HM Revenue & Customs

Diverted Profits Tax: Guidance

This document updates the interim guidance (published in March 2015) on the Diverted Profits Tax that was introduced in the Finance Act 2015. It replaces all previously published guidance.

30 November 2015

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December 2018

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Foreword to November 2015 Update

In the Autumn Statement of 2014, the Government announced the introduction of the Diverted Profits Tax, designed to counter the use of aggressive tax planning techniques used by multinational enterprises to divert profits from the UK. The legislation was included in the Finance Act 2015, and applies from 1 April 2015.

This guidance note provides details on the Diverted Profits Tax and should be read alongside the legislation, Explanatory Notes and the Tax Information and Impact Note which were published on 24 March 2015. It explains how it works by reference to practical examples and has benefited greatly from suggestions and comments from external stakeholders. We are very grateful for these, although we have not been able to reflect all of them in the revisions at this stage.

It is still early in the implementation of this legislation, which contains a number of novel features. HMRC will continue to review and periodically update this guidance in light of experience and comments made by businesses, advisers and other interested parties. It will, in due course, be incorporated into HMRC's International Manual (INTM). Any comments on the guidance should be sent to divertedprofits.mailbox@hmrc.gsi.gov.uk

We would welcome in particular suggested examples that bring out principles from the legislation.

Chapter 1 - Introduction and overview

Chapter Summary

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DPT1000 - Overview

The Diverted Profits Tax (DPT) is an important new tool to be used to counter profit shifting. It is, however, a closely targeted measure which addresses certain specific arrangements and it should therefore be seen in the context of HMRC's wider strategy to tackle international tax risk.

DPT applies to profits arising from 1 April 2015 and is focused on contrived arrangements designed to erode the UK tax base. Its primary aim is to ensure that the profits taxed in the UK fully reflect the economic activity here: this is consistent with the aims of the OECD Base Erosion and Profit Shifting project. Specifically DPT aims to deter and counteract the diversion of profits from the UK by large groups that either:

(i) seek to avoid creating a UK permanent establishment that would bring a foreign company into the charge to UK Corporation Tax, or

(ii) use arrangements or entities which lack economic substance to exploit tax mismatches either through expenditure or the diversion of income within the group.

DPT is set at a higher rate than corporation tax to encourage those businesses with arrangements within the scope of DPT to change those arrangements and pay corporation tax on profits in line with economic activity.

The requirement to pay the tax "up front" provides a strong incentive for groups to provide timely information about high-risk transactions and how they fit into the group's global operations.

It reduces the information bias inherent in complex cases and promotes full disclosure and constructive early engagement with HMRC.

DPT1010 - Who is affected?

DPT is aimed at large groups (typically multi-national enterprises) that use contrived arrangements to circumvent rules on permanent establishment and transfer pricing. DPT addresses three situations

- a UK company uses entities or transactions that lack economic substance to exploit tax mismatches; or
- a foreign company with a UK-taxable presence (a permanent establishment) uses entities or transactions that lack economic substance to exploit tax mismatches; or

- a person carries on activity in the UK in connection with the supply of goods, services or other property by a foreign company and that activity is designed to ensure that the foreign company does not create a permanent establishment in the UK, and either the main purpose or one of
- the main purposes of the arrangements put in place is to avoid UK tax, or there are arrangements designed to secure a tax mismatch, such that the total tax derived from UK activities is significantly reduced.

Although in many cases the arrangements put in place to divert profits will involve non-UK companies, DPT may also apply in circumstances where wholly domestic structures are used if a UK tax reduction is secured.

The legislation contains some specific exemptions, including for small and medium-sized companies (SMEs), companies with limited UK sales or expenses, and where arrangements give rise to loan relationships only. The exemptions and the situations in which they apply are set out in Chapter 2.

DPT addresses the erosion of the UK tax base by the diversion of profits that have been generated by UK economic activity. Profits which have been diverted from the UK are computed using the same principles which apply for corporation tax, including transfer pricing rules, except where the legislation requires them to be calculated by reference to the arrangements that it is just and reasonable to assume would have been made if tax on income had not been a consideration.

