

Transfer Pricing

Introduction



Transfer pricing is the term used to describe the prices of transactions effected between connected parties. These connected parties are usually individuals transacting with companies or companies transacting with other companies.

The tax legislation that deals with transfer pricing requires that transactions between these connected parties must be on an arms length basis. This effectively means that the “price” of the goods or

service involved must be the same as if the transaction was being undertaken between two unconnected third parties.

The transfer pricing legislation applies to transactions between the UK and overseas parties and between two UK parties. It also applies to all types of transaction. This could be a simple sale of goods, but also includes the provision of services, financing transactions, royalties, patent rights, management charges, loans and guarantees.

In addition, there are relatively strict documentation requirements, such that companies must ensure that they have a transfer pricing policy which evidences the reasons for transactions between connected parties being at a certain price or level, and seeks to explain any differences between that price or level, and the price or level applied to third party transactions.

Minimum Thresholds

UK transfer pricing legislation only applies to companies of a certain size.

Small companies with less than 50 employees and either turnover or assets of less than €10million are not subject to the UK transfer pricing legislation. Transactions between connected parties whose size is below this threshold cannot be challenged under these rules.

Medium-sized companies with less than 250 employees and either turnover of less than €50million or assets of less than €43million are also exempt from the UK transfer pricing legislation. However, HM Revenue & Customs can, by delivery of a notice to a medium-sized enterprise require it to increase profits or reduce losses on an arms length basis. Clearly HMRC will only intervene in respect of medium-sized enterprises where they perceive that

enterprise’s transactions between connected parties as particularly abusive.

All other companies in excess of the medium-sized enterprise threshold are within the provisions of the UK transfer pricing legislation.

In addition, the thresholds detailed above apply on a group basis. Therefore if the medium-sized enterprise thresholds are not breached on a single company basis, but the group of companies of which it is part does breach the thresholds, the whole group is subject to the UK transfer pricing regime.



Overseas Issues



It should be noted that a number of overseas territories, such as France, Germany and the US do not operate a minimum threshold in terms of their transfer pricing regime. Therefore where a UK company is connected to, for example, a US company, the UK company may not fall within the UK

regulations due to its small size, but the transaction will still need to be on an arms length basis to meet the requirements of the US regime.

Therefore the UK regime is not necessarily the only consideration in these circumstances.

Other Risks

Taxpayers may think that where they have a group of companies that is “small” within the meaning of the UK transfer pricing legislation, profits can be moved between companies with little risk of challenge by HMRC.

However, HMRC may seek to deny a deduction for a particular cost (perhaps a management charge) where it is not wholly and exclusively for the benefit of that company’s trade.

This risk of challenge under the transfer pricing rules must therefore also be assessed in conjunction with the application of this wholly and exclusively for the benefit of the trade requirement.

We would strongly urge taxpayers to seek advice where they are undertaking transactions that may not necessarily be on strict third party terms.



Further Information

For more information please contact **Dominic Bourquin** who will be pleased to help on **01225 472800** or e-mail **dominicb2@monahans.co.uk**