions and/or where there is an elevated risk of double taxation. They can be:

- Unilateral: a ‘domestic agreement’ between a business and HMRC;
- BAPA: an agreement made under the Mutual Agreement Procedure “MAP” clause of the applicable tax treaty; or
- Multilateral: since there is no specific mechanism for reaching multilateral APA, these are effectively multiple and complementary BAPA between the business and all relevant administrations affected by the transfer pricing issues.

The potential scope of an APA is flexible and broad ranging. It can relate all the transfer pricing issues of the business in question, or it may be limited to one or more specific issues.

An APA cannot, however, determine either:

- Whether a permanent establishment “PE” does or does not exist, or
- The potential impact of the DPT.

HMRC do not impose a charge for the APA process.

Key features of the UK APA programme include:

- The APA process is initiated by the business submitting to HMRC an expression of interest (EOI). If HMRC are willing to consider an APA, the entity will normally need to submit a formal written application within six months;
- HMRC expect the actual pricing of the transactions covered by an APA to be consistent with the transfer pricing methodology and terms defined by the APA, and that the economic, accounting and tax positions of the arm’s length price are aligned;
- A business may withdraw an APA request at any time before final agreement is reached;
- An APA will typicaly cover a period of three to five years. A longer term will only be possible in exceptional circumstances. It is possible to revise and/or renew an APA;
- Subject to agreement, and where an agreed methodology is appropriate, an APA can ‘roll back’ to cover an earlier period, and can be used as a basis for amending an entity’s return for that prior period;
- An the entity is required to lodge an Annual Report for each accounting period covered by the APA;
- HMRC has the power to revoke an APA where the entity does not comply with its terms or where a critical assumption ceases to be valid. The APA may be nullified, and penalties can be applied, if false or misleading information is supplied fraudulently or negligently at any time during the APA process; and
- HMRC aim to complete the APA process within 30 months from the date of the formal submission. According to published data from HMRC, the average time taken to agree an APA in the UK in the 2023/24 tax year was 53 months. HMRC granted 27 APAs during the same period.

At Spring Statement 2025, the UK government confirmed that businesses will be able to use the UK’s APA programme to obtain certainty on the transfer pricing treatment of Cost Contribution Arrangements (CCA).

Thin capitalisation issues (that is, transfer pricing issues relating to complex financing arrangmeents) can be adressed under the seperate Advance Thin Capitalisation Agreement (ATCA) regime.

Transfer Pricing Audits

The UK tansfer pricing regime is self-assessed as part of the UK’s compliance framework for corporation tax. Transfer pricing related enquiries into company tax returns are, therefore, subject to the UK’s normal corporation tax enquiry rules.

The general rule is that HMRC may open an enquiry into a corporation tax return within twelve months from the date the return is filed, but this can be extended to four years for a discovery assessments, six years in cases involving careless behaviour, and 20 years in cases involving deliberate behaviour. HMRC does not have to justify opening an enquiry and will not normally provide reasons (although they may identify the areas that an enquiry will focus on).

HMRC adopts a risk-based methodology when opening transfer pricing related enquiries. There is no set, mechanistic process, or regularity in their approach. HMRC emphasise the importance of understanding how a business makes its profits or losses. They will look to where a company carries on its key functions, holds its key assets, and bears key risks. HMRC guidance states that any significant mismatch between that location and the location where the business generates its profits may be an indication of non-arm’s length pricing.

HMRC will examine numerous factors to identify potentially suspect transactions but should involve the business throughout the process. The process will involve gathering key information about the business, including the markets in which the group operates, the group’s accounts, intellectual property, processes, and main competitors. HMRC will then assess whether any risks exist, including the potential amount of tax at stake, and consider the implications of those risks.

HMRC will collect information from a wide variety of sources to inform their assessment including the business’ website, conducting meetings with the business, accessing commercial databases, as well as open-source resources (such as press reports, trade magazines and internet searches).

Enquiry Process

HMRC aims to resolve new transfer pricing enquiries within specific periods:

- 18 months in most cases.
- 36 months in complex or high-risk cases.