The Finance Act 2016 introduced changes to the rules in respect of the deduction of income tax from payments of royalties. To ensure that these changes cause no advantages to accrue to a person within the charge to diverted profits tax, the calculation of profits diverted from the UK may also include, for accounting periods ending on or after 28 June 2016, an amount equal to payments of royalties and other sums in respect of intellectual property that would have been subject to the deduction of income tax at source had an avoided permanent establishment (PE) been an actual permanent establishment in the UK.

Further information about the application of the DPT legislation, including the detail of the conditions which must be met, examples of the situations to which it applies, and the computation of diverted profit, is given in Chapter 2.

DPT1020 - Customer engagement with HMRC

HMRC is committed to helping its customers get their tax affairs right. Groups potentially affected by DPT are encouraged to engage with HMRC in an open and transparent way to help this process. Chapter 3 contains more information about how to do this.

DPT1030 - The DPT charge

DPT applies to diverted profits arising on or after 1 April 2015. There are apportionment rules for accounting periods that straddle that date.

The normal rate of DPT is 25% of the diverted profit plus any “true-up interest”.

Where taxable diverted profits are ring-fence profits or notional ring-fence profits in the oil sector, DPT is charged at a rate of 55% plus true-up interest.

Finance (No.2) Act 2015 introduced a surcharge of 8% on the taxable profits of banking companies arising on or after 1 January 2016. There are consequential amendments to the DPT legislation to apply DPT at a rate of 33% in cases where taxable diverted profits would have been subject to the surcharge.

Guidance about the computation of the tax, including the availability of credits and its interaction with other taxes, is in Chapter 4.

DPT1040 - Process and procedure

As a tax in its own right, not corporation tax, DPT has its own rules for notification, assessment and payment. DPT is not self-assessed but companies are required to notify HMRC within 3 months of the end of an accounting period in which they are potentially within the scope of the tax and do not meet certain conditions for exemption. There is a tax-geared penalty for failure to do so.

For accounting periods ending on or before 31 March 2016, the notification period is extended to 6 months.

DPT is brought into charge by a designated HMRC officer issuing a charging notice. There are a number of safeguards which provide companies with opportunities to demonstrate that they are not subject to DPT before a charging notice is issued. However, once a tax charge is raised, it must be paid within 30 days of the issue of the notice and payment may not be postponed on any grounds, whether or not the charge is subject to review or appeal. Further tax may become payable by virtue of a supplementary charging notice. If a non-UK resident does not pay the tax due, it may be collected from a related party.

Information about notification, assessment and payment, including interest, penalties, appeals and the interaction with other taxes, is given in Chapter 4.

Information about the procedures HMRC has to follow to impose a charge, including governance procedures, is set out in Chapter 5.

Chapter 2 - Application of Diverted Profits Tax

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- DPT1300 - Involvement of entities or transactions lacking economic substance - section 80 & 81
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PART 1: Legislation – Finance Act 2015 - Core Provisions

DPT1100 - Overview of Diverted Profits Tax

Sections 80 and 81 relate to cases where a company with an existing UK taxable presence is party to arrangements involving entities or transactions that lack economic substance. In these cases the calculation of taxable diverted profits follows the rules set out in sections 82 to 85 while section 96 explains how those profits are estimated for the purposes of preliminary and charging notices.

Section 86 deals with cases where a foreign company avoids carrying on a trade in the UK through a UK PE in circumstances where either the mismatch condition applies, because provision is made or imposed between the foreign company and entities where either the transactions or entities lack economic substance, or where there are tax avoidance arrangements. In these cases the calculation of taxable diverted profits follows the rules set out in sections 88 to 91 while section 97 explains how those profits are estimated for the purposes of preliminary and charging notices.

DPT1110 - Section 80 - Involvement of entities or transactions lacking economic substance - Situation 1 – UK company (see also DPT1300)

A UK resident company may incur a charge to DPT if it is party to an arrangement meeting the specific conditions set out in section 80. The rules operate by reference to the concept of "provision", which is consistent with the description of "provision" in the transfer pricing rules at Part 4 TIOPA 2010 (see INTM412050). The provision must be made or imposed between a UK resident company and another person. "Person" is explained further in INTM412030.

