Keeping Up with Tax for Insurance

May 2021

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Introduction

Welcome to another edition of Keeping Up with Tax for Insurance. The months seem to be speeding by and as many of us put year end audits behind us, I am excited by what the spring and summer hold for us. The sun is out and I have been able to return to the office, to meet some of my team and some of my clients in person and feel rejuvenated and more positive for what the future holds. It has been great to get back to hosting in person meetings in our offices with some of you and I look forward to seeing many more over the rest of the year.

We have talked a lot recently about how we are seeing a deals-led recovery, particularly in the insurance industry and one of the main topics on the tongues of investors is ESG ("Environmental, Social, and Corporate Governance"). Despite the momentum of the ESG agenda and the deluge of articles around the subject, this remains an area that insurers grapple with, as guidance fluctuates between high-level ESG pieces and deep technical literature. In the latest report that we have published, ESG and Insurance, we offer a framework for insurers to consider and introduce practical initiatives that address ESG and identify growth opportunities.

This latest thought leadership is the first in our series of in-depth industry focused ESG reports. These follow on from our cross-industry article: 'ESG and growth: a new way of thinking' where clients can register for the upcoming sector reports.

Coming home to tax, I wanted to mention 23 March, the first ever Tax Day, which had been heralded as a chance for consultations on future tax policy to receive more focus and stakeholder scrutiny outside the normal Budget Day process. In the end, it was more notable for what was not included than what was, as there was nothing on the reform of capital gains or inheritance tax, nothing on equalising the treatment of the employed and self employed, and nothing on pensions tax relief (three areas where there were clear recommendations from the cross-party Treasury committee).

In outlining a future pathway for tax administration and tax policy development, notable announcements were; the "notification of uncertain tax treatment by large businesses - second consultation" which seeks to define an uncertain treatment as well as the requirements to notify and the penalty regime for not doing so; and the wide ranging "R&D Tax Reliefs: consultation" which has the potential to result in the biggest reform of R&D credits since the regime was introduced over 20 years ago. A further item of interest for insurers will be the consultation on transfer pricing documentation, which we have discussed in an article below.

In this month's edition, we have included the following articles:

- **EU Commission review of VAT rules for financial and insurance services**
- **Restoring trust in corporate governance – a new regime for internal controls over tax**
- **Super Deductions – Fixed assets vs intangibles**
- **Re-structuring your UK property footprint – tax pitfalls and opportunities for occupier businesses**
- **Consultation on UK Transfer Pricing documentation requirements**

I hope you enjoy the articles that we have put together, and as always please get in touch with me or your PwC team if there is anything that you would like to discuss further.

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EU Commission launches its review of VAT rules for financial and insurance services

The EU Commission has launched a public consultation, responses for which closed on 3 May 2021, to obtain the views of stakeholders on the current VAT rules on financial and insurance services and their functioning as well as on possible changes to these rules.

The EU Commission's two key policy objectives are:

1. To address the competitive disadvantage to financial and insurance businesses (arising from irrecoverable VAT); and
2. To clarify and further harmonise the VAT rules for financial and insurance services (diminishing the existing discrepancies that exist within the EU).

The contributions to the consultation are expected to feed into the relevant provisions of the VAT directive and into any future proposed changes to the legislation.

Summary of the Key Consultation Points

In summary, the Commission considers that:

- the rules on the VAT treatment of financial and insurance services are believed to be complex and difficult to apply in practice;
- the rules have not kept pace with the developments of new services in the financial industry (fintech services including those linked to cryptocurrencies and e-money);
- this has led to a lack of VAT neutrality, increasing litigation, legal uncertainty, and high administrative and regulatory costs; and
- the rules are interpreted and applied inconsistently by Member States, contributing to distortions within the EU and in dealings with third countries.

The Commission has already attempted to carry out a similar review of the VAT treatment of insurance and financial services which commenced in 2007, however this was later abandoned in 2016 as a result of Member States not being able to agree on the VAT treatment of certain supplies.

