



UK LAW REFORM IN TRANSFER PRICING, PERMANENT ESTABLISHMENT AND DIVERTED PROFITS TAX

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ICAEW welcomes the opportunity to comment on the UK law reform in transfer pricing, permanent establishment and diverted profits tax consultation published by HM Treasury on 19 June 2023, a copy of which is available from this [link](#).

For questions on this response please contact the ICAEW Tax Faculty at taxfac@icaew.com quoting ICAEW REP 74/23.

This response of 11 August 2023 has been prepared by the ICAEW Tax Faculty.

Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

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OVERVIEW

1. All members who engaged on this consultation welcomed that the proposed changes took steps to more closely align domestic law with OECD principles. It was anticipated that this move in policy should increase certainty and make treaty negotiations easier for international businesses. Although some members had concerns around the shift in definition of permanent establishment (PE) and considered that it could cause complexities for multi-national businesses stating that there were clear reasons why the OECD position was not fully implemented in 2017.
2. Members agreed that bringing diverted profits tax (DPT) into the corporation tax regime could simplify matters but they also questioned the retention of DPT in the context of unilateral measures more widely, although we appreciate its role in securing the tax base. OECD guidelines are the widely accepted global authority on transfer pricing and should protect the UK tax base without the need for domestic measures which go beyond these principles. DPT does increase complexity and reduce the attractiveness of the UK as a place to invest. We would be happy to discuss this aspect further.
3. Only a relatively small proportion of our members operate in this specialist international space on a routine basis. Therefore, we have not had as much feedback as we might see during a consultation period on a more mainstream area of tax. On this basis we have chosen to provide a high-level response, focusing on the tax simplification and growth agenda. We consider that responses on the detailed technical aspects of the consultation will be better served by large international businesses and advisors regularly operating in this area. We have therefore not chosen to answer each question individually.

TRANSFER PRICING

The provision

4. Members supported this move to clarify the definition of provision in statute and put beyond doubt that it is aligned with the OECD model convention.
5. While the consultation document indicates that the UK definition of provision could be viewed as narrower than the OECD model convention, some members did not agree. They did not consider that there was ever meant to be any difference in the way domestic law should be interpreted when comparing this to the OECD guidelines.

The participation condition

6. Members did not consider changes were required in this area. While it was accepted that the existing rules can be complex, this is because they are very prescriptive and mechanical. This means that in the majority of cases they provide certainty.
7. More guidance would be welcome to navigate the rules as opposed to fundamental changes to the UK position on participation which members think provides a balanced outcome.
8. It was also noted that some of the approaches mentioned in the consultation document were a radical change from the existing approach and could indeed complicate the issue considerably. Members stressed that the government is minded to make changes these should be, as far as possible, in statute and clearly framed.
9. However, one area where members accepted there could be room for simplification was in the 'acting together' rules affecting financing deductions.
10. The rules around joint ventures can also be complex, especially to the extent that transactions between the parties could be viewed as a comparable price where no transfer pricing adjustment is required. Members think that more clarity on this issue could be helpful

to enable businesses to use such comparable prices with certainty where there is evidence that these are in fact a reasonable comparator notwithstanding the joint-venture relationship.

Re-introduction of a UK-UK exemption

11. Members were unanimous in their view that this would be a welcome simplification.
12. Currently there are no transfer pricing documentation requirements for UK-UK transactions. Where there are exceptions to the UK-UK exemption members suggested it would be beneficial to make clear what, if any, documentation requirements are needed.
13. In terms of exceptions to the exemption, members could accept that it may be appropriate to consider instances where particular regimes resulted in different effective rates of tax (eg oil and gas and patent box). It was acknowledged that this policy move would need to be accompanied with relevant safeguards and exclusions and that a return to the previous 'blanket' exemption was unlikely.
14. However, members suggested that the exemption should be as wide as possible. If exclusions try to capture all situations where there are cash-tax differences (eg use of losses) the exemption could become unduly onerous. In reality the rules around group relief are structured such that this type of situation (eg trapped losses) is becoming much less frequent.

Arm's length valuation

15. Members agreed that a single valuation standard of 'arms-length' for regimes such as intangible fixed assets was sensible. UK law would be more closely aligned with OECD principles which should increase certainty and reduce complexity.

One-way street

16. The consultation document indicated that more guidance will be issued on this matter and members were supportive of this, agreeing with comments in the consultation document that the rules are not always well understood.
17. Members also considered that this would be an opportune time for the government to articulate a more pragmatic interpretation of what 'arms-length' might look like. Members considered that the OECD takes a broader view here which results in a more flexible approach.

Transfer pricing and financial transactions

18. A tension currently exists between UK rules and OECD guidelines in respect of how guarantees and 'implicit support' are disregarded under domestic rules. OECD guidelines do take-account of such measures when considering borrowing costs. Alignment in these areas would be very welcome.
19. The proposed changes should make the UK a more attractive jurisdiction to invest or locate a holding company.

DIVERTED PROFITS TAX

20. Members agreed that bringing DPT into the corporation tax regime could simplify matters and allow access to procedures for obtaining relief from double taxation under the UK's tax treaties. In turn, it should assist to reduce uncertainty and aid negotiations.
21. Some members accepted that DPT was a useful tool given it offers HMRC certain investigative and collection powers which can also act as a deterrent to large businesses considering profit diversion or avoidance.
22. However, many members didn't take this view and questioned whether unilateral measures such as DPT were still appropriate in light of global solutions such as Pillar 1 and Pillar 2 and

the wider BEPS action plan. DPT has obviously served an initial purpose to flush out non-compliance (when the BEPS project was not as developed) but many jurisdictions do not have such a measure, instead relying on OECD guidelines as the global consensus on transfer pricing.

23. In the interests of simplification and growth members did question the rationale for retention of DPT given that it puts the UK in a place where it is going beyond OECD principles – the widely accepted global authority on transfer pricing.
24. There was also concern around how the DPT rules would be enacted within the corporation tax framework and the potential complexity that could arise. Members stressed that this should be done via statute to mitigate any ambiguity and subsequent complications wherever possible.

PERMANENT ESTABLISHMENT

25. There were mixed views on this part of the consultation regarding permanent establishment (PE).
26. Some members agreed that aligning the UK PE regime (including those provisions relating to the dependent agent PE conditions) to the 2017 OECD model would assist in delivering a simplified regime for multinational enterprises while increasing tax certainty for non-resident entities trading in the UK. However, in order to maximise the benefit of this policy it is important that the definition and language genuinely align with the OECD guidelines.
27. The consultation document indicated that the exemptions for UK brokers and investment managers will be retained, and members confirmed that this would be reassuring for the UK insurance and asset management sector.
28. However, some members had concerns around these changes indicating that the UK chose not to adopt all the changes put forward by the OECD in 2017 around PE for good reason and indicated that the shift in definition would likely cause concern for large multi-national businesses. The shift in definition of 'dependent agent' to include those with a 'principal role' in concluding contracts will widen the definition and could be complicated to interpret and define.
29. These members also felt that Option B (defining a UK PE by direct reference to the OECD model treaty) could result in the UK losing autonomy. This is because should the OECD definition alter, the UK definition of a PE would automatically be required to alter alongside this.
30. Some members also indicated that domestic law currently only applies for the purposes of corporation tax and in the interests of simplification it would be worthwhile considering taxing income and capital gains tax under the same PE standard.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <https://goo.gl/x6UjJ5>).