Chartered Institute of Taxation.

Diverted profits tax

Clause 27 (Application of section 124 of TIOPA 2010 in relation to diverted profits tax)
Clause 28 (Diverted profits tax: closure notices etc)

Executive Summary

Diverted profits tax (DPT) was introduced in 2015 at a rate 5% higher than the rate of corporation tax. The intention was that this new tax would incentivise multinationals not to enter into abusive 'profit shifting' arrangements at all and to change their behaviour, resulting in larger amounts of corporation tax being payable, as well as to ensure that multinationals that did divert profits from the UK could nevertheless be subject to UK tax on profits considered to be attributable to the UK.

These clauses make changes to the rules on DPT, both in relation to relief that may be available under double tax treaties and correcting aspects of its interaction with corporation tax. DPT was always intended to interact with and reinforce corporation tax rather than operate independently in its own right.

At the time DPT was introduced, it was dubbed 'the Google tax' and said to be aimed at a small group of aggressive tax avoiders. It has been used much more widely, effectively as a new framework for transfer pricing enquiries. Our members perceive that DPT has had a significant impact on the behaviour of multinational businesses.

1 Background

1.1 Diverted profits tax (DPT) was introduced with effect from 1 April 2015, anticipating the outcome of the 'BEPS Project' (the G20/OECD's efforts at that time to address 'Base Erosion and Profit Shifting'). It was intended to tackle the issue of large multinational enterprises with business activities in the UK who entered into contrived arrangements to divert profits from the UK. This might be by arranging their businesses so as to avoid having a taxable presence in the UK under the terms generally prevailing in double tax treaties, or by making that presence so limited that under internationally agreed transfer pricing principles, only modest profits were allocated to the UK. The DPT legislation is now contained in:

- Part 3 of the Finance Act 2015; and
- Schedule 6 to the Finance Act 2019.

1.2 The rate of DPT was set higher than corporation tax: 25% rather than the 20% rate of corporation tax in 2015[1], and a proposed 31% for DPT rather than 25% for corporation tax from 1 April 2023. Additionally the compliance regime for DPT is tougher - for example there are shorter time limits to notify HMRC about potential liabilities to DPT and any disputed tax needs to be paid while the dispute is in progress.

1.3 HMRC have been clear throughout[2] that the primary purpose of the DPT is not to raise money itself but rather to be used alongside transfer pricing[3] inquiries to incentivise multinationals to change their behaviour so they do not enter into abusive 'profit shifting' arrangements at all, resulting in larger amounts of corporation tax being payable (see further section 4 below).

2 Application of section 124 of TIOPA 2010 in relation to diverted profits tax (clause 27)

2.1 This measure allows relief against DPT to be given where that is necessary to give effect to a decision reached under a Mutual Agreement Procedure (MAP). MAP is a procedure established in relation to double tax treaties whereby the tax authorities of the contracting states to the double tax treaty, who might both be seeking to assess the same profits of a multinational to tax in their jurisdiction, reach an agreement as to where the relevant profits should be taxed by consultation and mutual agreement. Most of the UK's double tax treaties include a MAP article. A request that a particular issue is considered by a MAP can be made by the taxpayer. This measure will be relevant to large multinational enterprises with business activities in the UK who have been subject to DPT, and have sought relief under the MAP of the relevant tax treaty from what they consider to be taxation not in accordance with the treaty.

2.2 Currently, the UK law that gives effect to tax treaties does so only in relation to income tax, capital gains tax and corporation tax (and their foreign equivalents) and does not cover DPT. As DPT was introduced as an entirely new and separate tax, HMRC have argued that the existing double tax treaties do not cover DPT. This position has not yet been tested and the alternative view is that, as a tax on profits, DPT is anyway within the terms of some, if not all treaties. In any event, some companies who have DPT liabilities have applied for access to a treaty's MAP and this has been accepted by the other (non-UK) jurisdiction, resulting in a MAP procedure being undertaken by the UK and the tax authority of the other jurisdiction. This measure will ensure that the UK law gives effect to the conclusion of the MAP, including permitting relief in respect of any DPT paid in respect of profits that are agreed to be taxable in the non-UK jurisdiction. However, tax treaties will still not apply more generally to DPT, so multinationals will not be able to seek to apply the provisions of treaties to DPT independently of the tax authority of the other jurisdiction seeking to tax the profits.

