

## **Part 1: Transfer pricing**

### **Overview**

1. This Part provides the rules on transfer pricing. These rules apply where “provision” is made between two persons by means of a transaction and, broadly, one of the persons controls the other or both are controlled by the same person or persons. The actual provision is compared to the arm’s length provision (that is to say the provision that would have been made between independent enterprises) and, if the actual provision confers a potential UK tax advantage, the taxable profits of the person receiving that tax advantage are adjusted to what they would have been if the persons had been at arm’s length.
2. This basic rule is also applied where “provision” is made between the ring-fence trade of an oil company and other activities carried on by the same company.
3. The Part also provides for claims and adjustments to be made between a person whose profits are increased as a result of a non-arm’s length transaction and a person whose profits are reduced. These either eliminate double counting of profits or restore the cash position of the companies involved to its original state.
4. This Part rewrites Schedule 28AA to ICTA (provision not at arm’s length) and sections 110 and 111 of FA 1998 (determinations requiring the sanction of the Commissioners for HM Revenue and Customs).
5. Schedule 28AA was inserted into ICTA by section 108 of and Schedule 16 to FA 1998, replacing the transfer pricing legislation in sections 770 to 773 of ICTA. Schedule 28AA was then substantially amended by FA 2004 and F(No.2)A 2005.
6. Chapter 1 explains the circumstances in which the legislation applies, the main instances being where “provision” has been made between persons who meet the “participatory condition”. Chapter 2 explains the concepts used in the definition of the “participatory condition”.
7. Chapter 3 gives the basic rule, that, where the persons are not at arm’s length, profits and losses must be computed as if they were. This Chapter also contains exemptions to the basic rule and has special provision about application of the rule to companies issuing securities (thin capitalisation).
8. Chapters 4 and 5 deal with claims to prevent double taxation following an uplift in profits and Chapter 6 with balancing payments made by the disadvantaged to the advantaged person.
9. Chapter 7 deals with oil-related matters and finally Chapter 8 contains supplementary provisions and definitions.

## **Chapter 1: Introduction to Part**

### **Overview**

10. This Chapter acts as a general introduction to the Part. It explains when the Part applies and gives some important definitions for this Chapter and the Part.

### **Clause 1: Part applies where provision made or imposed**

11. This clause gives the two circumstances when the Part applies: first, where transactions take place between two persons who meet the participation condition and, second, where a person carries on an oil-related ring-fence trade and a transaction takes place between that ring-fence trade and another activity carried on by the same person.

12. The clause is based on paragraphs 1(1) and (2), 9(1), 10, and 11(1) and (3). of Schedule 28AA to ICTA.

13. In *subsection (2)* the words “oil-related” have been added to “ring-fence trade” in paragraph 11(1) and (3) of Schedule 28AA to make clear the area of taxation referred to. “Oil-related ring-fence trade” is defined in clause 60.

### **Clause 2: Meaning of “affected persons” and “actual provision”**

14. This clause gives the meaning for this Part of two terms used in clause 1. It is based on paragraphs 11(3) and 14(1) of Schedule 28AA to ICTA.

### **Clause 3: The “participation condition” referred to in section 1(1)(b)**

15. This clause explains when the participation provision is met in clause 1. It is based on paragraphs 1(1), 4A(6) and 4B(1) and (2) of Schedule 28AA to ICTA.

## **Chapter 2: Participation in management, control or capital of a person**

### **Overview**

16. This Chapter explains what is meant by participation by a person in the management, control or capital of another person. The term is used in clause 3 which defines the “participation condition” for clause 1. The term is also used in subsequent provisions. Direct and indirect participation were dealt with together in paragraph 4 of Schedule 28AA to ICTA. In this Chapter they have been separated. Direct participation is explained in clause 4 and indirect participation in clauses 6 to 10.

### **Clause 4: Direct participation**

17. This clause explains what is meant by direct participation in the management, control or capital of another. The clause is based on paragraph 4(1) of Schedule 28AA to ICTA.

18. “Partnership” in paragraph 4(1) is rewritten in *subsection (2)* as “firm” in accordance with rewrite practice.

**Clause 5: Meaning of “control” in cases involving sales of oil**

19. This clause applies a special meaning of “control” for applying the transfer pricing rules in relation to company oil sales. It is based on paragraph 9 of Schedule 28AA to ICTA. It qualifies the general definition of “control” given by clause 72.

20. This clause causes the oil producer, seller and buyer to be connected persons for the purposes of the Part where the control threshold would not otherwise be met because the shareholding is insufficient. This allows the transfer pricing rules to apply where the oil-producing company is owned by a consortium.

**Clause 6: Indirect participation: defined by sections 7 to 10**

21. Clauses 7 and 10 set out four possible meanings of indirect participation in the management, control or capital of another person. For each reference to indirect participation, this clause lists the meanings which apply. It is based on paragraphs 4(2), 4A(1) and (2) and 6(4C) of Schedule 28AA to ICTA and section 85(6) of FA 1999.

**Clause 7: Indirect participation: potential direct participant**

22. This clause provides for a person to be indirectly participating in the management, control or capital of another if the person would be a direct participant in the other (see clause 4) were the person to have the rights and powers listed in *subsection (3)*. It is based on paragraph 4(2) to (6) and (10) of Schedule 28AA to ICTA.

