

Private and Confidential

Martin O'Rourke,
Business Assets and International,
HM Revenue and Customs
100 Parliament Street
Westminster
London
SW1A 2BQ

1 June 2021

Your ref: Transfer Pricing
Our ref: KA/PD

Direct line: 020 7486 5888
Email: ken.almand@bdo.co.uk

Dear Sir

Transfer Pricing Documentation - Consultation

We welcome the opportunity to respond to the consultation document on the updating of transfer pricing documentation requirements, and have consulted our clients in producing our response.

BDO recognises the importance that robust transfer pricing documentation plays in helping multinational enterprises (MNEs) support an arm's length price for transactions between associated enterprises. We also understand the need for HMRC to have high quality data for risk assessing purposes to enable it to apply its resources to the greatest transfer pricing risks. Nevertheless, these benefits do need to be weighed against the additional costs and resources that MNEs will need to incur. It is important that the costs of MNEs complying with these requirements are not disproportionately high relative to the size and complexity of the controlled transactions in point, and the tax at risk.

It is vital that the UK has a competitive tax regime that does not discourage investment, be overly complex or go beyond the compliance requirements in other countries. In our opinion, a full adoption of these measures would, in some instances, result in limited benefits for HMRC and MNEs, but create an excessive compliance burden for MNEs.

We have first set out overall comments on the consultation, before responding to the specific questions raised.

If you would like to discuss our response, please get in touch.

Yours faithfully



Ken Almand
Partner
For and on behalf of BDO LLP

Overview

We agree that there have been significant developments in the field of international tax in recent years, and appreciate why the government considers that now is an appropriate point for it to review transfer pricing documentation requirements (some five years after adopting the CbCR minimum standard from BEPS Action 13).

BDO can see the merit for the introduction of a mandatory requirement for large businesses (based on the CbCR threshold - group turnover of €750m or more) to provide a master file and local file to HMRC on request. These documents will provide useful information to assist HMRC progress enquiries and, in many cases, businesses already produce these documents. We suggest however, that a materiality threshold is applied so that businesses with a small UK presence who present a low transfer pricing risk do not need to produce these files.

BDO regards the proposed requirements to produce an evidence log and International Dealings Schedule (IDS) as a significant shift from HMRC's current requirements set out in paragraph 21(1) of Schedule 18 to the Finance Act 1998. While some jurisdictions have adapted the OECD's three-tiered approach to transfer pricing documentation to fit their own requirements, HMRC's proposals go beyond what is required by most jurisdictions.

We recognise the benefits of having an evidence log available where HMRC has an enquiry in progress, and propose that HMRC explores how this could be achieved through information requests supported by information powers where necessary. We also recognise an evidence log may be an aspect of encouraging behavioural change. However, we believe a requirement for all businesses who are required to produce a local file to accompany this with an evidence log would result in an unnecessary compliance burden for many businesses, as it is likely that the vast majority of local files and evidence logs will not be requested by HMRC.

We understand that an IDS would provide HMRC with useful data for risk assessing purposes, especially for MNEs who are not within the CbC reporting regime. However, it is important that materiality thresholds are used to ensure that businesses with a small UK presence who present a low transfer pricing risk do not need to produce an IDS, and that for those who do produce an IDS, immaterial transactions do not need to be reported. The scope of the IDS should not be too broad both in terms of numbers of questions and areas covered, so that the IDS is relatively easy for businesses to collate. HMRC could also consider a phased introduction of the IDS to provide smaller businesses with an opportunity to ensure they have adequate systems in place.

Answers to specific questions

Question 1: Do you agree that most MNE groups within the CbC reporting regime will already routinely be preparing master files to comply with the OECD's standardised approach and to comply with transfer pricing documentation requirements in other countries?

We agree this statement.

Question 2: In the event that a MNE reports that the group does not maintain a master file, or that the master file is not within the power or possession of the MNE, what steps could be taken to ensure equality of treatment?

In our response to Question 8 we have outlined proposals whereby MNEs would only need to produce a local file if their transactions were sufficiently material, and that only these MNEs would need to produce a master file. We envisage that if suitable materiality limits were applied the vast majority of the MNEs for whom a master file was requested by HMRC would have a master file within their power or possession.

Question 3: Do you agree that any new master file requirement should apply only to MNEs within CbC reporting groups?

We agree this proposal. Although some MNEs below the CbC threshold already prepare master files, making this mandatory would result in a disproportionately onerous compliance burden for many MNEs.

Question 4: The government would welcome observations on the extent to which local file requirements align with transfer pricing documentation which MNEs already routinely maintain.

In our experience most MNEs within the CbC reporting regime which include a significant UK presence will already produce a UK local file. MNEs with a smaller UK presence are less likely to produce a local file, but may maintain transfer pricing documentation broadly aligned to local file requirements.

Question 5: The government invites comments on the possibility of issuing further practical guidance about local file documentation, including the possible requirement to maintain an evidence log or similar appendix.