The conditions set out in section 80 are that:

- there is a company (C) that is UK resident and another person (P) whether or not UK resident;
- __provision ("the material provision") has been made or imposed as between C and P by means of a transaction or series of transactions (DPT1115);
- C and P are connected in accordance with the participation condition (DPT1170);
- the material provision must result in "an effective tax mismatch outcome" between C and P (DPT1180);
- the effective tax mismatch outcome is not an excepted loan relationship outcome (DPT1116);
- the "insufficient economic substance condition" is met (DPT1190);
- C and P are not both small or medium-sized enterprises within the definition of section 172 TIOPA 2010 (INTM412080) (DPT1117).

DPT1115 - Transaction or series of transactions

"The material provision" must be made or imposed as between C and P by means of a transaction or series of transactions. "Transaction" has the same meaning as in the transfer pricing rules at Part 4 TIOPA 2010 (see INTM412050), and includes arrangements, understandings and mutual practices (whether or not they are legally enforceable).

Similarly the meaning of a series of transactions is consistent with section 150 TIOPA and a series exists whether or not:

- there is a transaction in the series to which both connected persons are party

- the arrangements by which the series of transactions are entered into are between the two connected persons
- there is a transaction in the series to which neither connected person is a party.

"Arrangement" means any scheme or arrangement of any kind (whether or not they are legally enforceable or intended to be so).

This wide definition means that provision may be made between C and P even if it is done so indirectly through a series of transactions some of which may involve third parties.

DPT1116 - Section 80 exceptions - Excepted loan relationship outcome

An effective tax mismatch outcome is an excepted loan relationship outcome if it arises wholly from either:

- anything that would produce debits or credits under Part 5 of CTA 2009 if a party to it was within the charge to corporation tax, or
- a loan relationship and a derivative contract entered into entirely as a hedge of risk in connection with the loan relationship.

The existence of a loan relationship, or loan relationships, within the material provision that gives rise to an effective tax mismatch outcome does not of course automatically mean that the outcome is excepted. It must arise wholly from the loan relationship(s) and /or hedging contract.

Example: Excepted loan relationship rule

Company A is a UK resident company that has a group financing subsidiary resident in a low tax territory. The group financing company is a Controlled Foreign Company within the finance company partial exemption rules.

Company Z (a non-UK resident company in the same group as Company A) requires debt funding for the purposes of its trade. For the last two years Company A has provided this funding through a long-term loan, but now arranges to terminate the loan early and injects equity into the group financing company which then on lends the funds to Company Z.

Provision has been made or imposed as between Company A and group finance company, which is effectively given the opportunity to lend its capital to Company Z. There is an effective tax mismatch outcome on the basis that there is a reduction in A's taxable income giving a reduction in the amount of corporation tax payable that we assume here exceeds the resulting increase in relevant taxes payable by the group finance company . However, this tax mismatch outcome arises wholly from a matter (i.e. the intragroup loan) that is within the excepted loan relationship rule. Hence, the excepted loan relationship outcome rule means that this arrangement is not within scope of DPT.

DPT1117 – Section 80 exceptions - Small or medium-sized enterprises ("SMEs")

Any provision between the two parties C and P is exempted if both C and P meet the definition for SMEs at section 172 TIOPA 2010. This definition contains some important modifications to the EU definition (2003/361/EC) of SMEs. For example the EU definition allows a period of grace for a SME, meaning that if it falls within a definition of large enterprise for a single accounting period, it maintains its SME status for that accounting period. This period of grace does not apply for the purposes of the DPT SME

exclusion. Instead, section 172 TIOPA 2010 applies, with the result that if a company falls within the definition of a large enterprise for a single accounting period it is treated as a large enterprise for that accounting period.

DPT1118 - Application to Partnerships

Where the UK company is a member of a partnership, any provision made or imposed between the partnership and another person is treated as made or imposed between the company and that other person.