Governance Process

Although opening enquiries is not mechanistic, HMRC's governance process for transfer pricing enquiry cases follows three broad stages:

1) Selection: Ensuring the selection of appropriate cases.
2) Progress: Ensuring effective progress in each enquiry, including the issue of the formal enquiry notice, an action plan, and an anticipated timeline for the enquiry.
3) Conclusion: Ensuring an appropriate conclusion is reached, including the submission of conclusions to an appropriate HMRC panel for review, the agreement (or determination) of any transfer pricing adjustments, and imposition of any penalties.

According to published data from HMRC, the total number of enquiry cases settled during the 2023/24 tax year was 128. The average age of settled enquiries for the same year was 33.1 months.

The Burden of Proof in Transfer Pricing: Theory versus Practice

Since the UK tansfer pricing regime is self-assessed, entities within scope are required to determine their transfer pricing position accurately, and HMRC have the power to demand they justify transfer prices as part of any enquiry. The burden of proof under self-assessment lies clearly with the taxpayer.

HMRC will expect entities to prepare and retain documentation that might reasonably be expected of an entity similar in nature, size and complexity, and operating in a similar market, in order for that entity to be able to adequately demonstrate that their transfer pricing meets the arm's length principle. The documents required will include:

- Primary accounting records (i.e., records of transactions entered in an entity's accounting system);
- Tax adjustment records (i.e., records that identify adjustments made by a business for tax purposes);
- Records of transactions with associated businesses (i.e., records which identify transactions to which the transfer pricing rules apply); and
- Arm's length calcualtions (i.e., records demonstrating arm's length for the purpose of transfer pricing rules).

A penalty up to £3,000 can be charged for each failure to keep or to preserve adequate records in respect of a tax return: this includes transfer pricing records. In addition, for the purposes of calculating tax-geared penalties, an inaccuracy in a submitted corporation tax return will be presumed to be careless where relevant transfer pricing records relating to the inaccuracy have not been maintained. The same presumption applies where HMRC makes a transfer pricing related discovery assessment of tax due, and the company has not maintained appropriate transfer pricing records.

Given HMRC's emphasis on adopting a risk-based approach to opening transfer pricing related enquiries, a company should consider regularly ensuring that its transfer pricing policy matches the reality of its commercial transactions and arrangements.

In additon, it should ensure that its transfer pricing documentation clearly identifies economically significant risks, and records all relevant related decision-making processes. It may also be appropriate to conduct reviews of its value chain, functional analyses, economic analyses and pricing methodologies, as well incorporating transfer pricing into other internal financial operating policies and procedures. Where the analysis suggests there is a risk of challenge from HMRC, the company should adjust transfer pricing policies and documentation accordingly, and might consider applying to obtain an APA.

Transfer Pricing Penalties

Entities self-assess their compliance with the UK transfer pricing regime. Penalties will apply in situations where HMRC become aware of non-compliance. As highlighted already, entities within the charge to UK tax must keep records demonstrating that the results of their transactions with connected parties are determined in accordance with the arm's length principle.

Failure to keep or to preserve adequate records can result in a penalty of up to £3,000. Such a failure will also result in a presumption of carelessness for any inaccuracy contained in any document. However, where the entity can show that it has taken reasonable care there will be no penalty even if an adjustment is necessary. As a result, the higher the quality of the records retained by the entity the greater the protection against the imposition of penalties.

As already noted, HMRC can request transfer pricing records informally or as part of a formal enquiry. A failure to comply with an information request notice from HMRC within a reasonable period (normally 30 days) will result in a £300 fixed penalty and £60 per day for every subsequent day of delay.

The submission of incomplete or inaccurate documents (including tax returns, the Master File and Local File) will also result in tax-geared penalties being charged depending on the severity of the failure and whether the entity has addressed the error voluntarily or not. Errors considered to be careless can trigger penalties equal to up to 30% of the extra tax due when the mistake is corrected. Deliberate, but unconcealed, errors can result in a penalty of up to 70% of the extra tax due, while deliberate and concealed errors will incur penalties equal to up to 100% of the extra tax due.

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Senior Accounting Officer (SAO)

Maintaining the specified transfer pricing records forms part of the responsibilities imposed by the UK's SAO regime. The SAO applies to UK incorporated companies that either alone or as part of a group have an aggregate turnover in excess of £200m and/or a relevant balance sheet total of more than £2bn.