However, since then, the ECJ's judgment in DNB Banka (C-326/15) precluded financial services and insurance businesses from applying the VAT cost sharing exemption, this has led to an increase in the cost of irrecoverable VAT in the sector.

The consultation is therefore seeking views from stakeholders on the following policy options:

Area of Intervention	Policy Options Available
Service definitions	Legislative change to definitions; New definitions for 'innovative' services; Non-binding guidelines on the application of the existing definitions
Removal of exemption(s)	Remove all FS and Insurance exemptions, and apply (1) Standard Rate VAT; or (2) Reduced Rate VAT; Retain Insurance exemption and remove FS exemption and apply (1) Standard Rate VAT; or (2) Reduced Rate VAT; Retain Insurance exemptions and FS (Banking) exemption, and apply taxation (1) or (2) to Investment Management services
Cost Sharing Arrangements	Introduce Cost Sharing Arrangements for providers of FS and Insurance
Option to Tax	Require introduction of Option to Tax by all Member States. Option to Tax could be applied either on a transaction-by transaction basis, or a whole entity approach.
Fixed Rate of Deduction	Mandatory fixed rate of deduction; Optional fixed rate of deduction

Implications for Businesses

This is a wide-ranging consultation encompassing some possibilities which could fundamentally change the VAT accounting environment for financial services and insurance providers and whilst the UK is no longer an EU Member State, many of the UK's financial and insurance businesses are multinational, and/or trading with or in competition with EU counterparts. The outcome of the Commission's review will therefore affect those UK businesses to some extent.

It is yet to be seen whether the UK could look to emulate some of the points arising from the EU consultation, or alternatively if there will be a divergence between the EU model of VAT for financial services and the UK model over the coming years.

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Restoring trust in corporate governance – A new regime for internal controls over tax

In brief

The government's much-anticipated policy paper on reforming corporate governance and the audit sector has been released. The paper sets out a package of measures and the government will consult on the proposals over the coming months. This builds on the recommendations arising from the recent Kingman, Brydon and CMA reviews. Of particular interest to the tax community will be the recommendation for the UK to adopt a toughened internal controls regime, akin to the US Sarbanes-Oxley ('SOX') regime.

In detail

In the US, it is widely recognised that SOX has driven a much greater sense of accountability in management for ensuring the effectiveness of a firm's internal controls and, as a consequence, has enhanced them. Other benefits have arguably included an increase in investor confidence, more reliable and resilient financial reporting and increased oversight obligation for the audit committee. Firms that do this well are able to leverage their work to better understand their processes, drive efficiencies and make better use of their technology investments.

Outline of the proposals for internal controls

The policy paper sets out three options for strengthening the UK's internal controls framework, though it acknowledges that these are not mutually exclusive.

- **Option A –** Focus on the responsibility and accountability of directors by requiring them to review and provide an explicit statement about the effectiveness of internal controls and risk management systems.
- **Option B –** Increase transparency of existing work undertaken by auditors on internal controls via the auditor's report.
- **Option C –** Require auditors to provide assurance and a formal opinion on the directors' assessment of the effectiveness of the internal control systems.

Although it does not preclude discussion of alternatives, the government's preference is option A. Such a directors' statement would go beyond the existing requirements of the UK Corporate Governance Code, in that it would require the CEO and CFO, or alternatively the board collectively, to:

- explain the outcome of the annual review of the risk management and internal control systems and make a statement as to whether they consider the systems to have operated effectively;
- disclose the benchmark system, if any, that has been used to make the assessment;
- explain how the directors have assured themselves that it is appropriate to make a statement; and
- if deficiencies have been identified, set out the remedial action that is being taken and over what timeframe.

Unlike the US approach to internal controls which mandates external auditor attestation, in most cases (the 'Section 404' requirement) this approach, per the government's recommendation, would be optional in the UK and left to the directors, the audit committee and shareholders to decide whether such external attestation was required.