DPT1120 - Section 81 - Involvement of entities or transactions lacking economic substance - Extension to foreign companies with a UK permanent establishment - Situation 2 (see DPT1300)

The second situation where a DPT charge may arise is set out in section 81. This is an extension to the first situation, applying where a non-UK resident company ("the foreign company") trades through a UK permanent establishment ("UKPE"). The section 80 rules are extended and adapted by section 81 so that they can work in the same way as for UK resident companies.

For this purpose, UKPE is treated as a separate UK resident company under the control of the foreign company and as having entered into any transaction or series of transactions entered into by the foreign company, to the extent that they are relevant to the computation of UKPE's chargeable profits for corporation tax.

In order for DPT to apply in this situation the following basic conditions must be met:

- Chapter 4 of Part 2 CTA 2009 applies to determine the chargeable profits of the foreign company, and
- if the UKPE were a distinct and separate person under the same control as the foreign company, section 80 would have applied to the UKPE.

Whether the material provision results in an effective tax mismatch outcome (DPT1180) and whether the insufficient economic substance condition is met (DPT1190) are considered based on the treatment of the UKPE as a separate UK resident company as described above.

The section 80 exemptions for excepted loan relationship outcomes and SMEs also apply to section 81.

DPT1130 - Consequences of section 80 or 81 applying

There is a distinction between the calculation of the initial estimated charge and its final determination. The initial estimated charge is calculated in accordance with section 96 and charged by a charging notice (see DPT2110 - 2150). The tax charged in the charging notice may not be postponed on any grounds, and must be paid within 30 days after the date the notice is issued. The guidance in the following paragraphs sets out how the ultimate charge is determined. Guidance on the calculation of the initial estimated charge is at DPT1139. Guidance on other aspects of the process of issuing a charging notice is in Chapter 4 of this guidance.

There are three ways in which taxable diverted profits (if any) may be determined in a case where the conditions of section 80 or 81 are met, depending on the details of the material provision and the transfer pricing treatment that has been adopted. These are covered by three sections in the legislation: 83, 84 and 85. Section 82 sets out the key expressions used in those sections. Section 83 sets out where no taxable diverted profits arise, section 84 where the calculation is by reference to the actual provision and section 85 where the calculation is by reference, at least in part, to the relevant alternative provision. The terms actual provision condition and relevant alternative provision are explained below.

DPT1132 - Consequences of section 80 or 81 applying: key definitions

Sections 83 to 85 employ concepts that are first introduced in section 82. The key terms are:

"The relevant alternative provision": This means the alternative provision that it is just and reasonable to assume would have been made or imposed, as between the relevant company and any connected ~~company~~companies, instead of the material provision, had tax on income not been a relevant consideration for any person at any time. The words "at any time" are designed to prevent companies from arguing that current (non-tax) synergies that were not anticipated when the structure was planned or implemented should be taken into account when determining whether the material provision in question would have been undertaken had tax not been a consideration. In other words, current unforeseen non-tax benefits cannot be used to justify historic and ongoing avoidance. An example illustration of the relevant alternative provision is outlined in DPT1330.

In some cases, had tax not been a consideration, no transactions at all would have been undertaken. The legislation makes clear that this is to be treated as an alternative provision.

"The actual provision condition" is met if the material provision results in the relevant company having expenses that would (ignoring any transfer pricing disallowance) be allowable in its tax computation and the relevant alternative provision:

- would also have resulted in allowable expenses of the relevant company of the same type and for the same purpose as the actual expenses (that give rise to or contribute to the effective tax mismatch outcome), and
- would not have resulted in "relevant taxable income" of a connected company.

So, for example, the actual provision condition would be met if a company incurs an actual royalty expense for use of an asset and the relevant alternative provision would also have resulted in the company paying a royalty for access to an equivalent asset, even if the contractual framework would have been structured differently, the amount would have differed and/or it would not have been payable to the same person. In addition, for this condition to be met, the relevant alternative provision must be a provision that would not have resulted in relevant taxable income of a company connected with the relevant company.

"Relevant taxable income" means income of a company connected with the relevant company which would have resulted from the relevant alternative provision and would have been within the charge to corporation tax less expenses that would have been incurred in earning that income.