23. *Subsection (6)*, which rewrites paragraph 4(6) of Schedule 28AA, serves to clarify that *all* connected parties must be considered in applying the rule in *subsection (3)(e)*, which rewrites paragraph 4(3)(d) of Schedule 28AA.

**Clause 8: Indirect participation: one of several major participants**

24. This clause provides that if two persons taken together control a body corporate or firm, and each of the two persons has at least 40% of their combined stake in the body or firm, then each of the two persons is indirectly participating in the body or firm. It is based on paragraph 4(2) and (7) to (10) of Schedule 28AA to ICTA and section 85(6) of FA 1999.

25. “Enterprise” in *subsections (2) and (3)* is not defined. It is a term used in Article 9 of the OECD Model Taxation Convention and defined in Article 3 as “the carrying on of any business”. Article 3 goes on to say that “business” includes the performance of professional services and of other activities of an independent character. This meaning of enterprise applies here by virtue of clause 15 which requires this Part to be read consistently with Article 9.

**Clause 9: Indirect participation: sections 3(2)(a) and (3)(a) and 29(2)(a): financing cases**

26. Under this clause an affected person acting with others to provide financing arrangements to the other affected person is treated as indirectly participating in that person's management, control or capital. It is based on paragraphs 4A(1), (3) to (6) and 6(4C) of Schedule 28AA to ICTA.

**Clause 10: Indirect participation: sections 3(2)(b) and (3)(b) and 29(2)(b): financing cases**

27. This clause provides for someone other than an affected person acting with others to provide financing arrangements to the other affected persons to be treated as indirectly participating in their management, control or capital. It is based on paragraphs 4A(2), (3) to (6) and 6(4C) of Schedule 28AA to ICTA.

**Clause 11: Meaning of "connected" in sections 7**

28. This clause gives the meaning of "connected" for clause 7. It is based on paragraph 4(11) and (12) of Schedule 28AA to ICTA.

**Chapter 3: Basic rule: Substitution of arm's length provision**

**Overview**

29. This Chapter gives the basic rule of the transfer pricing provisions: where a profit is less or a loss greater than it would have been if a transaction had taken place at arm's length, they are to be computed as if the transaction had been at arm's length. The Chapter also deals with various administrative issues (notices and appeals) and rules for applying the arm's length concept to issues of securities (thin capitalisation).

**Clause 12: Basic transfer-pricing rule.**

30. The clause gives the basic rule. It is based on paragraphs 1(2) and 4A(7) of Schedule 28AA to ICTA.

31. Paragraph 1(2) of Schedule 28AA makes the basic rule subject to paragraph 8 of the Schedule. *Subsection (6)(d)* recognises that paragraph 8 is being rewritten in Bill 5, Parts 6 (loan relationships) and 8 (derivative contracts).

**Clause 13: Meaning of "arm's length provision"**

32. This clause gives the meaning of "arm's length provision" by reference to clause 12 and also provides that the basic rule applies where a transaction that has occurred would not in fact have occurred between independent enterprises. The clause is based on paragraphs 1(3) and 14(1) of Schedule 28AA to ICTA.

**Clause 14: Meaning of "potential advantage" in relation to United Kingdom taxation**

33. This clause explains what is meant by conferring a potential advantage in relation to United Kingdom taxation in this Part. It is based on paragraph 5(1) and (7) of Schedule 28AA to ICTA.

**Clause 15: Interpreting Part in accordance with OECD principles**

34. This clause requires the Part to be read in a way that is consistent with the way in which Article 9 of the OECD model taxation treaty is read when included in a tax treaty entered into by the United Kingdom. The clause is based on paragraphs 2 and 14(1) of Schedule 28AA to, and section 828(1) and (3) of, ICTA.

35. This requirement applies whether or not there is a tax treaty between the United Kingdom and any particular non-UK territory.

36. This clause imports into the transfer pricing legislation not only the principles of Article 9 of the OECD model taxation treaty but also that organisations' transfer pricing guidelines. The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration referred to in *subsection (4)(a)*, were first issued in 1979 and extensively updated in 1995 with revisions and additions published periodically.

37. No Treasury order has been issued under paragraph 2(3)(b) of Schedule 28AA to ICTA, which is the provision rewritten by subsection (4)(b).

**Clause 16: Exemption from basic rule: dormant companies**

38. This clause exempts dormant companies from the basic rule in clause 12. This clause is based on paragraph 5A of Schedule 28AA to ICTA and section 1297(5) of the Companies Act 2006.

39. Paragraph 5A(4) of Schedule 28AA to ICTA adopted the definition of "dormant" given by the Companies Act 1985. Section 1297(5) of the Companies Act 2006 provided for that to be read as a reference to the corresponding definition given by the 2006 Act. *Subsection (4)* reflects this.

**Clause 17: Exemption from basic rule: small and medium-sized enterprises**

40. This clause exempts, with three exceptions, small and medium-sized enterprises (defined in clause 23) from the basic rule in clause 12. This clause is based on paragraph 5B(1) and (2) of Schedule 28AA to ICTA.

**Clause 18: Small and medium-sized enterprises: exceptions from exemption**

41. This clause gives two of the exceptions to clause 17: where there is an election that the exemption should not apply and where the other affected person is a resident of a non-qualifying territory. This clause is based on paragraph 5B of Schedule 28AA to ICTA.

