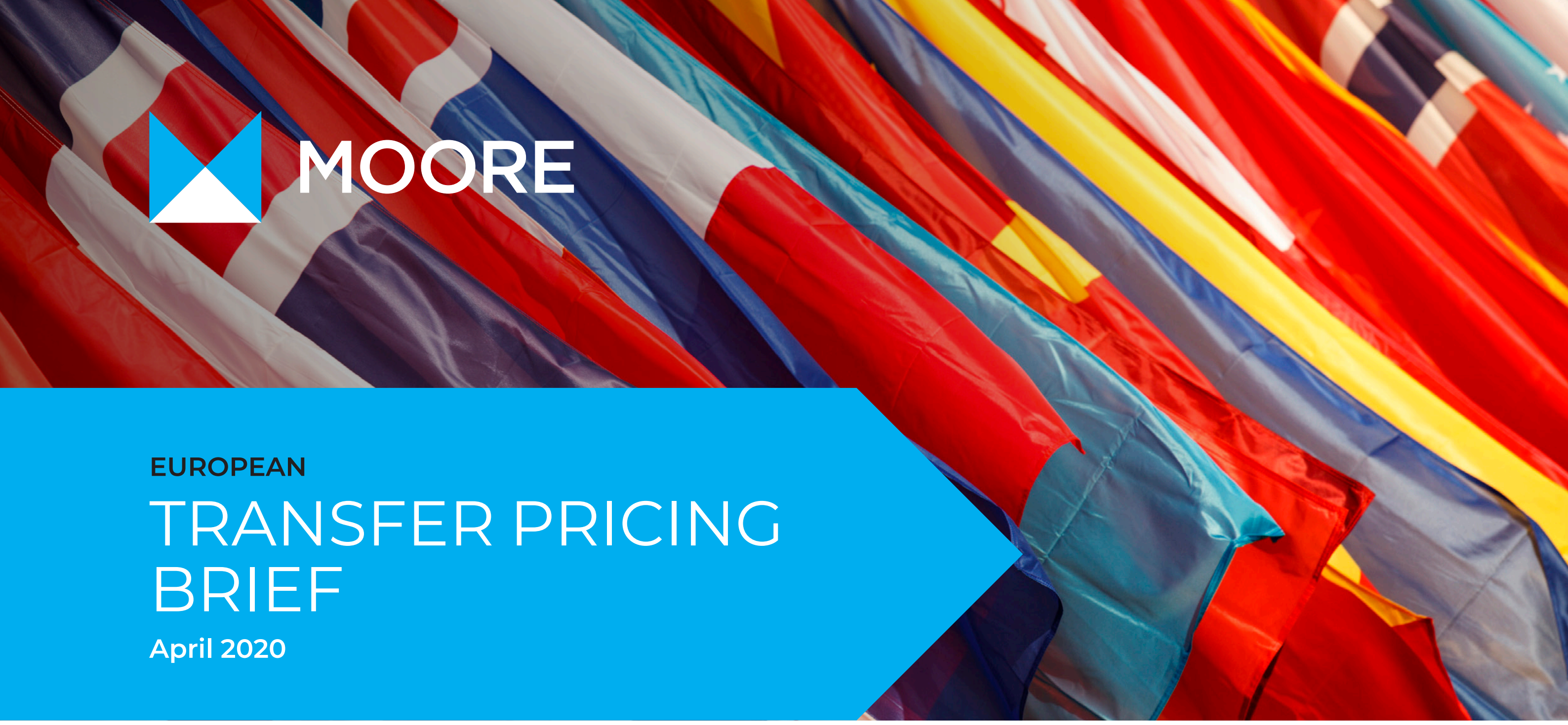

EUROPEAN

TRANSFER PRICING BRIEF

April 2020

CONTENTS

INTRODUCTION

Recent years have witnessed a quickening pace of globalisation and a concomitant increase in cross-border business. In addition, competition between globally operating multinational enterprises (MNEs) continues to intensify.

Digitalisation is accelerating these developments. We have also experienced an increasing amount of 'competition' between the tax administrations of the countries in which the MNEs operate, aimed at securing their 'fair share' of the taxable income generated along the value-creation chain. The OECD BEPS initiative and its final report in October 2015 containing measures against base erosion and profit shifting is one key element that needs to be mentioned in this context.

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INTRODUCTION CONT.

These developments have a tremendous impact on the arm's length principle as the basic benchmark of globally applied transfer-pricing regulations. This principle governs the allocation of income within an MNE between the involved legal entities (including permanent establishments) in different jurisdictions and hence their tax liabilities in those jurisdictions.