We have five key questions for a UK SOX regime:

- **Scope –** What should be the scope? The policy paper does not conclude on whether the directors' statement should cover internal controls over financial reporting only, as it does in the US, or extend beyond to include broader operational and non-financial controls. However, the government would appear to lean towards the former. Any auditor's attestation would logically match the scope of the directors' statement.
- **Application** – To which companies should it apply? The preferred option would see the requirements apply initially to premium listed companies and then be extended after two years to all companies where there is a significant public interest, including large private companies.
- **Standards –** How deep should the framework go? And how rigorous is the documentation, testing and evidence gathering that supports the directors' statement expected to be? On this, the policy paper is relatively silent.
- **Assurance** – Should assurance over the statement be mandated? As noted above, the government's preferred approach would be for this to remain optional. This would appear, in part, to be driven by considerations of internal and external cost.
- **Framework** – What framework should be used? COSO is acknowledged to be tried and tested, though an option is presented to develop a new UK-tailored framework to ensure an emphasis on higher-risk areas.

Tax Internal Controls in an Era of Transparency and Disclosure

Those tasked with managing tax affairs should follow the proposals closely, as many will recall the amount of work that went into adopting US SOX for tax back in 2002. Moreover, tax controls are hard to get right and a survey by the PCAOB as recently as 2016 found that tax accounting in the US was the second leading cause of financial restatements; an average of thirty-six hours was spent on each key control (including design, documentation, and testing); and almost sixty percent of reported tax material weaknesses were attributed to insufficient tax accounting expertise, insufficient review, and lack of general procedures.

Restoring trust in corporate governance – A new regime for internal controls over tax

These findings clearly indicate that tax accounting is a high risk area, but why is this? There are a number of factors that contribute to the heightened level of inherent risk relating to accounting and financial reporting for tax. These include:

- nature and volume of transactions undertaken e.g. certain taxes like VAT are operational in nature and impact nearly every transaction entered into;
- the combination of automated and manual processes;
- complexity driven by the interaction between tax law and accounting rules, such as in respect of financial instruments and withholding taxes;
- high level of management judgement involved in the process;
- complexity driven by tax reporting processes straddling multiple systems and functions across the organisation;
- reliance on upstream processes owned by different teams such as Finance, Operations, HR and Treasury; and
- infrequent operation of controls, potentially quarterly at best.

Given the level of risk and complexity faced, we recommend that firms should implement a robust framework to identify tax reporting risks and design, implement and test key controls, ensuring identified issues are appropriately remediated. This should be integrated as much as possible with the firm's wider tax risk management framework. The key steps that should be followed include:

- **Scoping –** this involves defining materiality thresholds, identifying material locations and processes which impact tax reporting and confirming roles and obligations between the tax team, finance and other areas;
- **Risk assessment –** this involves reviewing end-to-end processes to identify where material tax reporting risks arise. Key areas to focus on include processes that are manual or straddle alternative systems or functions, as well as where material management judgement is applied;
- **Process design and mapping –** this should highlight key steps in the end to end tax reporting processes, identifying where key risks and related controls as well as roles and obligations lie;
- **Controls design effectiveness testing –** the focus here is to ensure that the controls that are in place are designed effectively, mitigate the risks they aim to and that the processes are adequately documented;
- **Controls operating effectiveness testing –** the objective here is, through the testing of controls and other assurance activity, to determine whether controls operate as designed, are evidenced and that any control issues are identified;
- **Issue evaluation and remediation –** this activity involves assessing identified control issues so that they can be prioritised for mitigation, remediation, and, where required, escalation and reporting.

A key factor to consider in delivering on these steps, informed by our experience of the introduction of SOX for tax in the US, is to ensure that the work is done in a proportionate manner so that processes that are put in place are effective but also can be managed efficiently, avoiding excessive administrative overheads and pull on management time.

What happens next?

With the release of the policy paper, the consultation period is now open and stakeholders have until 8 July to provide feedback. This will then lead to some tweaks to the proposed course of action and a legislative timetable. The quickest scenario would be this becoming law this year with staggered implementation timetables for the various measures over a few years. `

The takeaway

Heads of Tax should be following the audit proposals very closely, as many will remember the amount of work that went into adopting US SOX for tax back in 2002. There is of course a discernible distinction between the approach of those who are already subject to SOX and those who are not.