**Clause 19: Medium-sized enterprises: exception from exemption: transfer pricing notice**

42. This clause gives the third exception to the exemption in clause 17. This is where the Commissioners for Her Majesty's Revenue and Customs give a notice (a "transfer pricing notice") to the potentially advantaged person that clause 12 is to apply. This clause is based on paragraph 5C(1) of Schedule 28AA to ICTA.

43. “In question” in paragraph 5C(1)(a) of Schedule 28AA was not rewritten on the ground that it was unnecessary.

44. “The Board” in paragraph 5C(1)(b) (which meant the Commissioners of Inland Revenue) is rewritten as “the Commissioners for Her Majesty’s Revenue and Customs” in accordance with section 50(1) of the Commissioners of Revenue and Customs Act 2005.

**Clause 20: Giving of transfer pricing notices**

45. This clause gives details of transfer pricing notices given under clause 19. It is based on paragraph 5C(2) to (4) and (12) of Schedule 28AA to ICTA.

46. “Officer of the Board” in paragraph 5C(4) and (6) is rewritten as “officer of Revenue and Customs” both here and in clause 21 in accordance with section 50(2) of the Commissioners for Revenue and Customs Act 2005.

**Clause 21: Appeals against transfer pricing notices**

47. This clause enables a person receiving a transfer pricing notice to appeal within 30 days against the decision to give the notice. It is based on paragraph 5C(5) to (7) of Schedule 28AA to ICTA.

**Clause 22: Tax returns where transfer pricing notice given**

48. This clause allows the taxpayer to make amendments to his tax return following receipt of a transfer pricing notice under clause 19. It is based on paragraph 5C(8) to (12) of Schedule 28AA to ICTA.

49. Paragraph 5C(8)(b) refers to the taxpayer appealing “against the notice” although paragraph 5C(5) states that appeals are against the *decision to give* the notice. In rewriting paragraph 5C(8)(b) subsection (1) has been made consistent with clause 21(1).

**Clause 23: Meaning of “small enterprise” and “medium-sized enterprise”**

50. This clause defines “small enterprise” and “medium-sized enterprise” for purposes of Chapter 3. It is based on paragraph 5D of Schedule 28AA to ICTA.

**Clause 24: Meaning of “qualifying territory” and “non-qualifying territory”**

51. This clause defines “qualifying territory” and “non-qualifying territory” for the purposes of Chapter 3. It is based on paragraph 5E of Schedule 28AA to and section 828(1) of ICTA.

**Clause 25: Arm’s length provision where actual provision relates to securities**

52. This clause deals with what is generally known as “thin capitalisation” and applies where a security is issued between connected companies. It is based on paragraph 1A(1) to (5) of Schedule 28AA to ICTA.

53. It provides that, in applying the basic rule in clause 12, account must be taken as to whether the loan concerned would have been made, and would have been made on the same terms, if the parties had been at arm's length.

54. *Subsection (4)* stops the argument that an arm's length measure is not possible because the company in question would not make loans at arm's length.

**Clause 26: Arm's length provision where security issued and guarantee given**

55. This clause provides that, where a security is issued by one of the affected persons and a guarantee given by the other, in applying the basic rule in clause 12, account must be taken of whether that guarantee would have been given, and would have been given on the same terms, if the parties had been at arm's length. It is based on paragraph 1B(1) to (5) of Schedule 28AA to ICTA.

**Clause 27: Interpretation of sections 25 and 26**

56. This clause explains terms used in the two preceding clauses. It is based on paragraphs 1A(6) to (10) and 1B(6) of Schedule 28AA to ICTA.

**Chapter 4: Position, if only one affected person potentially advantaged, of other affected person**

*Overview*

57. This Chapter provides for claims to be made by the person whose profits have increased or losses decreased (the disadvantaged person) as a result of another persons' profits decreasing (the advantaged person). The claim prevents double taxation and is only relevant where both the advantaged and disadvantaged persons are liable to UK taxation.

58. Suppose company A sells goods to connected company B for an amount less than an arm's length price would require. While this reduces A's profits it increases B's profits by the same amount. B may therefore make a claim to reduce its profits by the same amount by which A's are increased to avoid double taxation on the arm's length differential which would otherwise arise.

**Clause 28: Claim by the affected person who is not potentially advantaged**

59. This clause allows the affected person who is not potentially advantaged to make a claim to calculate profits in accordance with the arm's length provision imposed on the advantaged person. It is based on paragraphs 6(1) and (2) and 6A(1) of Schedule 28AA to ICTA.

60. "For the purposes of this paragraph" in paragraph 6(2) of Schedule 28AA has not been rewritten on the grounds that it was unnecessary to do so since the person making the claim can be expected to identify the purpose for which the claim is made. This omission is consistent with the approach taken in paragraph 6C(2) of Schedule 28AA to ICTA.

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61. Paragraph 6(2) of Schedule 28AA makes a claim subject to paragraph 8 of the Schedule. *Subsection (4)* of this clause recognises that paragraph 8 is being rewritten in Bill 5, Parts 6 (loan relationships) and 8 (derivative contracts).