DPT1134 - Consequences of section 80 or 81 applying: section 83: cases where no taxable diverted profits arise

Section 83 applies where the actual provision condition is met (that is, both the material provision and the relevant alternative provision would have resulted in expenses of the same type and for the same purpose and also would not have resulted in relevant taxable income) and either there are no diverted profits or there are diverted profits but the relevant company makes full transfer pricing adjustments before the end of the review period.

Where section 83 applies, no taxable diverted profits will arise to the relevant company for the accounting period.

This means that where the actual provision condition is met there will be no taxable diverted profits if the actual transactions have been correctly priced, or, despite their being incorrectly priced (as compared with the position at arm's length), the company has made transfer pricing adjustments, before the end of the review period, that put it in the same tax position as if arm's length pricing had been used.

DPT1136 - Consequences of section 80 or 81 applying: section 84: calculation by reference to the actual provision

If section 83 does not apply, section 84 applies where the actual provision condition is met (that is, both the material provision and the relevant alternative provision would have resulted in expenses of the same type and for the same purpose (even if paid to a different person) and also would not have resulted in relevant taxable income), but the relevant company i.e. the one making the payment, has not made the full transfer pricing adjustment.

Where section 84 applies, taxable diverted profits equal the amount which is chargeable to CT by virtue of Part 4 of TIOPA 2010 (transfer pricing) or which, in a case where section 81 applies, are attributable to the UKPE under sections 20 to 32 of CTA 2009 (profit attribution to UK permanent establishments) less any adjustment in respect of these amounts that the relevant company includes in its corporation tax return by the end of the review period.

It follows that a charge under section 84 will only arise if the payments are excessive by reference to the arm's length rate, and the company does not take remedial action under transfer pricing rules.

The actual provision condition avoids unnecessary complications in situations where the relevant alternative provision would not result in any greater level of reward to the UK than the actual provision priced on the basis of the arm's length principle. For example UK Company A's business might depend on the use of an IP asset which is held by a group company (B) that has little substance in terms of functionality and which is resident in a low tax territory. If all the functions around development, enhancement and exploitation had been carried out by other non-UK resident group companies there might be considerable doubt as to the exact form of the relevant alternative provision, other than that it would involve the UK company in making payments of the same type and for the same purpose as the actual payments to the company that owns the IP. Under section 84 the issue is to determine the price that would have been paid by an unconnected party in the position of the UK Company A to the owner of the IP in the position of Company B, without hypothesising any changes to the structure of the arrangements. The contributions of the other non-UK group companies would be reflected in the value of what B provides to A.

DPT1138 - Consequences of section 80 or 81 applying: section 85: calculation by reference to the relevant alternative provision

Section 85 applies where the actual provision condition is not met. That is, either the relevant alternative provision would not have resulted in expenses of the same type and for the same purpose or would have resulted in relevant taxable income (or both).

Where section 85 applies, the taxable diverted profits are to be determined as if the relevant alternative provision had been made or imposed.

However, if the only reason the actual provision condition is not met is that the relevant alternative provision would have resulted in relevant taxable income, then the taxable diverted profits that arise to the relevant company, in relation to a particular material provision, will be an amount equal to the sum of relevant taxable income and any additional amounts, over and above those in the company's CT return, from transfer pricing adjustments, i.e. transfer pricing adjustments based on the material provision.

Otherwise, the taxable diverted profits will be the sum of the relevant taxable income (if any) plus the "notional additional amount." The notional additional amount is, in relation to the particular material provision being considered, the amount that would have been chargeable to CT had the relevant alternative provision been made or imposed less the amount included by the company in its corporation tax return in respect of the actual material provision and which is chargeable to CT by virtue of Part 4 of TIOPA 2010 or which, in a case where section 81 applies, are attributable to the UKPE under sections 20 to 32 of CTA 2009.