In the meantime, groups may want to look at reviewing their tax internal controls and governance procedures in any event given the general direction of travel and the fact that we expect an increase in tax disputes as a result of governments seeking to reduce rising deficits.

It is also worth monitoring the Making Tax Digital for Corporation Tax agenda as work to address this will impact on the nature of the processes and a broadening control environment for tax.

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Super Deductions – Fixed assets vs intangibles

Overview

The UK Government announced the introduction of the new 'Super Deduction' tax relief in the Spring 2021 Budget. The policy objective is to incentivise businesses to bring forward capital investment expenditure from later periods in order to accelerate UK economic growth over the next 2 years.

In summary, the relief will provide a **130% first year allowance** for expenditure that qualifies for main pool plant and machinery ('P&M') allowances (normally attracting 18% writing down allowances) in the period of expenditure. Additionally, a **50% first year allowance** will be available for expenditure incurred on assets qualifying for special rate pool P&M allowances (normally attracting 6% writing down allowances). The relief provides a significant opportunity to generate additional and accelerated tax relief compared to the existing capital allowances rates.

The relief is only available for a 2 year period commencing 1 April 2021 and there are various qualifying conditions/restrictions which must be considered before making a claim. Accordingly, businesses in the financial services sector will need to assess their eligibility for the Super Deduction over the coming months and consider whether planned/future capital expenditure could be accelerated in order to benefit from this temporary relief.

For businesses in the financial services sector, we expect the Super Deduction to apply to a wide range of projects and investments. This includes projects such as IT/software upgrade programmes, along with expenditure incurred on UK real estate, including office refurbishments, fit-outs, relocations or making space Covid compliant.

Worked examples

Set out below are two worked examples which show how the Super Deductions can be claimed by a business.

Example 1 – Office fit out

A company is incurring £1m on a head office fit out.

Without Super Deductions – Ordinarily P&M allowances would be available on the fit out. For illustrative purposes, assuming £350,000 of the fit out qualifies for main pool P&M allowances and £350,000 qualifies for special rate pool P&M allowances, then this would give £84,000 of P&M allowances to utilise against profit before tax in the year the expenditure is incurred.

Writing down allowances would also be available in future periods on a reducing balance basis. Under the existing rates, the main pool P&M would take approximately 15 years to be fully written down and the special rate pool P&M would take approximately 25 years to be fully written down.

With Super Deductions – The super deduction enables main pool P&M and special rate pool P&M to be claimed at 130% and 50% respectively. Using the same example above, an upfront first year allowance of £630,000 would be available in the year the expenditure is incurred on the fit out.

So, the difference in year 1, assuming a company is in a tax paying position would **be £546,000 (£630,000 – £84,000)** additional tax savings. This excludes factoring in any annual investment allowance and structures and buildings allowances, for simplicity purposes.

Example 2 – intangible expenditure

A company is incurring £10m on a new software project (for example, to develop technical capabilities for IFRS 17). The costs are accounted for as capital expenditure, namely an intangible fixed asset.

Let's assume that £2m of the expenditure is deemed revenue in nature for tax and is eligible for Research and Development expenditure credit. For example, this may include cost incurred in product testing, integration and staff salaries whereby technological uncertainty is being resolved on a project. This leaves £8m which could potentially be deemed capital in nature for tax and in most cases a company will obtain tax relief under the intangibles regime, as the costs are amortised in the P&L.

However, subject to meeting certain conditions, it should be possible to elect to treat the £8m as qualifying for plant and machinery allowances, under CTA2009 s.815.

Without Super Deductions – Ordinarily this would be qualifying main pool expenditure at 18% writing down allowances, which would give £1.44m P&M allowances to utilise against profit before tax in the year. The remaining writing down allowances could be claimed over a circa 15 year period.

