

Business Helpsheet

International tax – transfer pricing

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About 60% of global trade now consists of transactions between related parties. The prices charged on these transactions (the transfer price) affects the tax paid in different countries, and this makes transfer pricing probably the most significant international tax issue faced by companies today.

1. What is transfer pricing?

Transfer pricing involves the pricing of business transactions between related parties, particularly between companies within the same group. To prevent the artificial shift of profits to low tax countries, tax authorities require such transactions to be priced on an 'arm's length' basis. This means the prices must be comparable to those that would be charged between two unrelated parties. Where this cannot be demonstrated, a tax authority may adjust the profits upwards to what they would have been if arm's length pricing had been used.

2. What transactions are affected?

Transfer pricing issues affect a wide range of cross-border transactions including payments for:

- Inter-group services such as management assistance, marketing, legal and accounting support, training, IT and Research and Development.
- Tangible property such as purchase and sale of goods, machinery and equipment or rental of property.
- Debt finance in terms of the amount, interest rate charged and guarantees provided.
- Intangible Property rights such as trademarks, patents and know-how.

3. Who needs to transfer price?

The UK's transfer pricing legislation applies to transactions between entities where both are resident in the UK, as well as to cross-border transactions. To mitigate the significant compliance costs for smaller businesses, exemptions have been introduced for small and medium sized UK enterprises:

	Maximum number of staff	And less than one of the following limits Annual Turnover	Total Assets
Small Enterprise	50	EUR 10 million	EUR 10 million
Medium Enterprise	250	EUR 50 million	EUR 43 million

There are various points that need to be taken into account:

- Where the entity is a member of a group, or has an associated entity, these limits apply to the whole group, and not the entity by itself.
- Transactions are exempt only if they are with a related person based in a qualifying territory (one where the UK has a Double Taxation Convention which contains a non-discrimination article).
- Transactions between medium-sized enterprises are subject to transfer pricing by exception whereby HMRC may issue a transfer pricing notice.

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Relevant as at January 2009.


4. Why should you transfer price?

A transfer pricing study may be beneficial for a number of reasons such as:

- From a compliance perspective, as explained above, companies may be required to justify their transfer prices for tax purposes. Companies therefore need to prepare and retain such documentation, as is reasonable, given the complexity of the transactions.
- Establishing a coherent group transfer pricing policy can minimise the overall group tax burden and reduce the risk of double taxation.
- Specifically analysing the relevant transactions improves the understanding of the functions and risks of the various group companies and where value is being added.
- An accurate assessment of the performance of the various companies can be identified, which allows for directors and employees to be properly incentivised.

5. How Menzies can help

We can assist with a full transfer pricing solution including:

- A review of current arrangements and advice on transfer pricing risk.
 - Establishing the arm's length pricing of the various cross-border transactions.
 - Preparation of transfer pricing documentation to meet UK and OECD requirements.
 - Assistance in presenting cases as well as possible to the UK tax authorities.
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