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**Reform of UK law in relation to transfer pricing, permanent establishment and Diverted Profits Tax**

**Response by the Chartered Institute of Taxation**

## 1. Executive Summary

1.1. The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 20,000 members, and extensive volunteer network, in providing our response.

1.2. We welcome the proposed changes. These are a significant step in modernising the UK's approach to international taxation. As a general principle, alignment with the OECD Model and bilateral tax treaties reduces the compliance work for businesses, and the administrative burden for tax authorities.

1.3. Broadly, we welcome the proposed changes to the UK's TP rules, in particular the general exemption for UK:UK transfer pricing. However, the change to the participation rules to allow HMRC to issue a transfer pricing notice determining that there is a participation is not appropriate and should not be necessary. We welcome the alignment of the rules for guarantees with the Chapter X of the TPG, but there is a lack of clarity as to why the treatment of guarantees in relation to the quantum of the borrowing should be treated differently.

1.4. We welcome the aligning of the UK's permanent establishment definition with that in the OECD Model Tax Convention, while simultaneously broadening the investment management exemption to address key concerns that UK-based investment managers might be regarded as constituting permanent establishments of the funds for which they make investment decisions (notwithstanding that the funds have third-party investors). The changes to the investment management exemption make clear that commercial investment structures should not be caught.

1.5. We welcome the repeal of DPT and its integration into CT, via a new charging provision for UTPP, which clarifies the relationship between taxing diverted profits and transfer pricing. It also provides clearer access to treaty benefits. While the necessity for a separate charging provision in this area has lessened over the years, we recognise that the government considers the core features of DPT are what makes the tax an effective tool.

## 2. About us

2.1. 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. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2. 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.

2.3. 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.

2.4. Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

## 3. Introduction

3.1. During 2023 the previous government undertook a consultation on a package of changes to the UK's legislation concerning transfer pricing, permanent establishments and Diverted Profits Tax (DPT). Progress on those changes was delayed by the intervening general election. We welcome the announcements in April 2025 of the next steps in this area, and this consultation on the proposals for reforming transfer pricing, permanent establishment rules and DPT, published alongside draft legislation for stakeholder comments. Abbreviations used in the consultation document are used in this response.

3.2. Overall, we welcome the proposed changes which mark a significant step in modernising the UK's approach to international taxation. Our stated objectives are for a tax system that includes greater simplicity and clarity, so people can understand how much tax they should be paying and why, and greater certainty, so businesses and individuals can plan ahead with confidence, alongside a responsive and competent tax administration, with a minimum of bureaucracy. The proposed reforms set out in the consultation document should help to create simplified, streamlined, and modernised domestic laws while promoting tax certainty. Many of the government's proposals would provide welcome clarity. As a general principle, alignment with the OECD Model and bilateral tax treaties reduces the compliance work for businesses, and the administrative burden for tax authorities. Each incidence of countries doing things differently to the agreed international guidelines reduces the benefit of having reached a global consensus as to what the rules should be and increases the compliance burden for businesses and the administrative burden for tax authorities.

3.3. The reforms in this area are significant, and the process is a good example of collaborative consultation. HMRC has adopted a consultative approach, with open and informative stakeholder events that we welcome and commend. In our view the outcome is a set of changes that are well considered and well understood by stakeholders. We hope that this approach by HMRC continues through implementation and the updating of their guidance.

## 4. Transfer pricing

4.1. **Question 1: The government welcomes views on the proposed amendments to the participation condition, particularly whether the draft legislation will create participation in the intended scenarios**.

4.2. We do not consider the change to the participation rules to allow HMRC to issue a transfer pricing notice determining that there is a participation to be appropriate, nor that it should be necessary. The consultation says that this power is intended to be used 'in rare occasions', and only where there would be participation under Article 9 of the OECD Model Tax Convention, but there is not participation under Part 4 TIOPA 2010. Rather than the proposed transfer pricing notice, the solution should be to ensure that the legislation is clear and does properly capture participation under Article 9 as intended. We do not think that it is appropriate for HMRC to have a power to fill in what they subsequently perceive to be gaps in the legislation.