BDO is familiar with the use of evidence logs in the Profit Diversion Compliance Facility (PDCF). The PDCF is a facility targeted at MNEs that HMRC perceives may have diverted profits from the UK, and the evidence log is consistent with the extensive review performed as part of this process. However, we believe the proposal that all businesses who meet the local file requirements should also produce an evidence log would be an unnecessary burden for many businesses.

HMRC has proposed that the master file and local file (with supporting evidence log) only be provided to HMRC on request. We assume this means that these will not routinely be made available to HMRC, but may be provided as part of an enquiry or as an appendix to a PDCF report. If HMRC's proposal regarding the evidence log were implemented, many businesses would therefore produce an evidence log which would never actually need to be provided to HMRC, as

HMRC's own risk assessment has not identified significant underlying risks to give rise to an enquiry notice or PDCF 'nudge letter'. We consider this an unnecessary burden for these businesses especially as they will not need to produce the equivalent document to support local files in other jurisdictions. We believe that businesses should only be required to produce an evidence log where the business is perceived as 'high risk' by HMRC, but we suggest that there may be more effective alternatives.

We recognise from the PDCF that an evidence log can be a useful tool in identifying key facts and evidence and distinguishing these from technical analysis and opinion. For MNEs for whom HMRC has opened a transfer pricing enquiry, we can understand that as part of an in-depth review HMRC may wish to have access to the sort of information available in an evidence log. However, to prevent unnecessary costs for businesses HMRC do not perceive as high risk from a transfer pricing perspective, we recommend HMRC explores how the equivalent information could be obtained as part of the existing enquiry process through suitably worded informal information requests or, where necessary, using information powers. This could be performed in conjunction with the Action Plan which is mandatory for each transfer pricing enquiry under [INTM481050](#) which would include a timeline for detailed fact-finding and provision of information and supporting documentation. INTM481050 states that the Action Plan should be drawn up in collaboration with the customer where possible, but in our experience this does not always happen. We believe a wider application of the instructions at INTM481050 would result in a collaborative approach to the fact-finding and clearly distinguish this from the subsequent technical analysis and opinion.

Confidentiality is a particularly important issue in relation to transfer pricing documentation which may contain commercially sensitive material. It is not uncommon for MNEs to have to seek authority within the group or from external lawyers before releasing certain confidential information or documents to HMRC as part of an enquiry. It is anticipated that the production of an evidence log may require seeking such authority, and this is an unnecessary burden for many MNEs from whom HMRC will not request the local file and evidence log.

BDO would welcome further practical guidance about local file documentation. If HMRC proceeds with its proposal regarding the evidence log, detailed guidance beyond that at Annex B of the PDCF guidance should be provided. This would give a detailed explanation of the required format of the log, and provide examples of what should be included or excluded from the log.

Question 6: Do you think that requiring MNEs within the scope of the CbC reporting regime to maintain local file is proportionate?

We agree that any requirement for a local file should be restricted to MNEs within the scope of the CbC reporting regime. Although some MNEs below the CbC threshold already prepare local files, making this mandatory would result in a disproportionately onerous compliance burden for many MNEs.

Question 7: Do you agree that 30 days is an appropriate timescale for production of the master file and local file?

This timescale broadly aligns with the typical requirements of other jurisdictions and appears reasonable.

Question 8: What metrics would be appropriate to determine de minimis thresholds?

Chapter V Para 5.32 of the 2017 OECD transfer pricing guidelines considers materiality in local files. It suggests that individual countries should include specific materiality thresholds to take into account the size and nature of the local economy, the importance of the MNE group in that economy and the size and nature of local operating entities in addition to the overall size and nature of the MNE group.

As the local file will only be provided to HMRC on request, BDO believes HMRC should set realistic de minimis thresholds taking into account the likelihood that HMRC will make such a request. HMRC's own data should enable it to set the thresholds at a suitable level which result in MNEs only needing to produce a local file if their transactions are sufficiently material - thus reducing the compliance burden for MNEs without material transactions. An MNE with a relatively small presence in the UK (by reference to measures such as costs, turnover, balance sheet assets, employee numbers or size of aggregate transactions with overseas associated enterprises) is unlikely to pose a significant transfer pricing risk from a UK perspective and should, therefore, not be required to produce a local file. It is reasonable for MNEs who meet the criteria for not having to produce a UK local file to also not have to produce a master file.

Question 9: If a MNE considers all its transactions to be not material, should that mean the MNE is (i) required to submit an annual declaration to that effect or (ii) obliged to provide a short form local file upon request?

If appropriate de minimis thresholds were applied (see response to Question 8), it is unlikely that HMRC would require further information in respect of MNEs below these thresholds. Where, exceptionally, further information was required, a short form local file could be provided on request.

Question 10: With regard to the proposals in this chapter the government would welcome any other observations, comments or suggestions.

The introduction of a requirement to produce a master file and UK local file for large businesses (group turnover over €750m) may result in some additional costs and uses of resources being incurred, but for many businesses these additional costs will not be excessive. However, a de minimis threshold should be applied so that businesses within this category which have a small UK presence are not required to produce these files.