62. Subsection (4) provides that *subsection (2)* is subject to clause 34 (which rewrites the trading stock rules in paragraph 6A of Schedule 28AA). Although paragraph 6A was not listed in the opening words of paragraph 6(2) of Schedule 28AA, the opening words of paragraph 6A achieve the same result as would have been achieved by such listing.

**Clause 29: Claims under section 28 where actual provision relates to a security**

63. This clause prevents a claim from being made under clause 28 where the participatory condition is satisfied as a result of indirect participation (of a kind within clauses 9 and 10) and a guarantee has been issued in respect of a security. It is based on paragraphs 1A(7), (9) and (10) and 6(4A) and (4B) of Schedule 28AA to ICTA.

64. The meaning of guarantee in paragraph 6(4A) is provided by paragraph 1A. That definition in paragraph 1A(7) is, in part, in terms of the issuer of the security being a company although paragraph 6 does not specify that the affected person issuing the security mentioned in paragraph 6(4A) should be a company. Subsection (5)(b), in rewriting the parts of paragraph 1A(7) that referred to the issuing company, therefore defines “guarantee” only for cases where the person issuing the security is a company.

**Clause 30: Claims under section 28: advantaged person must have made a return**

65. As a result of this clause a claim under clause 28 may not be made by the disadvantaged person unless an arm’s length calculation of the advantaged person’s profits has been made and the claim is in accordance with that calculation. It is based on paragraph 6(3) and (4) of Schedule 28AA to ICTA.

**Clause 31: Time for making, or amending, claim under section 28**

66. This clause provides the time limit for making or amending claims under clause 28. It is based on paragraph 6(5) and (6) of Schedule 28AA to ICTA.

**Clause 32: Meaning of “return” in sections 30 and 31**

67. This clause provides the interpretation of “return” in clauses 30 and 31. It is based on paragraph 6(7) of Schedule 28AA of ICTA.

**Clause 33: Compensating payment if advantaged person is controlled foreign company**

68. This clause provides for a compensating adjustment to be made to the disadvantaged company where the advantaged company is a non-UK resident company whose profits have been apportioned to UK residents under the controlled foreign company (CFC) provisions in Chapter 4 of Part 17 of ICTA. It is based on paragraph 6B of Schedule 28AA to ICTA.

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69. Because the CFC's profits on which the adjustment is made are not those of a person on whom a potential advantage in relation to UK taxation is conferred, the "advantaged person" does not fall within clause 28(1). There is no advantage to the CFC in relation to UK taxation.

70. Special provision is therefore required to allow a claim under clause 28. This is done by treating the CFC as if it fell within that clause.

71. "Chargeable profits" in *subsection (1)(b)* is the term used by the controlled foreign company legislation for the CFC's taxable profits (section 747(6) of ICTA).

72. In *subsection (3)* the amended readings to clauses 28 to 32 are necessary because the return of the chargeable profits of the CFC is not made by the "advantaged person" (the CFC) but by the company which controls that company and on whom the apportionment of chargeable profits will be made. Likewise the relevant notice will be given to the same company.

**Clause 34: Application of section 28(2)(a) in relation to transfers of trading stock etc**

73. This clause provides for a broad timing match between the adjustments arising on the advantaged and disadvantaged company where there is a transfer of stock between the two. It is based on paragraph 6A of Schedule 28AA to ICTA.

74. A mismatch in timing may arise with stock transfers because, while an increase to open market value of the stock transferred will immediately result in an increase to the transferor company's profits, the compensating adjustment will not arise in the case of the transferee company until that stock has been disposed of.

**Clause 35: Section 36 applies to claims where actual provision relates to a security**

75. This and the following three clauses relate to claims under clause 28 where a security has been issued between companies. This clause provides that the claim may be in accordance with clause 36. It is based on paragraphs 1A(9) and (10) and 6C(1) and (2) of Schedule 28AA to ICTA.

**Clause 36: Making of section 36 claims**

76. This clause provides the basic requirements for the claim. It is based on paragraph 6C(3) to (5) of Schedule 28AA to ICTA.

77. *Subsection (3)* allows the claim to be made before the calculation of profits has been made by the advantaged person. This allows tax to be deducted from the arm's length sum rather than the actual sum, thus enabling inward investors to obtain certainty on the consequences of loan financing.

**Clause 37: Giving effect to sections 36 claims**

78. This clause gives rules applicable to a clause 36 claim. It is based on paragraph 6C(6) to (9) of Schedule 28AA to ICTA.

79. *Subsection (1)* means that a clause 36 claim is made outside the rules applied by Schedule 18 to FA 1998 to company tax returns and assessments as the claim relates to the deduction of tax.

80. Because the claim may be made before a clause 30 calculation has been made, *subsection (3)* allows claims to be treated as if they were consistent with the eventual calculation.

**Clause 38: Amending a section 36 claim if it is followed by a relevant notice**

81. This clause allows either the advantaged or disadvantaged person to amend a clause 36 claim where a closure notice or similar has been served on the advantaged person, in the former case the amendment being treated as made on the disadvantaged person's behalf. It is based on paragraph 6C(10) to (12) of Schedule 28AA to ICTA.

**Clause 39: Notice to potential claimants**

82. This clause requires HMRC, on giving a closure etc notice, to inform a disadvantaged person who appears to be entitled to make or amend a claim for compensating relief or to be heard by the Special Commissioners in any appeal relating to a transfer pricing adjustment. It is based on section 111(1), (2), (4) and (5) of FA 1998 and section 87(5) of FA 1999.