4.3. In addition, we think it is a missed opportunity to change the rules so that joint ventures are not inevitably included and automatically treated as connected.

4.4. As we said in our response in August 2023[1], currently, joint ventures are treated as connected, with the result that a transaction between a joint venture and a participant is treated as a controlled transaction. In reality, participants in a simple joint venture (say 50/50 ownership) often very robustly negotiate transactions between them and the joint venture, meaning that these are on arm's length terms. It is unnecessarily burdensome to have to treat these transactions as controlled transactions and then to have to demonstrate why they are on arm's length terms, particularly as these transactions are often hard to benchmark. Treating the transaction as a controlled transaction also prevents it from being a comparable uncontrolled price.

4.5. Automatically bringing these transactions within scope of the rules adds an extra piece of transfer pricing work. It would be preferable if the consideration of the arm's length relationship could come at the earlier stage of determining whether the parties are connected. We appreciate that it may not be possible to demonstrate an arm's length relationship where there are more complicated joint venture arrangements, and/or many transactions between the relevant parties. The legislation should be framed so that more complex arrangements are brought within the rules, or if it is not possible to demonstrate an arm's length relationship. But a rebuttal presumption around connectedness would be welcome to take out of scope those transactions where the relationship itself can clearly be demonstrated to be at arm's length.

4.6. Demonstrating that the parties participating in the joint venture are doing so on an arm's length basis, is often a more straightforward transfer pricing analysis (for taxpayers and tax authorities) than the work that must be done if the transactions are deemed to be controlled (which would then involve bench marking and profit split analysis). This approach would also mean that the price of the underlying arm's length transaction may be available to be used as a comparable uncontrolled price, and available as evidence, within the rest of the group.

4.7. **Question 2: The government welcomes views on the draft legislation relating to UK:UK transfer pricing. In particular, comments are invited on whether the proposed test will be simple to apply and the suggested exclusions (which include persons within the charge to income tax).**

4.8. We welcome the approach of having a general exemption from UK-UK transfer pricing where the related parties are both UK tax resident companies subject to CT at the same rate, alongside a list of exclusions where UK-UK transfer pricing will still apply. The list of exclusions is intended to prevent tax arbitrage. This is a better approach to having a rule around identifying a tax advantage that had previously been considered and

[1] 230810 Reform of UK law in relation to TP, PE and PDT - CIOT response

consulted on. This clearer general exemption with specific exclusions should ensure that businesses do not have to undertake significant work to determine whether the exemption can apply to them.

4.9. However, we note that the list of exclusions includes many financial services transactions, including life assurance, banking, investment trusts and securitisation vehicles. It is not clear to us why life insurers with basic life assurance and general annuity business (BLAGAB) are on the list of excluded companies. Most of the exclusions relate to corporates that would be taxed on a different basis to companies paying main rate CT. However, both BLAGAB and non-BLAGAB are taxed at the mainstream rate of CT on a trading basis and shareholder profits are taxed at the main corporation tax rate.

4.10. **Question 3: The government welcomes views on the draft legislation which applies a single valuation standard to transactions involving intangible fixed assets, in particular whether the proposed changes will increase simplicity and certainty.**

4.11. We support the proposed changes as a simplification measure that well help to provide clarity.

4.12. **Question 4: The government welcomes views on the proposed repeal of the requirement for HMRC's Commissioners to sanction transfer pricing determinations.**

4.13. We do not have any comments on question 4.

4.14. **Question 5: The government welcomes views on the proposed amendments to the guarantees and compensating adjustments legislation. In particular, comments are invited on whether those changes increase clarity and alignment with Chapter X of the TPG, and whether any practical difficulties may arise from the changes to compensating adjustment claims, the election for section 192 claims, and the transitional provision.**

4.15. We welcome the proposed changes to the UK rules to align with international standards and to allow the consideration of implicit support in determining the amount and terms of debt available at arm's length. We also welcome the transitional provisions to support long term debt that is already in place.