However, what is lacking is one universally applicable set of rules. The OECD's Transfer Pricing Guidelines, which the great majority of jurisdictions accept, are only guidelines and recommendations. Inevitably, therefore, the interpretation of those guidelines and the extent to which they are reflected in legislation and practice varies from country to country.

For these reasons, at Moore Global we believe it will be useful for you as member firms and your clients to have an overview on recent developments in key countries by means of this Transfer Pricing Brief, of which this is the first issue.

We hope that you may find it valuable for your practice. If you have any queries related to transfer-pricing matters, especially in relation to its key areas such as price setting, functional and risk analysis, benchmark analysis, preparing a Master File, a Country File and potentially even a Country-by-Country-Report, the Moore Global network and its strong Transfer Pricing Expert Group will be pleased to help and provide you with our professional services.

If you have any queries related to the particular issues and countries mentioned in this Brief, please do not hesitate to contact the experts whose names and contact details appear at the foot of each article.

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GERMANY

GERMANY'S TRANSFER-PRICING DOCUMENTATION RULES

In cases with cross-border transactions within a group of multinational enterprises involving Germany, checking whether the German transfer-pricing documentation provisions are applicable is highly to be recommended.

As a general principle, German tax law requires compliance with the arm's length principle for transactions between related parties (section 1(1)(1) of the German CFC Rules ('AStG' – *Außensteuergesetz*)).

Germany has also adopted in its CFC rules the OECD Transfer Pricing Guidelines, which are based on the arm's length principle as a general rule (see also section 1(1) of the German CFC Rules).

Based on this provision and, of course, the general provisions of German corporate tax law, income-tax adjustments are possible. In terms of the general provisions from German income-tax law, the requirements and tax consequences of a so-called hidden profit distribution (section 8(3)(2) of the German Corporate Income Tax Act ('KStG' – *Körperschaftsteuergesetz*)) and of a hidden contribution have to be considered (section 8(3)(3) KStG).

The requirements of the hidden-contribution rule on the one hand and of an adjustment under German CFC rules on the other are not the same. A hidden contribution is only possible if there is the contribution of an asset that can be contributed (which is e.g. not the case in terms of the correction of interest expenses). Therefore, the applicability of section 1 of the CFC Rules is broader. In addition, section 1 of the German CFC Rules also contains a definition of business relationships, which is essential when dealing with transfer prices (see section 1(3) and 1(4) of the CFC Rules) and what a so-called related party is (see section 1(2) of the CFC Rules), both of which are of the utmost importance in such a context.

As regards the documentation of intra-group relations, Germany has long had documentation provisions in its tax law – these were introduced in 2003 and 2004. These documentation requirements include, principally, the following (Article 90(3) of the German General Fiscal Code ('AO' – *Abgabenordnung*):

- Taxpayers must prepare documentation regarding the manner and content of their business relationships with related parties (documentation of facts and documentation of the arm's length character of transfer prices)
- The documentation has to comprise all economic and legal information for the determination of an agreement that follows the arm's length principle and other terms of business agreed with related parties
- The taxpayers have to provide their documentation to the tax authorities within 60 days of their request
- In the case of so-called extraordinary transactions, this time limit is reduced to 30 days
- The submission period may be extended in exceptional cases
- Any extraordinary transactions must be documented contemporaneously (article 3(1) of the Profit Allocation Documentation Regulations (*Gewinnabgrenzungsaufzeichnungsverordnung – GaufzV* – an Order issued by the German tax authorities under article 90(3) AO), no later than six months into the following fiscal year
- The tax authorities may request transfer-pricing documentation only within the context of a tax field audit – this differs from many other countries, where transfer-pricing documentation must normally be filed together with the annual income tax returns.

The main source in German law for the documentation requirements is found in Article 90 (in conjunction with Article 88) AO:

- Article 90(1) AO contains legal wording on the duties of a taxpayer to cooperate with the tax authorities
- Article 90(2) AO comprises provision on extended duties to cooperate in cross-border cases and transactions
- Article 90(3) AO provides for the duty to prepare transfer-pricing documentation as described above if an MNE in Germany has cross-border dealings with a related party abroad; this provision also contains rules on if and when to file a so-called Master File and a Country File Germany
- Article 138a AO defines the prerequisites for filing a Country-by-Country report.

A failure to comply with the transfer-pricing documentation requirements may expose taxpayers to severe consequences. If the taxpayer does not provide the required documentation, if the submitted documentation is insufficient, or if the documentation for extraordinary transactions was not prepared contemporaneously, the German tax authorities are entitled to assume the taxable income is higher than the income the taxpayer has reported in his tax declarations (see Article 162(1), (2) AO).

One decisive legal instrument that the tax authorities in Germany have in order to make such an income adjustment is that they can use the most disadvantageous point in the arm's length range of profit results when adjusting the taxpayer's taxable income (Article 162(3) AO).

