These notes refer to the Taxation (International and Other Provisions) Act 2010 (c.8) which received Royal Assent on 18 March 2010

TAXATION (INTERNATIONAL AND OTHER PROVISIONS) ACT 2010

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 4: Transfer pricing

Chapter 2: Key interpretative provisions

Overview

315. This Chapter explains terms used in Chapter 1, in particular what is meant by participation by a person in the management, control or capital of another person. The term is used in section 148 which defines the "participation condition" for section 147.

Section 149: "Actual provision" and "affected persons"

316. This section gives the meaning for this Part of two terms used in section 147. It is based on paragraphs 4A(7), 11(3) and 14(1) of Schedule 28AA to ICTA.

Section 150: "Transaction" and "series of transactions"

317. This section gives the meaning of "transaction" and "series of transactions" for this Part. It is based on paragraph 3 of Schedule 28AA to ICTA.

Section 151: "Arm's length provision"

318. This section gives the meaning of "arm's length provision" by reference to section 147 and also applies the basic rule where a transaction that has occurred would not in fact have occurred between independent enterprises. It is based on paragraphs 1(3) and 14(1) of Schedule 28AA to ICTA.

Section 152: Arm's length provision where actual provision relates to securities

319. This section deals with what is generally known as "thin capitalisation". It provides that, where a security is issued between connected companies, in applying the basic rule in section 147, 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. It is based on paragraph 1A(1) to (5) of Schedule 28AA to ICTA.

Section 153: Arm's length provision where security issued and guarantee given

320. This section 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 section 147, 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.

Section 154: Interpretation of sections 152 and 153

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

Section 155: "Potential advantage" in relation to United Kingdom taxation

322. This section 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), (7), (8) and (9) of Schedule 28AA to ICTA.

Section 156: "Losses" and "profits"

323. This section explains the meaning of "losses" and "profits" for this Part. It is based on paragraph 14(1) of Schedule 28AA to ICTA, paragraph 5(1) of Schedule 2 to ITTOIA, paragraph 5(1) of Schedule 2 to ITA and paragraph 5(1) of Schedule 2 to CTA 2009.

324. 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 the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) as amended). Although paragraph 14(1) of Schedule 28AA to ICTA was not amended in consequence of the repeal of section 468L of that Act, this section does not include a reference to relief under section 468L as there is now no such relief.

Section 157: Direct participation

325. This section explains what is meant by direct participation in the management, control or capital of another person. It is based on section 808B(9) of ICTA, paragraph 4(1) of Schedule 28AA to ICTA and section 85(6) of FA 1999.

326. "Partnership" in paragraph 4(1) is rewritten in *subsection (2)* as "firm" in accordance with rewrite practice ("firm" is defined for the Part in section 217(8)).

Section 158: Indirect participation: defined by sections 159 to 162

327. This section lists the meanings which apply for each reference to indirect participation in the Act. It is based on section 808B(9) of, and paragraphs 4(2), 4A(1) and (2) and 6(4C) of Schedule 28AA to, ICTA and section 85(6) of FA 1999.

328. Sections 159 to 162 set out four possible meanings of indirect participation in the management, control or capital of another person. Any particular reference to indirect participation has two or three of those meanings.

Section 159: Indirect participation: potential direct participant

329. This section provides for a person to be indirectly participating in the management, control or capital of another if that person would be a direct participant in the other (see section 157) were the person to have the rights and powers listed in *subsection (3)*. It is based on section 808B(9) of, and paragraph 4(2) to (6) and (10) of Schedule 28AA to, ICTA and section 85(6) of FA 1999.

330. *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.

Section 160: Indirect participation: one of several major participants

331. This section provides that a person is indirectly participating in the management, control or capital of another person where a 40% holdings test is met. It is based on

section 808B(9) of, and paragraph 4(2) and (7) to (10) of Schedule 28AA to, ICTA and section 85(6) of FA 1999.

332. For the 40% test to be met two conditions must apply. The first condition is that the person, along with another person, must between them control the body or firm. Then, looking at the holdings, rights and powers that give the pair control of the body or firm, the second condition is that each of the pair must have at least a 40% share of all holdings, rights and powers of the kinds that give them that control. It is possible to read the section (and the source legislation) as saying that each of the pair must merely have a 40% share of their combined stake. This alternative reading would, however, be less favourable to taxpayers and does not reflect the approach that has been taken in HMRC's published International Manual at INTM 432070.

333. "Enterprise" in *subsections (2)* and *(3)* is not defined. It is a term used in Article 9 of the OECD Model Tax 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 section 164 which requires this Part to be read consistently with Article 9.

Section 161: Indirect participation: sections 148 and 175: financing cases

334. Under this section 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.

Section 162: Indirect participation: sections 148 and 175: further financing cases

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

Section 163: Meaning of "connected" in section 159

336. This section gives the meaning of "connected" for section 159 and for *subsection (3)(b)*. It is based on paragraph 4(11) and (12) of Schedule 28AA to ICTA.

Section 164: Part to be interpreted in accordance with OECD principles

337. This section requires the Part to be read in a way that is consistent with the way in which Article 9 of the OECD Model Tax Convention is read when included in a tax treaty entered into by the United Kingdom. It is based on paragraphs 2 and 14(1) of Schedule 28AA to ICTA.

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

339. This section imports into the transfer pricing legislation not only the principles of Article 9 of the OECD Model Tax Convention but also that organisation's 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.

340. 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)*.

341. *Subsection (2)* recognises that paragraph 8 of Schedule 28AA to ICTA is rewritten in Parts 5 (loan relationships) and 7 (derivative contracts) of CTA 2009.