4.16. However, it is not clear to us why, in relation to guarantees, a distinction has been made between guarantees that lower the rate of interest and guarantees that increase the quantum of borrowing. This approach is inconsistent with the Chapter X of the TPG. Practically, the commercial effects of any guarantee may be hard to discern, and we are unclear as to the mischief that HMRC is seeking to counter by making the distinction. Even if the guarantee can be ascertained to permit a higher level of borrowing, the level of interest being paid will be subject to other UK rules in this area, such as the corporate interest restriction rules, so it is difficult to understand why the higher level of borrowing is necessarily an issue. We would prefer to see fuller alignment with Chapter X of the TPG on this point, as each incidence of countries doing things differently to the agreed international guidelines reduces the benefit of having reached a global consensus as to what the rules should be.

4.17. More generally, it is not clear to us why the level of detail proposed for the UK domestic rules is required to effectively replicate the rules in Chapter X of the TPG. The points are dealt with fully in Chapter X, and it would be preferable for those rules to simply be incorporated by reference to them, rather than to layer domestic rules on top. The proposed approach creates unnecessary complications, requiring a judgement around whether the UK domestic rules are the same as the OECD rules.

4.18. **Question 6: The government welcomes views on the proposed changes to the acting together rules. Specifically, does the draft legislation clarify when borrowers and lenders are 'acting together'? Question 7: The government welcomes views on the draft legislation relating to the loan relationship and derivative contract rules. Question 8: The government welcomes views on the draft legislation relating to exchange gains and losses, including the new matching rules and the proposed documentation requirements.**

4.19. We do not have any specific comments on questions 6 to 8, but would reiterate our view that it is helpful, so far as possible, for the UK's rules on transfer pricing to align with international standards. Any deviation by a jurisdiction from the international standards increases the compliance burden for businesses and the administrative burden for tax authorities.

## 5. Permanent establishment

5.1. **Question 9: The government invites comments on how the OECD guidance on the attribution of profits to permanent establishments has been incorporated into the draft legislation at Part 2, Chapter 4 CTA 2009 and section 1140A CTA 2010. Question 10: The government invites comments on the changes to section 1141 CTA 10 in the draft legislation, including any practical or administrative consequences that are expected to arise from the proposed change to the definition of a DAPE**.

5.2. We accept that aligning the UK domestic PE definition with Article 5 in the 2017 OECD Model would be a simplification for taxpayers and administrators. As we said in our response in August 2023[2], we support the principle of aligning with the OECD Model, because if each country does things differently to the agreed international guidelines, it complicates compliance for taxpayers and reduces the benefit of having reached a global consensus as to what the rules should be. However, we suggest that this adoption of the treaty definition should be limited to the 2017 OECD Model, particularly as it cannot be known in advance how widespread the adoption of any new model would be and whether it would benefit UK businesses and the UK tax base. If the model is changed, a new exercise to evaluate that for suitability should be undertaken. In this regard we note our views previously noted in September 2022[3] and 2023 that the provisions in Article 5 and the new 'preparatory or auxiliary' activities listed have not had much time to bed in.

5.3. The proposed change around attribution of profits, aligning domestic legislation on PE attribution with Article 7, supported by the commentary of the OECD Report on Attribution of Profits to PEs', will provide clarity as to the rules that should apply. It is also reflective of the approach generally already taken by HMRC, and, we understand, is generally supported by larger businesses in the UK. However, we do not agree that this approach necessarily reflects the 'latest international consensus'. The AOA is not universally accepted, and some countries, including those which prefer the UN Model Treaty have not adopted it[4]. A particular concern is that if a non-resident is in an overall loss position, the AOA may still require hypothetical profits to be attributed to its PE.