In addition to that, in cases where no documentation has been submitted or where the submitted documentation does not comply with the requirements as stipulated by German tax law, a penalty of 5% to 10% of the income adjustments may be imposed by the tax authorities (Article 162(4) AO).

Article 6(1) and 6(3) GaufzV provide for an important exemption from the duty to prepare and maintain up-to-date transfer-pricing documentation. They state that the duty applies only where the MNE has made cross-border supplies of goods to related parties for consideration greater than EUR 6 million or cross-border supplies of services to related parties for consideration greater than EUR 600 000 per annum.

Given this background, transfer-pricing corrections may not only trigger additional taxes but may also lead to significant penalties in cases where the documentation rules have not been complied with.

Another important aspect when preparing transfer-pricing documentation, i.e. a Country File Germany, is to determine and apply the 'right', i.e. acceptable, transfer-pricing method. The view of the German tax authorities in terms of a 'hierarchy' of methods and other requirements is contained in the tax-authority guidelines published in 1983 in a circular letter from the Federal Ministry of Finance (*Schreiben des Bundesfinanzministeriums* (BMF), BStBl. I 1983, S. 513 ff. *'Verwaltungsgrundsätze'*).

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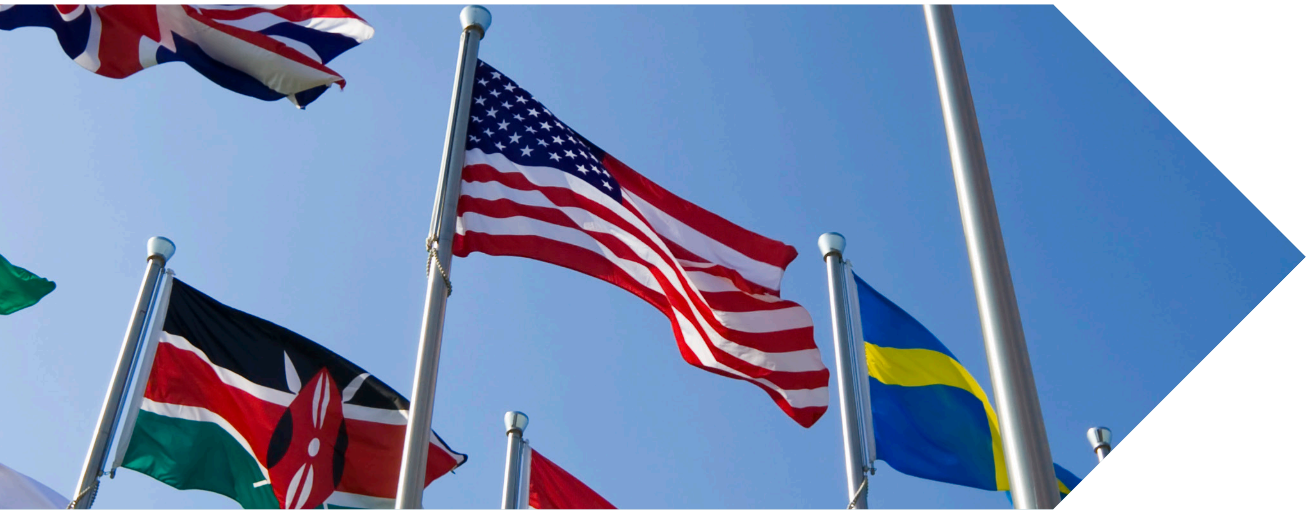

IRELAND

THE TRANSFER-PRICING REGIME IN IRELAND

Finance Act 2010 introduced formal transfer-pricing rules in Ireland for the first time, as set out in Part 35A of the Taxes Consolidation Act 1997 ('TCA 1997'). The rules came into effect for accounting periods commencing after 31 December 2010 and apply in relation to related-party trading transactions, any of the terms of which were agreed after 30 June 2010.

Irish transfer-pricing rules endorse Article 9 of the OECD Model Tax Convention (Associated Enterprises) and (hitherto) the 2010 OECD Transfer Pricing Guidelines (but see under 'Developments' below). However, the 2017 OECD guidelines have automatically applied where the provisions of a double taxation agreement were applicable.

Irish transfer-pricing rules contained in TCA 1997 section 835C apply the arm's length principle ('ALP'), whereby the amount charged by one related party to another for a product or service must be the same as would be charged between unrelated parties in comparable circumstances. Specifically, the transfer-pricing provisions apply only where the actual pricing would have the result that the taxable trading income of one of the persons is less (or the allowable trading loss is greater) than it would have been had arm's length pricing been used.