The SAO regime requires affected companies to certify that they have implemented adequate tax accounting arrangements to ensure that the correct tax liabilities are reported to HMRC. Failure to keep the appropriate transfer pricing records may be interpreted by HMRC as being an indication of not establishing and maintaining adequate accounting processes and arrangements for the purposes of SAO.

Penalties under the SAO regime, each at a fixed flat rate of £5,000, can be levied on:

- The company for failing to notify HMRC of the name of its SAO for the relevant financial year, and/or
- The SAO personally for:
  - Failing to comply with the obligations imposed by the regime, and/or
  - Failing to (or failing to accurately) certify compliance with the regime to HMRC.

Local Hot Topics and Recent Updates

During the summer of 2023, the UK government published a consultation on proposals to reform elements of the UK's international tax legislation, including transfer pricing and the DPT. On transfer pricing, the wide-ranging (and in places highly technical) proposals were intended to make the rules simpler, more certain, more consistently applied, and better aligned with tax treaties. On the DPT, the proposals included the removal of DPT's status as a separate tax (bringing an equivalent charge within the UK corporation tax framework) thereby:

- Clarifying the relationship between the DPT and the transfer pricing regime, and
- Confirming eligibility to double tax treaty benefits and MAP.

The government has announced a second, technical, round of consultation in the spring of 2025 further considering reform of the UK's transfer pricing and DPT rules. On transfer pricing, the new consultation considers:

- The removal of UK-to-UK transfer pricing rules;
- Lowering the thresholds for the SME exemption from transfer pricing for medium-sized businesses (the exemption for small businesses will be retained), and
- The introduction of a new reporting requirement for MNE in relation to certain cross-border related party transactions to HMRC in an attempt to more easily identify risks and facilitate more targeted enquiries.

If carried through to enactment, the proposed reforms to the UK's transfer pricing regime in 2025 will be significant but should result in a framework that is simplified and more closely aligned with the the OECD Model Tax Convention and the OECD TPG.

Documentation threshold

Master file	Mandatory for entities with consolidated group revenues of at least €750 million. Subject to exceptions, SME are exempt. Recommended for all entities maintaining transfer pricing records.
Local file	As for Master file above
CbCR	Consolidated group revenue of at least €750 million

Submission deadline

Master file	Within a reasonable period (normally 30 days) of receiving a request from HMRC.
Local file	Within a reasonable period (normally 30 days) of receiving a request from HMRC.
CbCR	Within 12 months after the end of the accounting period to which the CbC report relates.

Penalty Provisions

Documentation – late filing provision	Failure to keep or to preserve adequate records: up to £3,000. Failure to comply with an information notice: - £300 fixed penalty, plus - £60 per day daily penalties. Inaccurate documents and information, tax-geared penalty equal to a percentage of the extra tax due when the mistake is corrected: - Careless error, unprompted disclosure: 0% to 15% - Careless error, prompted disclosure: 15% to 30% - Deliberate but not concealed, unprompted disclosure: 20% to 70% - Deliberate but not concealed, prompted disclosure: 35% to 70% - Deliberate and concealed, unprompted disclosure: 30% to 100% - Deliberate and concealed, prompted disclosure: 50% to 100%

Tax return disclosure – late/incomplete/no filing	Failure to submit:
	- If submitted within 3 months of filing date: £100 fixed penalty (increased to £500 if late for three or more consecutive periods)
	- If submitted between 3 and 6 months after filing date: £200 fixed penalty (increased to £1,000 if late for three or more consecutive periods)
	- If submitted between 6 and 12 months after filing date:
	  – £200 fixed penalty (increased to £1,000 if late for three or more consecutive periods), plus
	  – Tax-geared penalty equal to 10% of unpaid tax
	- If submitted more than 12 months after filing date:
	  – £200 fixed penalty (increased to £1,000 if late for three or more consecutive periods), plus
	  – Tax-geared penalty equal to 20% of unpaid tax

CbCR – late/incomplete/no filing	Inaccurate documentation and information: up to £3,000. Late filing and failure to comply with an information notice: - £300 fixed penalty, plus - £60 per day daily penalties (potentially increased up to a maximum of £1,000 if the failure continues for more than 30 days)

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