With Super Deductions – The super deduction allows main pool P&M to be claimed at 130%. Using the same example above, an upfront first year allowance of £10.4m would be available in the year the expenditure is incurred.

So, the difference in year 1, assuming a company is in a tax paying position would be **£8.96m (£10.4m – £1.44m)** additional tax savings. This excludes factoring in any annual investment allowance for simplicity purposes.

Super Deductions – Fixed assets vs intangibles

Key points

The key points of Super Deductions are summarised below. This is based on our understanding of the draft legislation (which is not yet enacted) and our discussions with HMRC Policy:.

- **Relief for companies only –** The legislation is specifically intended to be limited to companies within the charge to corporation tax. Therefore, LPs and LLPs will not qualify for the relief, even in instances where the partners are companies.
- **Contract dates –** The super-deduction will apply to new expenditure incurred from 1 April 2021 only where contracts for the expenditure are entered into on or after Budget Day (3 March 2021). This point will need careful consideration, including potentially reviewing historical contracts, to determine if the condition is satisfied.
- **Exclusions –** A number of exclusions apply, which will need careful consideration. For example, there are exclusions on cars and assets which are used for leasing.
- **Tracking of assets –** HMRC envisages that clients will need to track assets where they have claimed the super-deduction until their disposals. They acknowledge that this will add administrative obligations and result in potential costs relating to record keeping requirements.
- **Disposals –** To the extent a claim for super deductions has been made, and those assets are disposed of at a later date, disposal receipts may need to be recognised which could 'clawback' any tax relief obtained to date.

Whether to Super Deduct or Not

Claiming Super Deductions on expenditure incurred between April 2021 to 2023 results in an immediate cash tax saving of up to circa 25% (130% x 19% CT tax) for a tax paying business. Deferring the same expenditure post April 2023 would still result in cash tax savings of 25% over time (albeit typically over 15 years in the main pool) following the corporation tax rate increase.

Whilst from a headline perspective, the Super Deductions is a worthwhile tax break, there is more complexity when determining whether a claim should be made on qualifying expenditure. A claim needs to be weighed against other tax incentives including Research and Development tax credits and Patent box relief, whilst factoring the interaction of the extended carry back loss provisions, as well as the impending 25% increase in corporation tax (effective from 1 April 2023). Additionally, consideration will need to be given to the impact this has on accounting profits.

To help with this complex scenario planning, PwC have developed a tech enabled model that illustrates how the incentive regimes interact and how these impact potential spending plans. This automated tool looks at the specific tax drivers and the profile of a business to assess the optimal tax incentives to claim, based on a client's specific business.

If you would like to discuss this further, we are here to help.

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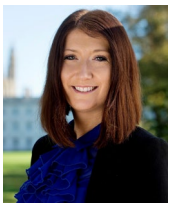

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[1]Note the small company exemption applies to the end user and not the contractor company

Re-structuring your UK property footprint – Tax pitfalls and opportunities for occupier businesses

Some key facts

1. 74% of financial services firms are reviewing their office space needs (CBI/PwC survey – September 2020)
2. 71% have 'repurposing' of property assets on the agenda (PwC Emerging Trends in Real Estate report 2021)
3. 91% of clients agree – there will be a lasting increase in the proportion of time employees spend working remotely (PwC Emerging Trends in Real Estate report 2021)

During recent PwC surveys, it has been highlighted that COVID-19 will likely have had a far greater impact on the commercial property industry than the recent global financial crises. The pandemic will reset market expectations and disrupt the traditional relationship that tenants have with landlords. In addition to different methods of working, other factors such as ESG agendas will drive and change how many occupiers look to procure new property leases for their business going forward.

For the purposes of this article, we will focus on your own UK property footprint (i.e. occupiers and leases/tenanted space). However there are some equally important tax considerations on property leases to consider if you manage property funds, own the freehold of your own premise or are otherwise a landlord.

What will your UK property footprint look like in the future?

Regardless of sector, over the last 12 – 18 months we've increasingly seen occupiers changing, altering and re-imagining their property footprints.