The provisions currently apply solely to any trading arrangement involving the supply and acquisition of goods, services, money or intangibles. Both cross-border and domestic transactions may be subject to Irish transfer-pricing regulations. It is apparent that the Irish transfer-pricing provisions apply to connected persons. However, while the controlling person may be an individual, the controlled person must be a company for the rules to apply.

Hitherto, Irish transfer-pricing rules have not applied to the following:

- non-trading or passive transactions between related parties (but see under 'Developments' below)
- 'Grandfathered arrangements' the terms of which were agreed before 1 July 2010 (but see under 'Developments' below)
- Small' or 'medium-sized' enterprises ('SMEs'). An SME must fall within the definition of micro, small and medium-sized enterprises, as defined in the Annex to the Commission Recommendations 2003/361/EC concerning the definition of micro, small and medium-sized enterprises. Therefore, the transfer-pricing regime will not apply to enterprises that employ fewer than 250 employees and have either:
  - a turnover not exceeding EUR 50 million or
  - total assets ('balance-sheet value') not exceeding EUR 43 million.

Enterprises must assess on an annual basis whether they are small or medium-sized enterprises and thus fall outside the scope of the transfer-pricing legislation. In order to make this determination, the turnover and total-assets figures are assessed on a worldwide group basis.

However, despite not being subject to the specific transfer-pricing rules, related parties may be subject to general Irish corporate tax principles, which include:

- The 'wholly and exclusively' test whereby a tax deduction is not allowed if a disbursement or expense is not wholly and exclusively incurred for the purpose of the trade of that company. This means that a deduction may be denied where an amount paid between related parties is in excess of the arm's length amount
- Where a non-resident company carries on business with a resident company and an Irish tax-authority ('Revenue') inspector believes that due to the close connection between the companies, it is arranged that the resident company produces smaller taxable profits than those that may have been expected to arise from the business, the non-resident company is chargeable to income tax in the name of the resident company as if it were an agent of the non-resident company.

Irish transfer-pricing documentation

Persons involved in transactions that are within the scope of Irish transfer-pricing legislation are required under TCA 1997 section 835F to have such documentation available as may reasonably be required to demonstrate compliance with the legislation, and specifically that their trading income is computed in accordance with the requirements of TCA 1997 section 835C. Compliance with the transfer-pricing requirements is subject to Revenue compliance interventions, including audit where applicable.

There is currently no requirement for documentation to be kept in a standard form. The company may have the required documentation kept in a form of its own choosing. However, the documentation must be submitted in one of the official languages of the State (Irish or English). The legislation does not require that the company itself must prepare the documentation or that the documentation must be located in Ireland. If appropriate documentation is available, for example where it has been prepared by an associated company for tax purposes in another jurisdiction, it will be sufficient that the documentation can be made available.

As mentioned above, transfer-pricing documentation must be sufficient to demonstrate a company's compliance with the transfer-pricing rules. The standard of documentation required will be dictated by the facts and circumstances of the transactions. It is accepted that the manner of meeting the requirement for documentation may take account of the cost and administrative burden involved.

The cost should be commensurate with the risk involved. It would therefore be expected that complex and high-value transactions would generally require more detailed documentation than simple high-volume transactions.

The EU Council has adopted a code of conduct under the title 'EU Transfer Pricing Documentation' (EU TPD2). Although not binding, this sets out good documentation practice for the purposes of Irish transfer-pricing obligations. Chapter V of the OECD Transfer Pricing Guidelines ('OECD TPG') also contains guidance on documentation which is recommended. In relation to transfer-pricing documentation, Revenue accepts both EU TPD and OECD TPG as representing good practice.

Therefore, while it is not intended to provide a prescriptive list of documentation that should be kept for transfer-pricing purposes, the relevant documentation must clearly identify the following:

- the associated persons for the purposes of the legislation
- the nature and terms of transactions within the scope of the legislation
- the method or methods by which the pricing of transactions was arrived at, including any study of comparables and any functional analysis undertaken
- how that method has resulted in arm's length pricing etc or, where it has not, what computational adjustment was required and how this has been calculated. This will usually include an analysis of market data or other information on third-party comparables
- any budgets, forecasts or other papers containing information relied on in arriving at arm's length terms etc or in calculating any adjustment made in order to satisfy the requirements of transfer-pricing legislation
- transactions with both third parties and associates.

Transfer prices and related documentation should be reviewed at regular intervals to determine whether the pricing remains arm's length. There is generally no requirement to conduct a fresh benchmarking exercise each year, but an annual review is recommended.

