Transfer pricing rules: size doesn't matter!

UK businesses could be mistaken in thinking they're too small to fall foul of transfer pricing rules

Misunderstandings about the global transfer pricing rules could be exposing UK businesses with overseas subsidiaries to the risk of tax penalties.

Businesses with branches in other countries may incorrectly believe they don't need to compile transfer pricing documentation – either because HMRC hasn't asked for it or because they think they're too small to be covered by the rules.

What is transfer pricing?
Transfer pricing refers to the common requirement of national tax authorities that prices for goods and services exchanged between subsidiaries that are part of a larger group are set at market value.

In principle, such rules exist to stop multinational corporations allocating earnings among their various subsidiaries to cut their global tax liability by shifting profits to lower-tax countries. Profits should be realised where they have been generated in practice, but the subjective nature of a term like market value does mean that a considerable amount of flexibility is still available.

Guarding against misuse
To guard against misuse, tax authorities around the world generally require qualifying businesses to produce transfer pricing reports, which set out inter-company pricing for goods and services and explain how that pricing is calculated.

In the UK, HMRC has stipulated a company only needs to produce such a report if it is part of a "large" group. However, in many other jurisdictions the size thresholds are much lower and some countries, including the US, have no qualifying threshold at all.

This means, for example, that a US-based subsidiary, no matter the size of its turnover, may be legally obliged to produce transfer pricing documentation in that country – and a UK parent company should be aware of this and take appropriate action to avoid potentially being penalised by the US tax authorities.

Shipleys is helping several companies with this issue, and we advise businesses with any kind of international subsidiary to check if they are obliged to hold transfer pricing documentation by the tax authority of another jurisdiction.

What should a transfer pricing report include?
Typically, a transfer pricing report needs to reflect the going market price for the inter-company transfer of the goods and services concerned. As well as taxable income, transfer pricing can also be applied to intellectual property such as research, patents and royalties. Compiling these detailed reports (one that we have been involved with ran to more than 120 pages) is usually outsourced to a specialist adviser.

It may need to include details justifying the allocation of profits to an overseas subsidiary – for example, because of high-value staff working in that jurisdiction. This is designed to stop allocation of profits to an international branch that might merely comprise a serviced office and, say, a single member of staff.

Further help
For help and guidance on transfer pricing, please do get in touch with your usual Shipleys contact. Through our membership of AGN International, we can cover most global jurisdictions. There's more on transfer pricing on the gov.uk website at:
https://tinyurl.com/yc8673c4
and from the OECD at:
https://tinyurl.com/mrxyw5dr

Case study

Shipleys was asked to advise a Canadian group which had recently acquired a UK company. The parent company sought our help in putting transfer pricing documentation in place across the whole of its international group. During our work, it became clear that the German, Hong Kong, Singapore and Indonesian subsidiaries were obliged to have transfer pricing documentation. There was some existing documentation – put together locally – in these jurisdictions but it was inconsistent and hadn't been shared with head office.

It also came to light during this assignment that one of the company's branches was in the midst of a transfer pricing investigation by the local tax authority.