5.4. We appreciate that there is not a clear, widely accepted alternative and that, therefore, Article 7 and the AOA may be the most pragmatic approach to formally adopt in our domestic law, with the benefits of some international alignment and clarity around approach. But the drawbacks should be recognised. In particular,

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[2] 230810 Reform of UK law in relation to TP, PE and PDT - CIOT response

[3] 220905 Review of treaty policy positions - CIOT response.pdf

[4] Para 1 of the Commentary on Art 7 provides further detail: https://financing.desa.un.org/sites/default/files/2023-05/UN%20Model_2021.pdf

the AOA is likely to be over-engineered and unnecessarily onerous for smaller PEs. The AOA is harder to support in a world where the threshold for PEs is low, and there is a danger of this increasingly becoming the norm, with questions around the extent to which globally mobile workers create small PEs. We are aware that the OECD is currently developing commentary to seek greater clarity around when mobile workers create PEs, and we would encourage the UK government to seek to ensure that changes to the commentary and definition of PEs coming out of this work ensure sensible thresholds for PEs.

5.5. **Question 11: The government invites comments on the repeal of the specific exemption for Lloyd's agents at section 1151 CTA 2010. Question 12: The government invites comments on the extension of the exclusion from Income Tax to the UK trading income of non-resident companies which do not have a permanent establishment.**

5.6. We do not have any specific comments on questions 11 or 12.

5.7. **Question 13: The government invites comments on the definition of 'investment transaction' in the draft legislation, including whether any transactions or persons which would previously have been in scope have been omitted and whether any practical difficulties in applying the definition are anticipated. Question 14: The government invites comments on the proposal to repeal the 20% test (formerly Condition D) and the charging provision in section 1152, including whether this would cause any practical difficulties to businesses previously in scope of the Investment Manager Exemption. Question 15: The government invites comments on the draft amendments to Statement of Practice 1/01, including whether it is consistent with the draft legislation and whether businesses foresee any difficulties in applying the revised guidance in respect of Condition C.**

5.8. Questions 13 – 15: We welcome these changes that should ensure the IME continues to provide an adequate safeguard for investment managers, while also materially simplifying how it operates. However, we are aware that concerns have been raised with you about the proposed definition of 'investment fund'. Specifically, that it does not include asset holding companies that are held by an investment fund. We would be grateful for your confirmation that this concern will be addressed, to enable transactions entered into by those asset holding companies to qualify for the IME.

5.9. **Question 16: The government invites comments on the draft amendments to the capital gains rules for permanent establishments.**

5.10. We do not have any specific comments on question 16.

5.11. **Question 17: The government invites comments on the consequential changes to other parts of the Taxes Acts in the draft permanent establishment legislation including any anticipated changes which appear to have been overlooked.**

5.12. Although we recognise that this is a wider point than the scope of this reform package, we suggest that the income tax test for non-residents trading in the UK in ITTOIA s 6 should also be amended so that this becomes by reference to a PE. The current income tax rules are more obscure and old fashioned and would also benefit from modernisation.

## 6. Diverted Profits Tax and Unassessed Transfer Pricing Profits

6.1. **Question 18: The government invites comments on the interaction between Part 4A TIOPA 2010 and transfer pricing in the draft legislation. Question 19: The government invites comments on the interaction between Part 4A TIOPA 2010 and the CT framework in the draft legislation. Question 20: The government invites comments on the operation of the UTPP assessment process in the draft legislation.**

6.2. We are broadly supportive of the proposals to create a new charging provision for UTPP that will retain the essential features of the DPT regime. While the necessity for a separate charging provision in this area has lessened over the years, because of changes coming out of the BEPS project, including to the TPG, we recognise that the government considers the core features of DPT, such as its higher rate and the preliminary and charging notices, are what makes the tax an effective tool to counter behaviours aimed at diverting profits from the UK and avoiding paying tax on profits that have been generated from activities in the UK.

6.3. There should be clarity that where existing arrangements have been looked at under the existing DPT legislation and found to be compliant, HMRC will not seek to revisit them considering the new legislation. This would reflect the policy intent not to broaden the scope.