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[1] 55% for ring fenced oil and gas companies (that is 5% higher than the supplementary charge rate of 50% for these companies)

[2] For example see [Transfer Pricing and Diverted Profits Tax statistics, to 2016/17 (publishing.service.gov.uk)]

[3] The UK's transfer pricing rules are intended to ensure that the profits attributed to a UK company are those which the UK company would have made had it been a separate, independent company dealing with the non-UK parts of the group on arm's length terms. Broadly, you look at the activities of the company and determine how much they would have made out of performing those activities for third party customers, not how much they actually did make performing them for the multinational group they are part of. This is to ensure that multinational groups of companies cannot price their activities amongst themselves to ensure that the profits end up in parts of the group that are in low (or no) tax countries. Other countries have similar rules.

2.3 The legislation governing which taxes can be subject to the UK's tax treaty network is at Part 2 of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010). This clause amends Part 2 of the TIOPA 2010 in order to make DPT one of the taxes in respect of which, subject to the terms of the relevant treaty, a MAP outcome can potentially be implemented. Specifically, this clause provides for the application of section 124 Taxation (International and Other Provisions) Act (TIOPA) 2010 (giving effect to solutions to cases and mutual agreements resolving cases) in relation to DPT. The measure will have effect for any MAP decisions involving DPT that are reached after 27 October 2021.

2.4 We welcome this change to the law, which will make it easier for companies to obtain relief where they suffer DPT in the UK as well as taxation on the same profits overseas.

3 Diverted profits tax: closure notices etc (clause 28)

3.1 This clause provides for the proper functioning of the provisions to give relief from DPT where a company makes an amendment to its company tax return and also provides for the proper functioning of the DPT legislation in respect of the interaction between the DPT and corporation tax closure notices.

3.2 This measure legislates to amend sections 101A and 101B of Part 3 of the Finance Act 2015 to ensure that companies can still use those relieving provisions to amend their company tax returns and bring taxable diverted profits into charge to corporation tax during the DPT review period. This measure will also legislate to amend Part 3 of the Finance Act 2015 to ensure that the interaction between DPT review periods and what happens when a corporation tax enquiry is closed functions as intended. Specifically, the measure will ensure that HMRC cannot issue a corporation tax closure notice in respect of profits subject to a DPT charge until after the review period ends.

3.3 The Government say this measure is being introduced to ensure that the DPT legislation functions as intended. will have effect for any DPT review periods which are open at 27 October 2021 or are opened after that date. We welcome the additional clarity as to how the rules operate and interact with corporation tax.

3.4 The change will ensure that relief can be given from DPT where a company makes an amendment to its company tax return so that profits become subject to corporation tax instead. It will also become clear that the only way to for a company to ensure that it pays corporation tax rather than DPT on the 'diverted profits' is for a company to make an amendment to its corporation tax return within the first 14 months of the review period. This also means that if a company does not agree with the transfer pricing position taken by HMRC and wishes to challenge this in litigation, they will be subject to DPT rather than corporation tax if there is eventually an adjustment.

4 Impact and yield of diverted profits tax

4.1 How much has DPT raised? Since it was introduced the total DPT yield[4] has been:
2015-16 £0
2016-17 £138m

[4] Source: Transfer Pricing and Diverted Profits Tax statistics, 2019 to 2020 - GOV.UK (www.gov.uk)

2017-18 £219m
2018-19 £12m
2019-20 £17m

4.2 It is important to note that these are net figures - the difference between DPT charged and DPT refunded. For example, in 2019-20 HMRC received £129 million from DPT charging notices and refunded £112 million charged in prior years. Where DPT is refunded this is usually because an enquiry has been settled on a transfer pricing basis and additional corporation tax has been paid.

4.3 However, as noted in paragraph 1.3 above, DPT is designed to have a deterrent effect, discouraging large companies from trying to minimise their tax liabilities through the use of contrived arrangements, so any assessment of its impact needs to go beyond the yield of DPT itself to consider its behavioural effects and the results in terms of overall increases in tax revenues.