**Clause 40: Extending claim period if notice under section 39 not given or given late**

83. This clause allows the Commissioners to extend the time limit for the making or amendment of claims for compensating relief if they consider any person has been prejudiced as a result of a notice under clause 39 not being given or being given late. It is based on section 111(3) of FA 1998.

**Clause 41: Tax treatment if actual interest exceeds arm's length interest**

84. This clause requires a company not to deduct tax from interest so far as it exceeds interest payable under the arm's length rule. It is based on paragraph 6E of Schedule 28AA to ICTA.

85. Without this rule interest would be deductible from the whole of the interest notwithstanding that that interest was not allowed in the calculation.

**Clause 42: Double taxation relief under section 788 or 799 of ICTA.**

86. This clause requires a reduction in the amount of double taxation relief given against UK tax, whether given unilaterally or by treaty, where a disadvantaged person's profits are reduced as a result of a claim under clause 28. It is based on paragraphs 7 and 14(1) and (3) of Schedule 28AA to ICTA.

87. Without the reduction required by this paragraph a UK resident would obtain relief for foreign tax which would exceed the actual foreign tax payable on the reduced profits. The foreign tax is therefore restricted to what would have been payable if the adjusted profits were the actual profits.

**Clause 43: Double taxation relief under section 811 of ICTA**

88. This clause requires a restriction in foreign tax given as a deduction from UK profits under section 811 of ICTA where a disadvantaged person's profits are reduced as a result of a claim under clause 28. It is based on paragraph 7(3) to (5) of Schedule 28AA to ICTA.

89. Without the reduction required by this clause a UK resident would obtain relief for foreign tax which would exceed the actual foreign tax payable on the reduced profits. The foreign tax is therefore restricted to what would have been payable if the adjusted profits were the actual profits.

**Clause 44: Meaning of "relevant notice"**

90. This clause gives the definition of "relevant notice" for the purposes of this Chapter. It is based on paragraphs 6(7) and 6C(10) of Schedule 28AA to ICTA and section 111(6) of FA 1998.

**Chapter 5: Position of guarantor of affected person's liabilities under a security issued by the person**

***Overview***

91. This Chapter provides for the guarantor company to obtain a deduction for interest which is disallowed on the advantaged company under clause 12 (basic transfer pricing rule) because clause 26 (guarantees on issue of a security) operates to cause the guarantee given on the issue of the security to be treated as one that would not be given if the parties were at arm's length.

**Clause 45: When sections 46 to 48 apply**

92. This clause explains that clause 46 (as supplemented by clauses 47 and 48) applies when interest paid under a security is disallowed under clause 12 as a result of the operation of clause 26 in the case of a guarantee given for liabilities under the security. The clause is based on paragraphs 1A(7), (9) and (10) and 6D(1) and (10) of Schedule 28AA to ICTA.

**Clause 46: Attribution to guarantor company of things done by issuing company**

93. This clause requires the guarantor company to be treated as the issuing company on the making of a claim but only in order to allow the guarantor company to obtain a deduction for the disallowed interest. The clause is based on paragraphs 1A(7) and 6D(2), (3), (10) and (11) of Schedule 28AA to ICTA.

94. The closing words of paragraph 6D(2) have not been rewritten as they add nothing to the preceding provisions of the sub-paragraph.

**Clause 47: Interaction between claims under sections 28 and 46(1)**

95. This clause ensures that only one compensating adjustment is given where the guarantor makes a claim under clause 46 and the lender makes a claim under clause 28. This may happen where the lender and borrower are connected for the purposes of this Part. The clause is based on paragraph 6D(4) to (7) of Schedule 28AA to ICTA.

**Clause 48: Claims under section 46(1): general provisions**

96. This clause explains who can make the claim under clause 46 and applies the provisions, as appropriate, in clauses 29 and 31. It is based on paragraph 6D(8) and (9) of Schedule 28AA to ICTA.

**Chapter 6: Balancing payments**

**Overview**

97. Balancing payments may be made following a transfer pricing adjustment and are not taken into account in computing profits and losses. These payments enable the result of a transaction between two connected persons to be adjusted so that the persons end up in a position they would have been in had they been taxed on the basis of their actual transaction.

98. Balancing payments may also be made in cases where a guarantee is given and there is a transfer pricing adjustment as a result of the operation of clause 26. Here the guarantor makes a payment to the borrower in recognition of the fact that the guarantor has received the benefit of the interest deduction, thus restoring the cash position to its original state.

99. The disadvantaged person or guarantor may alternatively elect to pay additional tax incurred by the advantaged person following a transfer pricing adjustment.

**Clause 49: Qualifying conditions for purposes of section 50**

100. This clause provides the qualifying conditions for clause 50. It is based on paragraph 7A(1) of Schedule 28AA to ICTA.

**Clause 50: Balancing payments between affected persons: no charge to, or relief from, tax**

101. This clause prevents balancing payments from being taken into account for tax purposes up to the level of the available compensating adjustment. It is based on paragraph 7A(1) to (3) of Schedule 28AA to ICTA.