It is best practice for the documentation to be prepared at the time the terms of the transaction are agreed. For a company to be in a position to make a correct and complete tax return for an accounting period in which there were trading transactions with associates, the documentation should exist by the time the tax return falls to be made i.e. generally due to be filed within nine months of the end of the taxpayer's accounting period. While no fixed submission deadlines exist for Irish transfer-pricing rules, documentation must generally be submitted within 28 days of its request by Revenue

A 'master file' and 'local file' under the three-tiered approach to transfer-pricing documentation set out in the OECD's 2017 transfer-pricing guidelines are not currently required. However, the information that has to be kept on a master file and local file should be treated as being reasonably required for the purposes of determining whether the trading income has been computed on an arm's length basis.

Transfer-pricing developments

Ireland's transfer-pricing regime has significantly developed from 1 January 2020 as amendments were introduced in Finance Act 2019. The changes include the following:

- The 2017 OECD Transfer Pricing Guidelines have been introduced into the legislation, including the OECD Guidance issued in 2018 on Hard-to-Value Intangibles and on the Transactional Profit-Split Method
- Grandfathering exemptions that existed for transactions agreed before 1 July 2010 have been removed
- Transfer-pricing rules now also apply to non-trading transactions with the exception of certain non-trading transactions where both parties to the transaction are within the charge to Irish tax, i.e. domestic transactions
- The transfer-pricing rules now apply to capital transactions where the transaction value/capital expenditure on the asset exceeds EUR 25 million. This will impact the market value of chargeable assets for the purposes of capital gains tax and capital allowances (tax depreciation)
- The transfer-pricing legislation now expressly permits recharacterisation of transactions where parties acting at arm's length would not have entered such arrangements
- The application of the transfer-pricing legislation is to be based on the substance of an arrangement where the substance is inconsistent with the form of the arrangement, e.g. contracts inconsistent with the actions of related parties
- It is proposed that the transfer-pricing rules will be extended to small and medium enterprises (as defined in EU Recommendation 2003/361). However, this extension of the transfer-pricing rules to SMEs is subject to Ministerial Order and the rules are not effective for SMEs in 2020. The Department of Finance has noted that the execution of a Ministerial Order will be signalled in advance.
- There continue to be no formal transfer-pricing documentation requirements for 'small enterprises' (enterprises that employ fewer than 50 persons and which have an annual turnover not exceeding EUR 10 million and/or an annual balance-sheet total not exceeding EUR 10 million)
- There continue to be no formal transfer-pricing documentation requirements for 'medium enterprises' (enterprises that qualify as SMEs but not as a small enterprise above), where one party to the transaction is not within the charge to Irish tax and the transaction value does not exceed EUR 1 million. However, medium enterprises will be required to have simplified transfer-pricing documentation (not comprehensively within the scope of OECD guidelines) when the transfer-pricing rules are extended to SMEs and
- The documentation requirements will require master files and local files as provided for in the OECD 2017 guidelines to be prepared. The requirement to prepare a master file is introduced for groups with consolidated revenues in excess of EUR 250 million. The requirement to prepare a local file is applicable for groups with consolidated revenues in excess of EUR 50 million.

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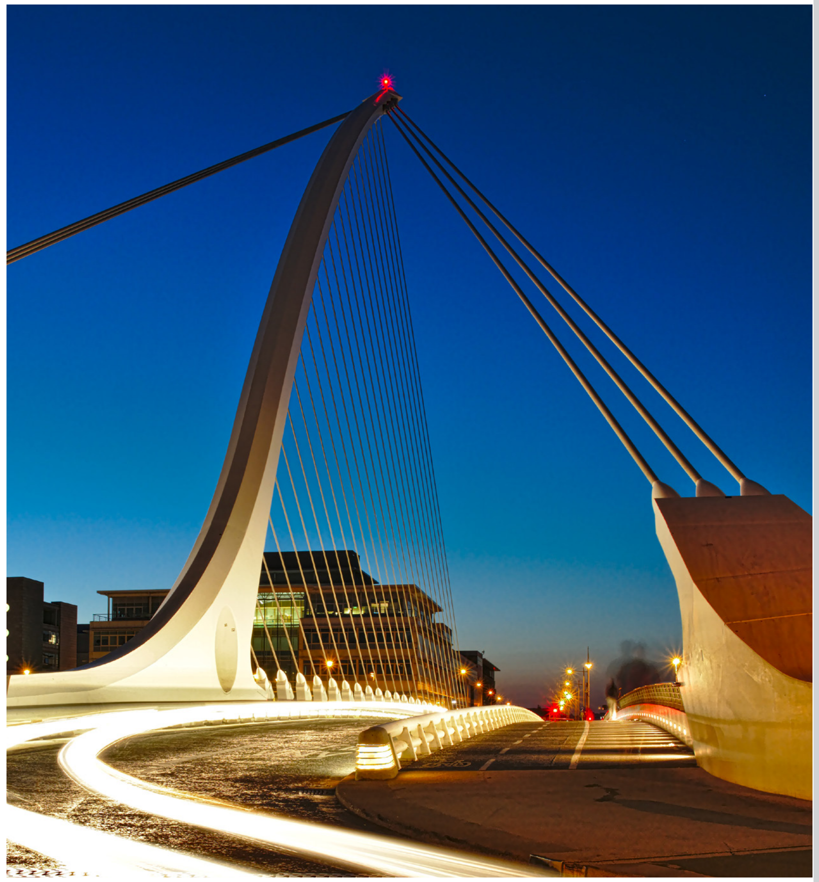