The introduction of an evidence log could result in significant additional costs and resources being incurred by many businesses, and as it would only be provided to HMRC on request, this requirement is disproportionate to the benefits it would produce for HMRC and businesses. The OECD has emphasised that transfer pricing documentation requirements should be balanced so that reporting obligations fulfil tax administrations' need for information to be able to enforce the transfer pricing rules and at the same time avoid the imposition of excessive documentation requirements on businesses. We suggest that information equivalent to that which would be present in an evidence log should instead be obtained using the existing enquiry process, and HMRC guidance adapted as necessary.

Question 11: The government welcomes comments about the extent to which your accounting/reporting system(s) can, or cannot, provide relevant to transfer pricing data and information.

Large businesses will already have systems in place to provide relevant data and information for the CbC Report. It is important that the IDS aligns to these systems to prevent the need for an overhaul of existing systems.

Those businesses with group turnover below €750m are less likely to have systems from which transfer pricing data and information can be readily extracted in this way. We understand that in other jurisdictions who introduced an IDS, many of these smaller businesses found it particularly challenging to adapt to the new requirements. A phased introduction of the IDS over a few years, with the focus initially on larger businesses, would give these smaller businesses sufficient time to develop and put adequate reporting processes in place. We recommend also that the IDS be restricted to a relatively small number of entries initially so that HMRC can consider its effectiveness before deciding whether additional entries are necessary. Perhaps an initial focus only on high risk transactions (e.g. transactions with associated enterprises in low tax jurisdictions) would assist HMRC to monitor the effectiveness of the IDS as a risk assessing tool before it considers extending the IDS to other transactions.

Question 12: The government welcomes comments on ideas for appropriate types of data and information which could be requested through an IDS filing requirement.

The IDS should be designed to provide HMRC with a useful snapshot for risk assessment purposes without producing an unnecessary burden on businesses. In designing the form, it is important that HMRC takes care to only request information that is likely to be both useful for risk assessing purposes and readily available to businesses.

Question 13: Please provide details of any impacts on administrative burdens which you could anticipate resulting from the introduction of an IDS requirement.

All MNEs required to produce an IDS are likely to incur additional costs and administrative burdens as a result of its introduction. MNEs not within the CbC reporting regime will be impacted most, as they are unlikely to have existing dedicated resource available.

Question 14: Businesses and advisers may have awareness or direct experience of reporting requirements for other tax authorities. The government welcomes comments or observations based on your experiences in other jurisdictions. If so, what processes work well to extract and report the relevant data?

Our understanding from the experience of clients who have produced an IDS or equivalent for other tax authorities is that the guidance provided by the tax authorities plays a crucial role in supporting businesses through the process. We would recommend HMRC reaches out to tax authorities who have already adopted an IDS to identify any lessons that may have been learned when their IDS was introduced with regard to the need for clear, unambiguous guidance.

Question 15: The government welcomes comments and suggestions on appropriate metrics to determine materiality limits and transactions which could be aggregated.

Paragraph 38 of HMRC's consultation paper says that one of the uses of the IDS will be to provide data to improve the efficiency and effectiveness of risk assessment for MNEs where there is no requirement to file a master file and local file. The proposal at paragraph 44 is that all UK businesses in scope of transfer pricing legislation would be required to file an IDS.

BDO anticipates that using these criteria, there would be many MNEs who would be required to file an IDS even when the MNE's UK presence is small and presents minimal transfer pricing risk. To prevent unnecessary compliance burden whilst still providing HMRC with the data it requires to perform data-led risk assessments in worthwhile cases, BDO proposes that an IDS need only be filed above thresholds set by reference to measures such as costs, turnover, balance sheet assets, employee numbers or size of aggregate transactions with overseas associated enterprises.

For MNEs above the thresholds, and therefore required to file an IDS, BDO suggests that a transactional materiality limit also be set in respect of transactions or aggregated transactions. This would exclude small transactions or transactions of a low risk nature from the IDS.

Question 16: Please comment on a possible option for one entity to file a version of the IDS on behalf of other UK group entities.

This appears reasonable.

Question 17: The government welcomes views on the format and structure of the IDS.

Structuring the IDS using different sections by theme as proposed at paragraph 51 seems reasonable.

Adopting the IDS as a supplementary page for a corporation tax return and submitted in iXBRL format seems reasonable, and we assume that once MTD for corporation tax is introduced that this would effectively mean quarterly submission of IDS data. For businesses with group turnover above €750m this should present no significant difficulty, but for groups approaching the threshold we suggest that a compliance grace period will need to be considered for first reporting.

We would hope that however the government chooses to change transfer pricing documentation over the next few years, it takes account of future reporting under MTD reporting so that businesses do not have to make repeated changes to their arrangements for compiling transfer pricing data.

Question 18: With regard to the proposals in this chapter the government would welcome any other observations, comments or suggestions

In summary, we suggest HMRC focuses on assisting smaller businesses who are most likely to be impacted by the introduction of the IDS. We have suggested a number of proposals above including a phased introduction, the application of appropriate de-minimis limits, and an emphasis on clear unambiguous guidance, all of which we believe would have a significant impact on the successful introduction of the IDS.