So, for example it may be the case that as a result of the material provision a UK company pays a royalty or other expense to an affiliate in a territory where no tax is paid in respect of an asset held there, but that the relevant alternative provision would have resulted in the UK company holding that asset itself, i.e. that there would have been no provision (on the basis that the main reason for the affiliate holding the asset is to secure the tax reduction). If so then the taxable diverted profits of the UK company would be: the profits to which it would have been chargeable to CT on the basis of the relevant alternative provision (i.e. that the UK company held the asset itself and no royalty was payable); LESS the profits to which it is chargeable to CT taking account of any transfer pricing adjustment in the company's CT return made before the end of the review period.

However, the notional additional amount would be at least the full amount of the royalty less any excess element adjusted for under transfer pricing rules. The DPT charge could only be eliminated in full in the event that the transfer pricing adjustment reduced the royalty to nil.

Taxable diverted profits would also arise where the relevant alternative provision would have resulted ~~in the~~a company being in receipt of relevant taxable income. For example, a UK company may use an asset that is located in a territory where no tax is paid which absent the contrived arrangement would have been held by another UK connected company. If, under the relevant alternative provision, the UK company would have paid a royalty to the other UK company for the use of that asset then that royalty income is to be added to the taxable diverted profits of the first UK company for the purposes of calculating the DPT.

This will be the case for as long as the relevant alternative provision would have continued to operate. In circumstances where the relevant alternative provision would have ceased to apply, the position is examined on the basis of the then applicable facts. The relevant alternative provision has no impact on the application of taxes other than DPT.

Example 1 UK Company A pays a royalty to a subsidiary in a low tax regime for the use of an asset held there. A's pre royalty profits are £50m and the deduction claimed in its accounts for the royalty is £20m, giving it taxable profits, as originally returned, of £30m. On consideration of the facts and circumstances HMRC concludes that the relevant alternative provision would have resulted in Company A holding the asset itself and that no royalty would have been paid.

During the review period the group agrees that the arm's length price for the royalty is £12m and adjusts A's CT return accordingly, increasing its taxable profits to £38m.

Based on the relevant alternative provision A would not have made a royalty payment for the use of the asset so the actual provision condition does not apply. The taxable diverted profits are therefore the amount by which the amount in respect of which A would have been chargeable to CT for the period had the relevant alternative provision been made or imposed instead of the material provision i.e. £~~50m~~20m exceeds the amount in respect of which the company Is chargeable to CT following transfer pricing adjustments made i.e. £~~38m~~8m, resulting in taxable diverted profits of £12m less an amount in respect of expenses it would be just and reasonable to assume would have been incurred by A in holding the asset. It should be noted that the profits chargeable to CT also increase by £8m. In this case there is no relevant taxable income.

Example 2

The facts are the same as example 1 except that consideration of the facts and circumstances leads HMRC to conclude that the relevant alternative provision would have resulted in a separate UK Company B holding the asset and charging royalties for its use to other group companies.

During the review period the group agrees that the arm's length price for the royalty is £12m and adjusts A's CT return accordingly, increasing its taxable profits to £38m.

Based on the relevant alternative provision A would have had expenses for which a deduction would be allowed for corporation tax purposes and the relevant alternative provision would also have resulted in expenses for Company A of the same type and for the same purpose as the material provision. However, the relevant alternative provision would result in the royalty being paid to B and which would be relevant taxable income within the meaning of section 82(8). Therefore, the taxable diverted profits will be calculated by reference to the relevant alternative provision but in accordance with section 85(3) and (4).

A's taxable diverted profits are the sum of the profits in respect of which A is chargeable to corporation tax following the application of the TP rules to the material provision, but which are not taken account of in an assessment to CT before the end of the review period plus the relevant taxable income of a connected company. In this case Company A has made an adjustment to its self-assessment to properly give effect to the TP rules. As the company has adjusted its return within the review period this element of diverted taxable profits is nil. In addition Company B has relevant taxable income of £12m less expenses which would have been incurred by Company B in earning that income.

On this basis A's total taxable diverted profits are £12m less an amount in respect of expenses it would be just and reasonable to assume would have been incurred by B.

DPT1139 - Estimating profits for notices – section 80 or 81 case

Section 96 applies for the purpose of estimating the taxable diverted profits to be included in a notice in a section 80 or 81 case. The basic rule is that the designated officer is to make a best of judgment estimate of the amount that is chargeable in accordance with sections 84 or 85.