6.4. Similarly, as we understand the intent is not to broaden the scope of arrangements targeted, we assume that existing examples in guidance will be maintained. These are helpful in ensuring that both HMRC and taxpayers understand what arrangements may be in scope, what evidence is sufficient to articulate non-tax design drivers and that relevant alternative provisions do not include impacts from outside the group.

6.5. We note the proposed section 217M (Appeal against assessment), and, in particular, section 217M(3), which we understand is to allow a tribunal to uphold HMRC's view of the correct transfer pricing adjustment (albeit only at the otherwise applicable rate of corporation tax rather than the UTPP rate) in a case where the taxpayer is able to establish that either (or both) the tax design condition is not met or there is no effective tax mismatch outcome. That is, in cases where the transfer pricing does not have any of the aggressive features of profit diversion. It seems to us that this creates a risk of excessive use of UTPP assessments, as (unlike the taxpayer, which is faced with accelerated payment and a significantly higher, 31%, tax rate if it fails on appeal) HMRC has no incentive to reach a settlement of a transfer pricing disputes where there may be no more than a genuine disagreement about the arm's length range. The absence of any incentive on HMRC not to issue an UTPP assessment in such a case seems to us to provide an unbalanced outcome because there is no reason for HMRC not to threaten the 31% rate (and are require pre-payment of the disputed tax) in any transfer pricing dispute.

6.6. There is a more general point that HMRC may be able to identify TP issues around foreign tax mismatches through compliance and information channels, including, potentially the proposed International Controlled Transactions Schedule (that is also subject to consultation) and tackle these through the normal transfer pricing enquiry routes. Arguably, this removes the need for the UTPP mechanism. However, as noted above, we recognise that HMRC wants to retain some incentive to discourage aggressive transfer pricing policies and hence wishes to keep the DPT assessment features.

6.7. We welcome the recently reached agreement between the G7 about how the US and global minimum tax rules (Pillar 2) will interact. Also, of course, HMRC are monitoring the US's One Big Beautiful Bill Act and we welcome the withdrawal of section 899. But US concerns about taxes (other than those that implement the Pillar 2 income inclusion rule and undertaxed payments rule) that it sees as discriminatory (notably DSTs, but probably also DPTs) may resurface. Accordingly, this may be an appropriate time to take stock and consider whether UTPP should continue to be described as a direct replacement for DPT. Because DPT appears to have become, in practice, an administrative mechanism for enforcing existing transfer pricing rules by requiring, in a limited range of cases, pre-payment of the disputed tax and a penalty for unsuccessfully taking the case to appeal where there are aggravating factors of an effective tax mismatch in an arrangement that was designed for tax avoidance.

6.8. **Question 21: The government invites comments on the functioning of the ETMO in the draft legislation. Question 22: The government invites comments on whether the legislation provides sufficient time for representations where the other party is a partnership.**

6.9. We do not have any specific comments in response to questions 21 or 22.

6.10. **Question 23: The government invites comments on the operation of the Tax Design Condition in the draft legislation.**

6.11. The proposed tax design condition in section 217E is too widely drafted. Firstly, the approach of the draft section around reasonable assumptions about the provision or arrangements is much wider than a motive test and, secondly, the inclusion of 'any foreign tax' considerably broadens its scope. We understand that there is no intention for the tax design condition to be broader than DPT's Insufficient Economic Substance Condition gateway test, and suggest that the government further considers the draft the tax design condition to ensure that this is the outcome.

6.12. We suggest that the tax design condition should be re-drafted as a 'main or one of the main purposes' test, thus using language that is well understood. This could be framed as considering the purpose of the transaction (rather than of a person).

6.13. Alternatively, consideration could be given to either using language along the lines of the principal purpose test in the BEPS Multilateral Instrument or the test could be based on the provisions in the TPG that address abusive transfer pricing. Either approach would provide an understood motive test and would further align the UK's rules with international ones.

## 7. Acknowledgement of submission

7.1. We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation
4 July 2025