**Clause 51: Qualifying conditions for purposes of section 52**

102. This clause provides the qualifying conditions for clause 52. It is based on paragraphs 1A(7), (9) and (10) and 7C(1) of Schedule 28AA to ICTA.

**Clause 52: Balancing payments by guarantor to issuer: no charge to, or relief from, tax**

103. This clause prevents balancing payments by the guarantor company from being taken into account for tax purposes. It is based on paragraph 7C(1) and (2) of Schedule 28AA to ICTA.

**Clause 53: Pre-conditions for making election under section 54**

104. This clause provides the conditions for clause 54. It is based on paragraphs 1A(9) and (10) and 7B(1) to (3) and (10) of Schedule 28AA to ICTA.

**Clause 54: Election to pay tax rather than make balancing payments**

105. This clause allows the disadvantaged person to elect to pay the tax of the advantaged person rather than to make a balancing payment within clause 50. It is based on paragraph 7B(2) and (4) of Schedule 28AA to ICTA.

**Clause 55: Pre-conditions for making election under section 56(1)**

106. This clause provides the conditions for clause 56. It is based on paragraphs 1A(7), (9) and (10), 7B(2) and 7D(1) to (3) of Schedule 28AA to ICTA.

**Clause 56: Election, in guarantee case, to pay tax rather than make balancing payments**

107. This clause allows the disadvantaged person in a guarantee case to elect to pay the tax of the advantaged person rather than to make a balancing payment within clause 52. It is based on paragraph 7B(2) and (4) and 7D(2) of Schedule 28AA to ICTA.

**Clause 57: Elections under section 54(1) or 56(1)**

108. This clause explains how elections under clauses 54 and 56 are to be made and the effect of such elections. It is based on paragraphs 7B(5) to (9) and 7D(2) of Schedule 28AA to ICTA.

**Clause 58: Meaning of “capital market condition” in sections 53 and 55**

109. This clause explains the meaning of “capital market condition” and is based on paragraphs 1A(8), 7B(1), (3),(9) and (10) and 7D(2) to Schedule 28AA to ICTA.

110. *Subsection (2)* defines “independent person” and this definition in turn depends on the meaning of “participatory relationship” given in *subsection (4)*.

111. Paragraph 7B(9) of Schedule 28AA on which *subsection (2)* is based excludes from the definition of “independent person” a person who has a participatory relationship with either of the affected persons. Paragraph 7B(10) applies the definition of “participatory person” given in paragraph 1A of Schedule 28AA. That definition is expressed to be about cases where one company has a participatory relationship with another company. It therefore suggests that a person excluded by paragraph (b) of the definition “independent person” must necessarily be a company.

## **Chapter 7: Oil-related ring-fence trades**

### **Overview**

112. This Chapter has to be read with clause 1(2). Between them they apply the Part to transactions between the ring-fence trade of an oil company and other activities engaged in by that same company as if they were separate enterprises.

### **Clause 59: Provision made or imposed between ring-fence trade and other activities**

113. If provision is made or imposed as between the ring-fence trade of an oil company and other activities of that company this clause has the effect that this Part applies as if that trade and those other activities were carried on by two separate persons controlled by the same person. It is based on paragraph 11(3) and (4) of Schedule 28AA to ICTA.

### **Clause 60: Meaning of “oil-related ring-fence trade” in sections 1 and 59**

114. This clause gives the meaning of “oil-related ring-fence trade” and is based on paragraph 11(1) of Schedule 28AA to ICTA and section 85(7) of FA 1999.

## **Chapter 8: Supplementary provisions and interpretation of Part**

### **Overview**

115. This Chapter contains provisions on various matters relating to the application of this Part: application to unit trusts, transfer-pricing determinations requiring the sanction of the Commissioners for HMRC, determination of appeals, effects on capital allowances and chargeable gains, the manner of making adjustments and various definitions.

### **Clause 61: Application of Part to unit trusts**

116. This clause explains how the transfer pricing rules in this Part are applied to unit trusts. It is based on paragraph 14(5) of Schedule 28AA to ICTA.

### **Clause 62: The determinations which require the Commissioners’ sanction**

117. This clause provides that certain determinations in transfer pricing cases require the sanction of the Commissioners for HM Revenue and Customs. It is based on section 110(1), (4) and (9) of FA 1998.

### **Clause 63: Determinations exempt from requirement for Commissioners’ sanction**

118. This clause sets out the circumstances in which a Commissioners’ sanction under clause 62 is not required. It is based on section 110(5) to (7) of FA 1998.

### **Clause 64: The requirement for the Commissioners’ sanction**

119. If a transfer-pricing determination requires the Commissioners’ sanction, the determination will be one made for the purposes of a notice or matter mentioned in clause 62(3). This clause applies when the notice, or notice of the matter, is given. If the determination (so far as relating to the notice or matter) has not been approved by the Commissioners or if the determination has been approved but the taxpayer is not

informed that approval has been given, the notice or matter has the effect it would have if it had been prepared without taking account of the determination. This clause is based on section 100(1) to (3) of FA 1998.

**Clause 65: Restriction of right to appeal against Commissioners' approval**

120. This clause provides that the Commissioners' approval of a determination for the purposes of clause 64(2) or (4) may not be questioned in an appeal. It is based on section 110(8) of FA 1998.