However, specific rules apply for determining the estimated charge where the "inflated expenses condition" is met. Under these rules there is an upfront 30% disallowance of payments that have been routed through the contrived arrangements and are relevant to the calculation of taxable diverted profits.

The inflated expenses condition is met if:

- the material provision results in expenses of the company for which a deduction has been taken into account for corporation tax purposes;
- those expenses, or part of them, are responsible for the effective tax mismatch outcome (DPT1180); and
- as a result the designated officer considers that those expenses, or part of them, might exceed an arm's length amount.

If the condition is met, the amount of the relevant expenses that would have been taken into account in estimating the taxable diverted profits in the notice are to be reduced by 30%, without regard to the transfer pricing rules in Part 4 of TIOPA.

However, the company may have made an adjustment to the deduction for the expenses under Part 4 of TIOPA 2010 (transfer pricing) in calculating its profits for corporation tax in a return made before the notice is issued. If this is the case any reduction in the amount of the deduction would be taken into account in applying the 30% reduction but not so as to reduce the amount below nil.

The calculation of the diverted profits can be adjusted during the review period, on the basis of evidence received, by the issue of either a supplementary charging notice or an amending notice (DPT2180 / 2190). -If so then the special rules for making estimated calculations are ignored when computing the amount of taxable diverted profits to be included in such a notice.

The inflated expenses condition can be applied only if either the actual provision condition is met or the only reason that the condition is not met is that the relevant alternative provision would have resulted in relevant taxable income. In any other case – i.e. where the relevant alternative provision would not have resulted in the relevant company incurring expenses of the same type and for the same purpose - the

designated HMRC officer will issue the notice based on a best estimate of the additional profits arising under the relevant alternative provision.

Example of inflated expenses condition where there is relevant taxable income

A UK resident company is making rental payments for a valuable asset used by it in the course of its trade to a connected UK company that owns the asset. The ownership of the asset is subsequently transferred to an affiliate in a low tax territory, and the rental payments are then increased, on the alleged grounds that with the change of ownership the group is taking the opportunity to review the rental payments and move them to current market rates.

The mismatch condition is met and it is also assumed that the insufficient economic substance test is met. It should be assumed that, in this case, the actual provision condition would be met but for the fact that the relevant alternative provision would have resulted in relevant taxable income for a connected UK company – the original owner of the asset which continues to manage it. In consequence of those facts, and taking into account the increase in rentals at the time of transfer to the low tax territory, it is likely to be reasonable for the designated officer to conclude that the inflated expenses condition is met. Accordingly, the initial estimated charge to taxable diverted profits will be equal to

- 30% of the rental payment,
- less any amount adjusted by the company under Part 4 of TIOPA 2010 and included in its tax return before the notice is issued.

Plus

the rent which would have been received by the UK connected company (which would also take into account the inflated expenses condition adjustment).

DPT1140 - Section 86 - avoidance of a UK taxable presence – Situation 3 (see DPT1310)

Section 86 of the legislation can apply where foreign companies make substantial sales through activity in the UK while avoiding the creation of a UK permanent establishment (PE). Such arrangements are often combined with other arrangements that allow the foreign company to transfer profits associated with those sales to companies resident in territories where little or no tax is paid. (These arrangements are sometimes given names such as “double Irish” in the press and tax publications, but there are many variations.)

The legislation seeks to identify these cases by identifying whether economic activity takes place in the UK in connection with the supply of services, goods or other property by a foreign company, but structured in a way so as to ensure that the foreign company is not carrying on a trade in the UK for corporation tax purposes. This includes, for example, arrangements involving significant sales activity in the UK, but designed to stop short of the conclusion of contracts.

Section 5(2) CTA 2009 (Territorial scope of charge), states that a non-UK resident company is within the charge to CT only if it carries on a trade in the UK through a PE in the UK. The meaning of PE is defined at paragraph 24 Chapter 2 CTA 2010 but the domestic law definition is restricted by any narrower definition given in a tax treaty in force between the UK and the country of residence of the foreign company.