The UK outlook is now looking a little more optimistic, with the Government setting out our roadmap for release from lockdown. This is therefore the perfect time to consider how your workforce will operate in the future. Our conversations with clients indicate that most are expecting their people to return to the office, but for fewer days per week than we've traditionally seen in the past.

Some of the common transactions that we've seen are:

1. **Re-gearing of leases** – tenants committing to longer term leases, in return for more immediate leases inducements (e.g. rent frees or capital contributions to undertake fit-outs during lockdown). This is typically undertaken by means of Surrender and Regrant.
2. **Sale and leasebacks** – for businesses that own the head office, this can be a fairly straightforward way of raising capital, which, given market conditions, has also been beneficial for prospective landlords.
3. **Sub-letting or 'off loading' leases** – both have been more common recently, although 'off loading' by means of lease assignment has been extremely prevalent. Assignments can be 'sales' when consideration is paid; however we are often seeing situations where the current tenants have to pay premiums to prospective tenants to agree to the deal.
4. **Early terminations** – where businesses don't need the space, surrendering leases to a landlord have been commonplace. However, in most cases, occupiers don't realise there may be other legal mechanisms to exit leases than a surrender (many of which can be more tax efficient).
5. **Renegotiations of terms** – there is significant variety in what can be done in renegotiations; we've recently seen everything from a change in payment terms right up to a change in the floor of the building being rented to reduce costs. Each of these has its own complexities and needs to be approached with care.

What are the tax implications of all of this?

The tax implications of transactions involving property leases in the UK are surprisingly complicated. Most scenarios require us to consider; direct tax (corporation tax, income tax, capital gains), indirect tax (VAT), Stamp Taxes, Capital Allowances, the Construction Industry Scheme (CIS), and Business Rates.

In addition to there being many tax implications to consider, tenants and occupiers may not recognise that the different methods to legally document an agreement could completely change the tax analysis. Whilst the potential variations in treatment are numerous and subject to the specifics of each individual transaction, below are a few common 'tax unknowns' which could be relevant:

1. **Re-gearing of leases** – Certain inducements (i.e. capital contributions) can be subject to CIS withholding by the landlord, even when the tenant is using the property wholly for its own business. This requires the tenant to register and recover CIS from HMRC (which can be time consuming).
2. **Sale and leasebacks** – Sale and leasebacks are rarely Transfers of Going Concerns (TOGC) for VAT; they are more likely to be exempt supplies (unless opted to tax). If an exempt supply is made, items in the capital goods scheme (CGS – e.g. fit-outs) require past input VAT recovery to be adjusted (i.e. potentially paying money back to HMRC).
3. **Sub-letting or 'off loading' leases** – If you're assigning a lease and paying a premium to the assignee, these payments are (in most cases) capital and not an enhancement for capital gains. For the recipient, where the lease will be transferred with plant and machinery, any premium received can also become taxable in the year of receipt.

Re-structuring your UK property footprint – Tax pitfalls and opportunities for occupier businesses

What are the tax implications of all of this? (cont'd)

4. **Early terminations** – 'surrender premiums' can cause various headaches on a lease exit for a tenant. These payments are also capital (in most cases) and are not an enhancement for capital gains. There may be other ways to structure exits so that these payments can be more tax efficient.
5. **Renegotiations of terms** – this all depends on legal documentation; the consequences of how a renegotiation is worded vary significantly.

Why consider tax upfront?

The underlying legal documentation will establish the tax treatment nine out of ten times. Where intentions are not clearly documented, this can introduce unnecessary tax filing risks, as the parties need to work out, post deal, how tax rules apply.

In addition, businesses often don't consider the consequences in full until significantly after the deal has been executed. There will also be multiple tax (or associated) filings made after the effective date of a transaction, as illustrated below:

Timeline of the effect of property leases

The consequence and effect of property leases are typically not felt in full until many months after the lease has been agreed, as illustrated below:

Lease signed

Month 0, a lease or agreement for lease is signed, binding the future accounting and tax treatment.