**Clause 66: Appeals**

121. This clause provides that, in some tax appeals, the issues to be decided on the appeal are to be decided by the Special Commissioners if that would not otherwise be the case - but only so far as they relate to transfer pricing matters under this Part. It is based on paragraph 12 of Schedule 28AA to ICTA.

**Clause 67: Capital allowances**

122. This clause prevents the transfer pricing provisions from applying for the purposes of capital allowances and balancing charges. It is based on paragraph 13(1) and (2) of Schedule 28AA to ICTA.

**Clause 68: Chargeable gains**

123. This clause prevents the transfer pricing provisions from applying for the purposes of chargeable gains, as TCGA 1992 has its own arm's length rule. It is based on paragraph 13(1) and (2) of Schedule 28AA to ICTA.

**Clause 69: Manner of making adjustments to give effect to Part**

124. This clause explains how adjustments under this Part are to be made. It is based on paragraphs 6C(8) and 14(4) of Schedule 28AA to ICTA.

**Clause 70: Meaning of "transaction" and "series of transactions"**

125. This clause is based on paragraph 3 of Schedule 28AA to ICTA.

**Clause 71: Meaning of "the relevant activities"**

126. This clause is based on paragraph 14(1) of Schedule 28AA to ICTA.

**Clause 72: Meaning of "control"**

127. This clause is based on paragraph 14(2) of Schedule 28AA to ICTA.

**Clause 73: Meaning of "losses" and "profits"**

128. This clause is based on paragraph 14(1) of Schedule 28AA to ICTA.

129. Paragraph 14(1) of Schedule 28AA to ICTA brings relief in accordance with section 468L(5) of ICTA within the definition of losses for the purposes of that Schedule. Section 468L was repealed by section 17(1) of F(No.2)A 2005 although section 17(3) confers power to make provision by regulations in place of the provisions repealed by section 17(1) (see SI 2006/964 as amended). Although

paragraph 14(1) of Schedule 28AA was not amended in consequence of the repeal of section 468L, this clause does not include a reference to relief under section 468L as there is now no such relief.

**Clause 74: Index of expressions defined for the purposes of the Part or a Chapter 130.** This clause gives Schedule [2] (index of defined expressions) effect for the purposes of this Part. It is new.

## **Part 2: Advance pricing agreements**

### ***Overview***

131. This Part provides the rules on advance pricing agreements (APAs). These are written agreements between an enterprise and the Commissioners for Her Majesty's Revenue and Customs which determine a method for resolving pricing issues in advance of a return being made. When the terms of the agreement are complied with they provide assurance that the treatment of those pricing issues will be accepted by both HMRC and the enterprise for the period covered by the agreement.

132. The APA legislation was put in place to enable HMRC to enter into APAs independently of pricing agreements under double taxation treaties.

133. The Part sets out the matters which can be covered by an APA, what a taxpayer must do to obtain an agreement and how an agreement will be applied.

### **Clause 75: Meaning of “advance pricing agreement”**

134. This clause gives the meaning of an APA and the matters it can cover. It is based on section 85(1) and (2) of FA 1999.

135. *Subsection (2)(a)* applies only to persons other than companies. It is based on section 85(2)(a) of FA 1999, but as it applies without the reading of “permanent establishment” applied by section 153(2)(c) of FA 2003 in cases where the taxpayer is a company. This subsection allows agreement on income chargeable as arising in the United Kingdom under the territorial provisions of ITTOIA 2005 (see in particular section 6(2)).

136. *Subsection (2)(b)* rewrites section 85(2)(a) with the modification for companies applied by section 153(2)(c) of FA 2003. It allows agreement in the case of income attributed to a permanent establishment under sections 11 and 11AA of ICTA (rewritten in draft Bill 5).

137. *Subsection (2)(c)* is based on section 85(2)(b). So far as the paragraph applies to companies, “permanent establishment” has the meaning given by section 148 of FA 2003.

138. *Subsection (2)(d)* allows agreement on the territorial location of income and subsection (2)(e) will cover transfer pricing matters.

139. *Subsection (2)(f)* deals with the application of transfer pricing provisions to oil-related ring-fence trades.

**Clause 76: Meaning of “associate” in section 75(e).**

140. This clause brings in the definition in paragraph 1(1) of Schedule 28AA of ICTA of direct and indirect participation for the purposes of clause 75(2)(e) (transfer pricing). It is based on section 85(6) of FA 1999.

**Clause 77: Advance pricing agreement: effect on party to agreement**

141. This clause provides that matters covered by an APA are to be determined under the agreement without reference to the usual means of determining such questions. In the case of transfer pricing matters, although reference to Part 1 may be excluded, an APA cannot exclude reference to other statutory provisions. The clause is based on section 85(1), (3) and (4) of FA 1999.

142. The opening words of section 85(3) of FA 1999 make section 85 subject to the following provisions of the section and to section 86. This is regarded, in fact, as referring to the remainder of section 85(3) and to sections 85(4) and 86(2) only and *subsection (3)* is drafted accordingly.

143. *Subsection (5)* rewrites “a question falling within another paragraph of [subsection (2)]” (section 85(4)(b)) as “a question that relates to a matter within another paragraph [of clause 75(2)]” since section 85(2) (and clause 75) lists matters rather than questions.

