



# ICAEW REPRESENTATION 126/16

## TAX REPRESENTATION

### INTRODUCTION OF SECONDARY ADJUSTMENTS INTO THE UK'S DOMESTIC TRANSFER PRICING LEGISLATION

ICAEW welcomes the opportunity to comment on the consultation document [Introduction of secondary adjustments into the UK's domestic transfer pricing legislation](#) published by HM Revenue & Customs on 26 May 2016.

This response of 16 August 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

#### Contents

	Paragraphs
Major points	
Key point summary	1
Responses to specific questions	2-21
Ten Tenets for a Better Tax System	Appendix 1

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 146,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

Copyright © ICAEW 2016  
All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

For more information, please contact ICAEW Tax Faculty: [taxfac@icaew.com](mailto:taxfac@icaew.com)

[icaew.com](http://icaew.com)

## MAJOR POINTS

### Key point summary

1. We do not support the introduction of secondary adjustments into the UK domestic transfer pricing rules unless there is more international consensus, not least so that potential double taxation can be addressed.

## RESPONSES TO SPECIFIC QUESTIONS

**Q 1 The sections below set out a number of specific questions on the design of a secondary adjustment rule. However, the government would be grateful for any wider comments, beyond responses to these specific questions.**

2. The OECD BEPS project represents an enormously significant change to the international tax landscape and the Inclusive Framework put in place to implement the minimum standards etc brought together 100 countries at the first meeting in Japan in June/July 2016.
3. In building on the achievements of the BEPS project and the challenges it will face in the future and to maintain the cohesion of the international tax scene we believe it would not be appropriate to introduce secondary adjustments unless there is international consensus. We do not support a unilateral approach.
4. Secondary adjustments are neither prevented nor required by the Commentary to the OECD Model Tax Convention and there is no requirement under Article 9 of the Model for corresponding relief to be given. As a result double taxation is likely to arise as a result of the unilateral proposal to introduce secondary adjustments in the UK rules.
5. The Commentary to the OECD Transfer Pricing Guidelines, paragraphs 4.66 to 4.76, makes it very clear that secondary adjustments are very problematic and cause considerable difficulties and we believe should not be pursued at this stage by the UK unless, and until, there is more international consensus as to how such adjustments can work and how the potential for double taxation can be appropriately addressed.

**Q 2 What advantages and disadvantages do you see of the constructive loan option rule, when compared to the other options available, taking into account interactions with other parts of the UK's corporate tax regime?**

6. The EU Joint Transfer Pricing Forum published in early 2013 a [Final Report on Secondary Adjustments](#) which noted that when EU member states do have legislation on secondary adjustments, which covered only a third of the EU member states, they usually take the form of a constructive dividend rather than the constructive loan as put forward in the present consultation.

**Q 3 What are your views on the advantages and disadvantages of either a 'notice led' or an 'automatic' rule?**

7. If the UK were to go ahead with secondary adjustments then we believe a notice led system is preferable.

**Q 4 What problems do you see in applying the rule by reference to a threshold and what alternatives are there?**

8. How the threshold is applied would need to be defined. Would it apply on an entity by entity basis and by reference to specific accounting periods?
9. We think there is merit in considering targeting transfer pricing adjustments between the UK and non-treaty jurisdictions.

**Q 5 What level would you consider it appropriate to set a threshold at?**

- 10.** We recommend that the de minimis threshold should be at least £10m and it should be applied to each accounting period and in relation to transactions entered into with a specific entity.

**Q 6 What views do you have on the options for the accounting periods to which the rule would be applied?**

- 11.** The proposed new rules, if introduced, should only apply to periods beginning on or after the effective date of the legislation.

**Q 7 What problems do you see with the above proposal and what alternatives are there?**

- 12.** We agree with the government's view that the loan should be deemed between the parties to which the primary adjustment arises. But there should be an opportunity for the entity that has benefited from the transaction to which the primary adjustment has been made to repatriate an amount equal to the primary pricing adjustment so that there is no need for the secondary adjustment.

**Q 8 What issues, if any do you see arising on the interaction of secondary adjustments and accounting standards?**

- 13.** If there are adjustments solely for tax purposes then we do not see that there need be adjustments for accounting purposes. Any record keeping for the deemed loans would take place outside the accounts and not fall within the relevant accounting standards.

**Q 9 Do you agree with this preferred approach? If not, what alternative approaches would you propose?**

- 14.** If the proposed new rules were ever to be introduced then we support the government proposal that the loan would be deemed to arise at the end of the accounting period to which the primary adjustment relates.

**Q 10 What are your views on how and at what rate of interest should be set?**

- 15.** The Final Report of the EU Joint Transfer Pricing Forum recommended that no interest should be payable on secondary adjustment loans, if that is the mechanism adopted by the member state, and we believe that is the right general approach. If there are to be penalties for breaches of the transfer pricing rules and guidelines then these should be in the legislation and not as a charging mechanism in relation to any secondary adjustment.

**Q 11 What are your views on the merits of repatriation being required in the above form and what alternatives are there?**

- 16.** The OECD Transfer Pricing Guidelines, at paragraph 4.72, has some alternative suggestions such as:

“The repatriation could be effected either by setting up an account receivable or by reclassifying other transfers, such as dividend payments where the adjustment is between parent and subsidiary, as a payment of additional transfer price (where the original price was too low) or as a refund of transfer price (where the original price was too high).”

**Q 12 What are your views on the wider UK tax implications arising on the repatriation of the amounts representing the deemed loan?**

- 17.** The repatriation of the loan should not be treated as taxable.

**Q 13 Do you see the need for an anti-avoidance rule? If so, what avoidance opportunities do you consider the rule would be open to and how would you suggest an anti-avoidance rule be designed to address these?**

**18.** We do not support the introduction of an anti-avoidance rule.

**Q 14** What legislative interaction issues need to be considered in deeming a loan, or something to be treated in a manner consistent with a loan, and how would the difficulties they create be overcome?

**19.** We are concerned not to make the existing UK to UK transfer pricing rules more complicated and we would urge caution before any changes are made.

**Q 15** What issues arise from the possibility of non-relievable double taxation and how may they be addressed?

**20.** Secondary adjustments present the risk of double taxation and if they are introduced on a unilateral basis then the potential for double taxation may not be addressed in double tax treaties. The OECD Transfer Pricing Guidelines, paragraph 4.71, encourages countries to structure these adjustments "in a way that the possibility of double taxation ...would be minimised ...".

**Q 16** What issues do you see arising in the application of a secondary adjustment rule within the operation and agreement of APAs and how may these be addressed?

**21.** We think that bilateral APAs should not include provisions for secondary adjustments as this would increase complexity and could reduce the attractiveness of entering into an agreement.

## 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 via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).