Stamp taxes paid

+0.5 months, Stamp taxes are paid based on the conditions of the lease. Rent will become due (subject to rent holiday).

Fit-out works and inducements

+2 months, You will start adapting the property to your trade. Cash inducements may be received from a landlord and will effect accounting and tax.

Tax provisioning

+0/12 months, For accounting, tax provisions are based on the tax you estimate you will have to pay for the accounting year ahead. This effects how you report to your stakeholders throughout the year.

VAT returns filed

+4 months, VAT returns will be due quarterly and may need to be filed digitally at a local level, increasingly making source data available to tax authorities.

Quarterly tax payments

+4 months, You will need to pay local corporation tax, based on anticipated trading performance. Predicted tax deductions will form a crucial part of this payment.

Accounts filing

+21 months, Local and US accounts will need to be filed and stakeholders informed of trading performance, you need to reasonably predict your tax liabilities and deductions.

Local tax returns filed

+24 months, Detailed local tax computations must be submitted to local tax authorities. A significant part of the deductions will be related to real estate.

US Tax return filed

+24 months, You will submit your US tax computation which will take into account all local liabilities.

Therefore, if tax is involved from the outset, any benefits and problems are identified early, giving the best opportunity to manage these and achieve the best outcome for all parties.

Re-structuring your UK property footprint – Tax pitfalls and opportunities for occupier businesses

Are there any landlord considerations on leases?

Whilst it hasn't been the focus of this article – yes, absolutely.

We have also helped a number of landlords seeking an understanding of the tax implications for their tenants, in light of the current circumstances. As picked up within our client surveyors within the PwC Real Estate Trends 2021 report, a number of clients remarked how occupiers are increasingly expecting landlords to listen and tailor solutions to their requirements.

Next steps for insurers

If this is an active conversation in your business and you are considering restructuring your UK property footprint or thinking about your wider EMEA/global property footprint, regardless of whether you're just starting to think about your options or close to executing a deal, please get in touch with your regular PwC contact or directly with one of the specialists from the Real Estate Deals team listed below who can introduce you to the relevant specialist across our global network.

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Transfer pricing

In brief

On 23 March 2021, HMRC released a public consultation document setting out proposed changes to the UK's transfer pricing (TP) documentation requirements. Two main changes are being considered:

The introduction of mandatory Master File and Local File requirements (in line with the BEPS Action 13 Report) for UK multinational enterprises (MNEs) within the scope of Country by Country (CbC) reporting requirements; and

The introduction of additional disclosures about cross border transactions with associated enterprises to be included in an International Dealings Schedule (IDS) as part of the annual tax return, for all businesses within the scope of UK TP rules.

These proposals could substantially increase the TP compliance obligations for many UK taxpayers, and HMRC has invited contributions from businesses, advisers and representative bodies on "possible options and design ideas which could benefit UK business and HMRC". The consultation period is relatively short, running for 10 weeks with a deadline of 1 June 2021.

The proposals are consistent with the greater focus we are seeing HMRC place on primary evidence, behaviours and governance demonstrated in the preparation of TP documentation. The potential addition of the "evidence log" and IDS could take the UK to the more complex end of the global compliance spectrum for TP documentation.

In detail

Objectives of the proposals

TP continues to be a major source of tax uncertainty for large UK businesses and a significant area of tax risk for HMRC. The objectives of the changes proposed in the consultation document are to:

provide greater certainty for UK businesses around documentation requirements for TP;

provide HMRC with better quality data to enable more efficient and targeted compliance interventions;

provide a platform for discussions between tax advisers and their clients via readily available TP documentation during the preparation of tax returns; and

align the UK's practice more closely with the documentation requirements of other jurisdictions and with the BEPS Action 13 Report, making cross border cooperation more efficient.

Introduction of master file and local file requirements

Whilst HMRC's current guidance references the BEPS Action 13 Report as an example of a standardised approach to TP documentation, and this is generally considered a best practice approach to TP documentation in the UK, there is no formal requirement to prepare TP documentation in this format at present.