**Clause 78: Advance pricing agreement: effect of revocation or breach of conditions**

144. This clause states the conditions under which an APA will not have effect. It is based on section 86(2) of FA 1999.

145. “Party to the agreement” in section 86(2)(b) of FA 1999 is rewritten as “party” in subsection (3), which is defined in subsection (5) as any party to the agreement other than the Commissioners for HMRC. See *Change jc701* in Annex 1.

**Q1. We welcome comments on the proposal to define “party” as any party to the agreement other than the Commissioners for HM Revenue and Customs.**

**Clause 79: Advance pricing agreement: effect on non-parties**

146. This clause applies if one of the parties to a transfer pricing transaction has entered into an APA in relation to that transaction. The clause provides that the APA also applies in the case of the other party to the transfer pricing transaction for the purpose of determining questions related to the transaction. The clause is based on section 87 of FA 1999.

**Clause 80: Advance pricing agreement: application for agreement**

147. This clause specifies the requirements that reply as regards an application for an APA made to HMRC by a taxpayer. It is based on section 85(1) and (5) of FA 1999.

**Clause 81: Advance pricing agreement: years ended or begun before agreement made**

148. This clause allows an APA to cover a period before the APA is made and gives effect to provisions of an APA relating to a period ending or beginning before the APA is made. It is based on section 86(1) and (7) of FA 1999.

**Clause 82: Advance pricing agreement: modification and revocation**

149. This clause allows an APA to provide for HMRC to determine the time from which any modification or revocation of the APA is to take effect in a case where the APA gives HMRC powers to modify or revoke the agreement. It is based on section 86(6) of FA 1999.

**Clause 83: Advance pricing agreement: annulment for misrepresentation**

150. This clause applies if one of the parties to a transfer pricing transaction has entered into an APA in relation to that transaction. The clause provides that the APA also applies in the case of the other party to the transfer pricing transaction for the purpose of determining questions related to the transaction. The clause is based on section 86(5) of FA 1999.

**Clause 84: Advance pricing agreement: penalty for misrepresentation**

151. This clause provides the maximum penalty for fraudulently and negligently providing false or misleading information in connection with the preparation of an APA. It is based on section 86(8) of FA 1999.

**Clause 85: Advance pricing agreement: party's duty to provide information**

152. This clause places a duty on a party to an APA to provide the Commissioners with reports and other information. It is based on section 86(4) of FA 1999.

153. "Party to a section 85 agreement" in section 86(4) of FA 1999 is rewritten in a way that excludes the Commissioners for HM Revenue and Customs. See *Change* in Annex 1.

**Q2. We welcome comments on the proposal to rewrite "party to a section 85 agreement" as meaning any party to such an agreement other than the Commissioners for HM Revenue and Customs.**

**Clause 86: Advance pricing agreement: modifications for double taxation purposes**

154. This clause provides that mutual agreements under a double taxation agreement take precedence over APAs. It is based on section 86(3) and (10) of FA 1999.

155. “Mutual agreement” is undefined in the Taxes Acts but considered to have the same meaning as in section 815AA of ICTA where it refers to agreements between the United Kingdom and an authority in a territory with which the United Kingdom has double taxation agreements. Such agreements are envisaged in Article 25 of the OECD model taxation convention.

**Clause 87: Interpretation of Part: meaning of “Commissioners” and “officer”**

156. This clause is based on sections 85(1) and (5) and 86(2) to (6) and (8) of FA 1999.

**ANNEX 1**

**Change : Advance pricing agreements: “party to the agreement” to mean taxpayer only where provisions are not complied with or information is to be supplied to the Commissioners for Revenue and Customs: clauses 78 and 85**

This change excludes HMRC from being included within the meaning of “parties to the agreement” (i) where an agreement does not have effect because a party has not complied with provisions which are a condition of the agreement and (ii) where a party must supply information to the Commissioners for Her Majesty’s Revenue and Customs.

Section 86(2) of FA 1999 provides three circumstances where questions cannot be determined under an advance pricing agreement. The second circumstance (section 86(2)(b)) is where the question relates to a time after or in relation to which there has been a failure by a party to the agreement to comply with any provision of the agreement which is a condition of its having effect.

“Party to the agreement” is not separately defined here but takes its meaning from section 85 of FA 1999 which refers to the Commissioners for Her Majesty’s Revenue and Customs making a written agreement with any person (“the taxpayer”). The Commissioners, and the taxpayer, will therefore each be a party to the agreement.

It seems certain that the party to the agreement referred to in section 86(2)(b) is the taxpayer since the provisions of the agreement which are conditions of its having effect are conditions laid on the taxpayer and not the Commissioners.

Section 86(4) of FA 1999 provides that it is the duty of any person who is party to a section 85 agreement to provide the Commissioners for Her Majesty’s Revenue and Customs from time to time with such reports and other information as may be required under the agreement or by virtue of any request made by an officer of Revenue and Customs in accordance with the terms of the agreement.

It seems certain that the Commissioners should not have to provide information to itself and hence “party to a section 85 agreement” must refer solely to the taxpayer.

In both these instances references to a party to the agreement have been rewritten as referring to the taxpayer only.

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It is HMRC practice to interpret party to the agreement in these contexts as referring to the taxpayer alone.

***This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle but not in practice) only administrative matters.***