NETHERLANDS

TRANSFER PRICING IN THE CONTEXT OF MANUFACTURING OPERATIONS

Introduction

Transfer pricing can be described as the art of finding prices for intragroup transactions that are acceptable for tax purposes. The overriding principle is the 'arm's length principle': which is that a common shareholder or other form of common control should not influence pricing between related parties. If the terms and conditions, including the pricing, are similar to what independent parties would have agreed upon under similar circumstances, then these prices should be acceptable for tax purposes also.

The intragroup sale of goods by a manufacturing entity is a common transaction within groups. When asked how the manufacturing function is remunerated and/or how the goods are priced, in the vast majority of cases the answer given by the business community will simply be 'cost-plus'.

In this article, we intend to give some context to this 'cost-plus' in manufacturing environments. The intention is to illustrate that – indeed – pricing is often based on a certain cost base with an added mark-up. By giving context, we hope to enrich the perception of this basic term with some of the underlying principles and points for special consideration.

The method

In many cases where a cost-based approach is used in a manufacturing environment, the method is a Transactional Net-Margin Method ('TNMM'[1]). This can be confusing, because the expectation may be that the transfer-pricing documentation mentions 'Cost-Plus' as the method. Adding to the potential confusion is the fact that there is actually a method called 'Cost-Plus', but it is used less regularly in our experience.

In short, without going through all the details of both methods (because that is beyond the scope of this article), the TNMM focuses on EBIT (earnings before interest and tax), taking into account the full cost base, whereas the 'real' Cost-Plus method analyses the gross margin and typically does not take into account operating expenses and/or indirect manufacturing cost.

To verify whether a reference to 'cost plus' during a call or meeting relates to a TNMM or the actual Cost-Plus Method, one could ask whether the company is analysing its gross margin or EBIT. That will likely answer the question.

In the next paragraphs we shall assume that a manufacturing entity is remunerated based on the TNMM, whereby a mark-up is added to its total cost base (except financials and extraordinary items). We shall refer to this as a 'cost-plus'. For example: if the entity's total operating cost is EUR 1 000 000 and the applicable mark-up is 5%, then it would sell intragroup for EUR 1 050 000, realising an EBIT of EUR 50 000, which is 5% of total operating cost.

Financial operations

Cost-plus is commonly applied and acceptable in most countries. Still, the method can have effects that are counterintuitive. Higher costs imply a higher profit[2]. Conversely, if an entity reduces its cost significantly, this will lead to a lower profit.

As a result, multinational groups (for internal cost-control purposes) and tax authorities (for tax purposes) tend to focus quite heavily on monitoring and controlling the budgeting process to ensure that the cost base is realistic. Also, where actual financial results deviate from the forecast or budgeted results, it is important to review whether that is the result of local (in)efficiencies that should then be allocated to the manufacturing entity. If the deviation is the result of factors outside the scope of management or control of the manufacturer, the financial impact should be allocated to the group company that managed these risks.

Procurement of group services

Many manufacturing entities receive services from a corporate headquarters, shared service centre, IT company, management company or other intragroup service provider.

The invoicing of such services to a manufacturing entity remunerated with a cost-plus is a point for further consideration[3]. Why? The incoming service charges would be reported above the EBIT line in the income statement of the manufacturing entity. That implies that these costs would be included in the cost base of the manufacturing entity and these costs would be marked up.

There is no true consensus on the best approach here. On the one hand, it can be argued that if the manufacturing entity had procured similar services from an external provider it is clear that these fees would be part of the cost base. On the other hand, it does not seem appropriate that the manufacturing entity receives a mark-up/remuneration for being the recipient of a group service, where the value was added by the service provider.

In practice, there are groups that choose not to invoice manufacturing entities remunerated with a cost-plus for intragroup services received. If that decision is made, attention should be paid to implications other than transfer pricing (e.g. cost allocation for management purposes, VAT compliance etc). If the alternative approach is chosen, i.e. to charge service fees to such manufacturing entities, it is advisable to ensure that no mark-up be applied by the manufacturer to the service fee. This avoids the phenomenon of ‘mark-up over mark-up’, which is often considered inappropriate.