The consultation document considers the introduction of a mandatory requirement for UK MNEs within a CbC reporting group (i.e. a group with consolidated group revenues over EUR 750m) to prepare a Group Master File and UK Local File, which would need to be provided to HMRC within 30 days after a request.

The consultation also discusses potential additional requirements, such as an 'evidence log' which could be included as an appendix to the local file to support the key facts on which the TP policies are based. Reference is made to the Profit Diversion Compliance Facility (PDCF) guidance which includes an example evidence log.

The consultation document sets out a number of questions which are focussed on understanding the extent to which the new requirements will increase the compliance burden on taxpayers, or whether the taxpayers within the scope of the new rules are likely to already be preparing documentation in line with the BEPS Action 13 guidance. There are also questions around potential transactional materiality thresholds, and the appropriateness of the proposed 30 day timescale for the production of the TP documentation.

International Dealings Schedule

The introduction of an IDS would be used to report transactional data about intragroup cross border transactions to HMRC in a structured format which could be used for HMRC's risk assessment purposes, enabling them to run analytics and more efficiently identify industry 'outliers' or significant transaction volumes with 'low tax' jurisdictions.

All UK businesses within the scope of UK TP legislation would be required to file an IDS under the current proposal, with potential materiality limits being considered to exclude certain transactions and reduce the potential administrative burden.

The consultation document includes the following types of information that could be within the scope of reporting via an IDS:

- The nature and amount of specific types of transactions
- Details of financial dealings
- Compensation, receipts or payments of a non-financial nature
- Information on restructuring activity
- Information on the TP methodologies applied
- Information on the level and type of supporting documentation for the TP methodology selected and applied
- Counterparty details for transactions including identity and country location
- Information on activities
- Corporate group information (to enable entity level data to be combined and attributed to a particular MNE group).

The questions raised in relation to the IDS proposals are aimed at understanding: the extent to which organisations' accounting / reporting systems are already able to provide TP data; the extent to which the proposals would impact administrative burdens; types of data and information which could be requested through the IDS; relevant experience of similar reporting requirements for other tax authorities; format and structure of the IDS; and approach to determining transactional materiality limits.

Transfer pricing

Key takeaways for insurers

Most insurers within the CbC reporting threshold are already preparing documentation broadly in line with the BEPS Action 13 requirements. In the majority of the cases they are preparing a Master File to meet requirements in other jurisdictions, and a UK report on the main intra-group transactions. Reinsurance is typically well documented, other intra-group transactions (e.g. certain intra-group services or financing) may be less so, and the implementation of the policies is less likely to be tested in these reports. However, overall, those within the scope of the proposed rules should be well equipped to comply with transfer pricing documentation requirements in line with BEPS Action 13.

Given the proposed introduction of an “evidence log” and the increased focus on evidence from HMRC more generally, insurers should consider incorporating evidence reviews into their annual TP processes to test and support the key facts on which TP policies are based. This should be especially considered with regards to reinsurance transactions and, for those in the run-off business, the focus should extend to M&A and investment management activities as well. If an “evidence log” is introduced, there is a question as to how the specific requirements (e.g. structure and breadth of evidence to be gathered) will apply to insurance. It is possible that this may result in an additional burden for all insurers, without adding significant value for HMRC or for those actually facing an enquiry.

Whilst some insurers will be relatively better prepared than others to comply with the proposed introduction of an IDS (of course, this will depend on the type of information requested), for many this may require significant investment in systems and processes to ensure the information required to submit the IDS can be compiled robustly and efficiently each year. This may particularly be the case for those who are not within the scope of CbC reporting requirements and to whom the IDS requirement would also apply. With the recent material investments made by some insurers on preparing for IFRS17, the IDS would need to be flexible enough to allow for the use of data already being prepared in order not to pose further burdens on insurers.

If you would like further information on the proposals, or if you would like to find out how you can provide input in response to the questions raised in the consultation document, please reach out to one of the contacts listed below, or your regular PwC contact.

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