4.4 Initially, the government's figures for DPT yield included both amounts received directly from DPT and additional amounts of corporation tax resulting from behavioural change. The latter included both behavioural change prompted by HMRC compliance activity (for example an inquiry into the business) and 'spontaneous behavioural change' such as changes in transfer pricing arrangements in response to the existence of the DPT. For example, in 2017-18 DPT yield was originally given as £388m, comprising £219m collected through DPT charging notices and £169m collected through behavioural change.[5]

4.5 However, after 2017/18 the Government decided to change their approach to how the yield from DPT is reported, and as a result no longer include additional corporation tax due to DPT-related behavioural change in the DPT yield figures. The notes accompanying the latest figures (2019/20[6]) explain that: '*Due to the close association between DPT and transfer pricing enquiries, we no longer consider this subdivision of transfer pricing yield to be appropriate.'* While HMRC report a total figure for revenue from transfer pricing compliance activity (£1.454 billion in 2019-20) they no longer attempt to identify a specific amount of that yield referable to the DPT. (NB. The figures in paragraph 4.1 are calculated on the new basis, not including additional corporation tax due to behavioural change.)

4.6 HMRC rolled out a Profit Diversion Compliance Facility (PDCF)[7] in early 2019. This involved identifying and writing to specific businesses they believed could be diverting profits away from the UK, encouraging them to pay any additional tax due on the diverted profits, with the incentive that disclosures under the PDCF will be treated as 'unprompted', leading to lower penalties than 'prompted' disclosures made after an enquiry has been launched.

4.7 HMRC considers DPT to have been a success in countering the diversion of profits from the UK and in raising tax yield both directly and indirectly. In November 2020 they published a report setting out how DPT has been used in HMRC's work to make sure that multinational companies pay the right amount of tax in the UK[8]. In the report HMRC state:

[5] Source: Diverted Profits Tax yield: methodological note - GOV.UK (www.gov.uk)

[6] Transparency data overview: Transfer Pricing and Diverted Profits Tax statistics, 2019 to 2020 - GOV.UK (www.gov.uk)

[7] Profit Diversion Compliance Facility - GOV.UK (www.gov.uk)

[8] Tackling profit diversion by multi-national companies - GOV.UK (www.gov.uk)

- DPT has revolutionised their approach in countering contrived arrangements used by some multinational corporations to shift their profits offshore and avoid paying tax in the UK on their economic activities here
- They have seen increases in both Corporation Tax and VAT as DPT starts to have an impact as a behaviour change tool, with the amount of DPT receipts beginning to fall away
- To the end of the 2019-20 tax year around £6 billion had been secured from what it calls the Diverted Profits Project, including:
    - more than £2.6 billion in VAT from businesses restructuring their operations
    - around £3 billion in Corporation Tax where DPT helped settle existing investigations
    - £386 million net from DPT charging notices
- HMRC were at the time carrying out around 100 investigations into multinationals with arrangements to divert profits - the total amount of tax under consideration was £5.3 billion at the end of March 2020

4.8 We commend the analysis of the impact of the DPT and related measures in HMRC's November 2020 report. HMRC should carry out more of this kind of analysis on the impact of new measures (in particular) as a matter of routine.

4.9 CIOT members we have spoken to share HMRC's assessment that DPT has had a significant impact on the behaviour of multinational businesses and that a significant number have changed their arrangements because they considered themselves to be at risk of falling within the (wider than expected – see next paragraph) scope of DPT.

4.10 At the time DPT was introduced, the impression given by the government was that the tax was only aimed at a small group of aggressive tax avoiders and mainly high-tech multinationals: it was dubbed 'the Google tax'. The view among many multinationals today is that it has been used much more widely, effectively as a new framework for transfer pricing enquiries, directed at raising more corporation tax but using initial DPT assessments to make the whole UK corporation tax compliance environment significantly more 'unfriendly'. Most such disputes end with more corporation tax (rather than DPT) payable. Up to 2,000 multinational businesses are considered to be in scope and have been sent nudge letters in respect of the PDCF (discussed at paragraph 4.6 above). HMRC tend to say in response that they are simply reacting to evidence of possible abuse.

4.11 There had been criticisms that the previous compliance regime with multinationals had been too 'cosy'. There is scope for debate about how tough a compliance regime should be. For example, excessive toughness may drive away business without ever raising the revenue to be gained from a more straightforward and open raising of the tax rate; on the other hand an authority which is markedly less aggressive over transfer pricing than other jurisdictions' tax authorities (for example, the German tax authority or the US Internal Revenue Service) risks multinationals declaring more profits in those other countries, if only out of defensiveness. Clearly, any tax authority should keep all this under review and make deliberate shifts from time to time. However, for this to happen as a by-product of something presented as a new tax, targeted at a particular sector, as DPT was, is perhaps a somewhat opaque way of effecting such a change.

5 The Chartered Institute of Taxation

5.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

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