



# Transfer Pricing and SMEs The UK perspective

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Christine Roots and Doug Jones

# The definition of small and medium-sized enterprises UK transfer pricing legislation

For the purposes of the UK transfer pricing legislation SMEs are defined by the Commission Recommendation 2003/361/EC of 6 May 2003:

	Maximum number of staff	And less than one of the following limits:	
		Annual turnover	Balance sheet total
Small enterprise	50	€10m	€10m
Medium enterprise	250	€50m	€43m

# The definition of small and medium-sized enterprises 2003/361/EC

Staff and financial data of connected and associated enterprises are included with that of the enterprise.

- Linked enterprises – enterprises which have the right to control the affairs of the enterprise seeking exemption. The control can be direct or indirect.
- Partnership enterprises - where one of them holds 25% or more of the capital or voting rights of the enterprise seeking exemption, but they are not linked enterprises

The UK follows the guidance in the User Guide published by the EU with one exception

# UK transfer pricing and SMEs Legislation

Basic rule of UK transfer pricing legislation is found at Schedule 28AA ICTA 1988

For chargeable periods beginning on or after 1<sup>st</sup> April 2004 SMEs are exempt from the transfer pricing legislation

There are exceptions to this:

- Where the SME elects for the exemption not to apply
- Where the entity has a transaction or series of transactions with an enterprise (or party) resident in a non-qualifying territory
- Where the Board gives notice for the SME exemption not to apply. This applies to medium-sized enterprises only.

## Notice from the Board – what happens

The Board may delegate its powers in respect of a notice to senior tax officials

The notice may only be given after a notice of enquiry has been given to the UK taxpayer

The taxpayer may appeal against the notice

The taxpayer has 90 days to submit a tax return in accordance with the arm's length principle. The 90 days is either from the date of the notice, or the date on which the appeal against the notice is determined.

Penalties for an incorrect return in respect of transfer pricing can only be applied to the return submitted in response to the Board's notice

# Documentation

Documentation requirements for UK transfer pricing are not specific.

The documents and evidence should demonstrate that the results of the transactions are determined for transfer pricing purposes in accordance with the arm's length rule.

Medium enterprises have 90 days to submit a tax return following a Board's notice. Evidence that the revised return is on an arm's length basis can be prepared during this period.

## Why was the legislation introduced?

During 2003 decisions at the ECJ had created uncertainty in the UK about the application of the existing transfer pricing and thin capitalisation rules. To remove that uncertainty the transfer pricing rules were extended to include domestic, as well as cross-border transactions.

Extension of the transfer pricing rules to domestic transactions had the potential to impose significant extra administrative work for businesses, especially smaller ones.

Smaller businesses can be in the same market as larger ones therefore it is appropriate to have a reserve power in cases of blatant manipulation by medium-sized businesses.

The SME exemption was introduced at the same time as the extension of transfer pricing to UK-UK transactions.

# What is the impact of the SME exemptions?

Regulatory impact assessment in early 2004 before the legislation was introduced

- The effect of the legislation on individual enterprises
- Tax receipts estimated to have a net increase of £95m over three years from its introduction and then a net reduction in receipts

There is no perceived need to amend or withdraw the current exemption.

# Potential problems with the SME partial exemptions legislation

## The definition of SMEs

- Was not devised by the UK legislature
- Definition was not devised for tax purposes
- Definition is in Euros, but most accounts are in sterling

## Perceived uncertainty for medium-sized businesses

- But businesses have 90 days or more to draw up returns on an arm's length basis following a notice from the Board.

# References

## Legislation

- Schedule 28AA ICTA 1988

## HMRC guidance

- International Manual published on the HMRC website, in particular INTM43112 and INTM433030

## Report on consultation with business December 2003

- Corporation tax reform: the next steps (published December 2003)

## Regulatory impact assessment

- Reform of corporation tax; regulatory impact assessment (published March 2004)

## HMRC website

- [www.hmrc.gov.uk](http://www.hmrc.gov.uk)



Thank you

HM Revenue & Customs  
100 Parliament Street  
London  
SW1A 2BQ

Telephone no. +44 7147 2697  
[christine.roots@hmrc.gsi.gov.uk](mailto:christine.roots@hmrc.gsi.gov.uk)  
[douglas.jones@hmrc.gsi.gov.uk](mailto:douglas.jones@hmrc.gsi.gov.uk)