Final considerations

Cost-plus is an appropriate way to remunerate manufacturing activities and it is attractive because of its simplicity. We hope that this article has given the reader some background to the term and its underlying principles and points for further consideration.

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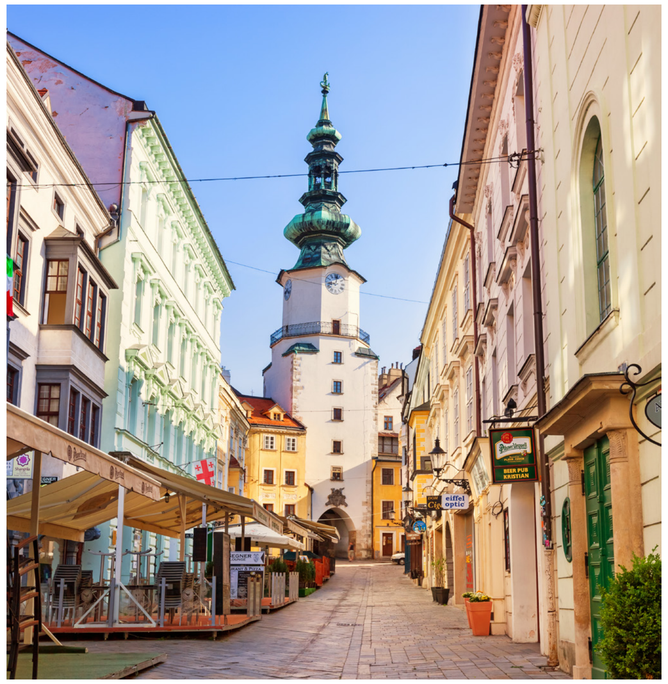
Notes

1). The US equivalent of the TNMM is the so-called Comparable Profits Method, often abbreviated to ‘CPM’

2). From an isolated local manufacturing-profitability perspective, giving all factory personnel an expensive leased car could therefore be worth considering.

3). The transfer pricing relating to such services is not discussed in this article, but in most cases service charges are based on a cost-based approach such as the TNMM.

4). For TP assignments DRV Accountants & Belastingadviseurs often work closely together with the TP specialists of Red.Tax



SLOVAKIA

NEW GUIDELINES ON THE CONTENTS OF TRANSFER-PRICING DOCUMENTATION

In 2018, the Slovak Ministry of Finance announced new guidelines (accessible on the Ministry of Finance’s website) defining the contents of transfer-pricing documentation. The new Guidelines make significant changes to the obligation to prepare such documentation.

As in the original text of the Guidelines, documentation related to transfer pricing is classified as complete, basic or abbreviated, depending on its scope. However, a significant change compared to the original text is that the scope of transfer-pricing documentation now depends on the type of controlled transaction (significant / insignificant, cross-border / domestic) and no longer on the type of taxpayer. Given the above, various controlled transactions may be reported in varying degrees, even though the same taxpayer is involved. These changes primarily affect small and medium-sized enterprises as well as enterprises receiving financial state aid.

The Guidelines also resolve the documentation obligations of permanent establishments. No significant changes were made with respect to specific public-sector transfer-pricing rules.

The process of defining the significance of a controlled transaction does not have a minimum defined transaction value. The new Guidelines, like the old, refer to the definition of significance contained in the Accounting Act and in international accounting standards (IFRS). The new Guideline does away with the EUR 1 000 000 minimum transaction value above which transactions had to be reported in detail in documentation.

Another significant change is that the Ministry of Finance has provided a standardised form for abbreviated documentation, as an annex to the Guidelines.

The Ministry of Finances notes that the Guidelines specify only the minimum scope of documentation. Hence, the tax authorities may call on a taxpayer to provide additional information to demonstrate the conformity of prices used in controlled transactions with the arm’s-length principle.

We note that the provisions of section 17(5) of the Income Tax Act remain unchanged. This means that the tax base for a related party includes the difference by which prices or conditions differ in controlled transactions from prices and conditions in comparable transactions, where the difference has had the effect of decreasing the tax base or increasing a tax loss. This means that even if a related party is not obliged to maintain transfer-pricing documentation in certain cases, the tax authorities may call on the party to demonstrate the conformity of prices with the arm’s-length principle.

In order to limit tax risk during a tax audit, we therefore recommend that businesses continue to apply the arm’s-length principle in price verification.

These Guidelines have effect in relation to documentation submitted for tax periods beginning on 31 December 2017 and subsequently, while taxpayers could still apply the original Guidelines published in 2016 until 30 June 2019 at the latest.

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UNITED KINGDOM

COMPLIANCE FACILITY NUDGE LETTERS

In January 2019, HMRC (the UK's tax authority) introduced a new Profit Diversion Compliance Facility to allow businesses to remedy any transfer-pricing non-compliance without prompting an investigation by HMRC. Anyone using the new facility can do so by making a full and accurate disclosure of additional corporation tax liabilities. The facility is intended to be used by companies active on an international level who, as a result of incorrect transfer pricing of intra-group transactions, may have reduced UK profits by under-rewarding UK activity and over-rewarding activity based in an overseas entity.

Group companies most likely to be within HMRC's sights are technology businesses that generate significant profit from intellectual property with cross-border income flows. However, any company with cross-border intra-group transactions that are not on an arm's length basis could attract HMRC scrutiny, particularly if it is large or if low-tax jurisdictions are involved.

Recently, HMRC has begun sending 'nudge letters' to multinational enterprises (MNEs) it thinks could have availed themselves of the facility but have not done so to date. In many instances, a subsequent failure by the MNE then to use the new disclosure facility has led to the issue by HMRC of notices of enquiry into the MNE's UK entity's tax return under Finance Act 1998 Schedule 18 paragraph 24, focusing initially on, for example, the contribution of the UK arm to the global value chain with relation to transfer pricing and the UK's diverted profits tax.

UK ADOPTS A DIGITAL SERVICES TAX

In his first Budget speech on 11 March, the UK's new Chancellor of the Exchequer, Rishi Sunak, confirmed that the UK would be introducing its digital services tax (DST) with effect from 1 April 2020.

The tax is charged at the rate of 2% on the amount of 'UK digital services revenues' arising to a group in an accounting period. 'Digital services revenues' are the total amount of revenues arising to members of the group in connection with any 'digital services activity' of any member of the group. 'UK digital services revenues' are the amount of those revenues that is attributable to UK users. The legislation identifies five cases where such an attribution may be made:

- online marketplace revenues arising in connection with a marketplace transaction to which a UK user is a party
- online marketplace revenues arising in connection with particular accommodation or land in the UK
- online marketplace revenues arising in connection with online advertising paid for by a UK user
- online advertising revenues viewed or otherwise consumed by UK users and
- any other revenues arising in connection with UK users

'Digital services activity' is defined in turn as the provision of a social media service, an internet search engine or an online marketplace. A 'UK user' may be an individual of whom it is reasonable to assume that the user 'is normally in' the UK or any other person of whom it is reasonable to assume that it is 'established' in the UK. 'Online financial marketplaces' (as defined) are excluded from the tax.

DST applies only to groups in respect of which both their total digital services revenues in any accounting period exceed GBP 500 million and their UK digital services exceed GBP 25 million. Furthermore, the first GBP 25 million will be exempt from the tax.

There is an optional alternative basis of charge, under which groups may be taxed on 0.8 times the operating margin on that part of their revenues exceeding GBP 25 million on any or all of their revenues from social media services, internet search engines and online marketplaces.

The accounting period for DST purposes is normally the year to 31 March (the year to 31 March 2021 being the first). DST returns must be filed on behalf of the group by either the parent company or a nominated 'responsible member'.

The UK Government has promised that it will withdraw the DST once agreement is reached at an OECD level on a substitute tax, but clearly does not believe this is likely in the immediate future.

PROFIT-FRAGMENTATION RULES NOW IN THEIR SECOND YEAR

Mention might also be made here of the UK's profit-fragmentation rules, which were introduced in 2019 and have been described by some as 'transfer pricing for SMEs'. They are intended to prevent UK traders and professionals from avoiding UK tax by arranging for their UK profits to accrue in low-tax territories, and come into play only where other existing anti-avoidance regimes, such as transfer pricing or CFC rules, do not apply.

The fragmentation rules apply where:

- A 'material provision' exists between a UK-resident party (RP) and an overseas party (OP)
- As a result of the material provision, there is a transfer of value from RP to OP deriving directly or indirectly from the profits of a business chargeable to UK income tax or corporation tax
- The value transferred is greater than it would have been if it had resulted from an arm's length provision and
- A party related to RP is able to enjoy the benefits of what is transferred

Put briefly, value must be transferred out of a business taxable in the United Kingdom in a way such that a party related to the UK transferor may enjoy the benefits of what is transferred. The related party may be RP itself, a fellow partner of RP or a participator in RP.

However, for arrangements to be profit-fragmentation arrangements under these rules, the material provision must result in a mismatch for a tax period of the resident party and it must be reasonable to conclude that the main purposes or one of the main purposes for entering into the arrangements was to obtain a tax advantage. The rules work by countering the tax advantage by adjustments to the UK party's (RP's) expenses, income, profits or losses so that they reflect what the appropriate element would have been had the transfer been at arm's length.

The rules were introduced for the purposes of corporation tax from 1 April 2019 and for the purposes of income tax from 6 April 2019.

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