Section 86 applies where the following conditions are met:

- there is a company, that carries on a trade, that is not resident in the UK (the “foreign company”);

- a person ("the avoided PE") is carrying on an activity in the UK in connection with the supplies of services, goods or other property by the foreign company in the course of its trade. It does not matter if that person is a UK resident;
- it is reasonable to assume that the activity of the avoided PE or the foreign company (or both) is designed so as to ensure that the foreign company does not, for the purposes of corporation tax, carry on the trade referred to in the first bullet in the UK (whether or not it is also designed
- to secure any commercial or other object). In practice, because of the effect of section 5(2) CTA 2009 mentioned above, this means that the activity is designed so as to ensure that the foreign company is not treated as carrying on a trade through a UK PE;

and

- the avoided PE and the foreign company are not small or medium sized enterprises, as defined by Section 172 TIOPA 2010 (INTM412080).

For it to be reasonable to assume that activity is designed to ensure that the foreign company is not carrying on a trade through a UK PE there will be some degree of contrivance in the arrangements present in the accounting period, irrespective of the accounting period in which that contrivance was designed. They will differ in some material way to the arrangements that we would expect to have been made if there had been no considerations around the PE threshold.

In addition either or both of the following conditions must be met:

- the mismatch condition (which is based on the section 80 rules described at DPT1110), or

  the tax avoidance condition.

These two conditions are described at DPT1150/1151.

DPT1141 – Section 86 - exceptions independent agents, etc.

Section 86(5)(a) provides an exception from a charge under section 86 where the activity of the 'avoided PE' is within either:

- section 1142 CTA 2010 – agent of independent status (INTM264080), subject to the qualification described below, or
- section 1144 CTA 2010 – alternative finance arrangements so that the foreign company would not be regarded as having a PE in the UK. This recognises that activity may be designed to some extent so as to ensure that these provisions apply, which might create uncertainty as to the potential application of section 86.

The exception will only apply where an agent acting on behalf of the company has and habitually exercises authority to do business on behalf of the company in accordance with section 1141 (1)(b) CTA 2010. Subject to the following paragraph it only applies if the foreign company and the avoided PE are not connected, within the meaning of section 1122 CTA 2010 at any time within the accounting period.

However, section 86(5)(b) extends the exception at section 86(5)(a) to connected parties where the 'avoided PE' is regarded as an agent of independent status within section 1142(1) CTA 2010 because it meets the conditions at section 1145 CTA 2010 (Independent Broker), section 1146 CTA 2010 ("investment manager exemption" (IME)) or section 1151 CTA 2010 (Lloyd's agents) (INTM269010).

For investment managers the exception will only apply where the arrangements fall within section 1142 /

1144 CTA 2010 and the foreign company is not connected with 'the avoided PE', or where the IME applies.

The application of the IME at section 1146 CTA 2010 is itself subject to there being an investment transaction carried out on behalf of a non-UK resident company.

HMRC is aware that there will be many cases where a foreign company appoints a connected investment adviser in the UK that cannot fall within the IME because the terms of the appointment do not include discretionary authority to execute business on behalf of the foreign company. In these circumstances section 86(5)(b) will not apply to give the comfort of exception from section 86.

Such an arrangement is not likely to give rise to a DPT charge under section 86 if it is reasonable to assume that the relationship between the foreign company and the investment adviser would have met the IME conditions had discretionary authority been given. Where that was the case it would be unlikely that the relevant activity could be regarded as designed so as to ensure that the foreign company does not carry on its trade in the UK for the purpose of corporation tax, as is required by section 86(1)(e) in order for section 86 to apply.

On a wider point in relation to the financial sector, a foreign company may appoint a UK manager / adviser whose activities are restricted because of regulatory constraints - most obviously a lack of regulatory authority to carry out transactions. As a result it is not uncommon for services agreements to explicitly acknowledge that the manager / adviser is not authorised to do business on behalf of the foreign company or hold itself out as being able to do so.

Where a company is unable to obtain regulatory authority to perform certain activities and this directly leads to limitations imposed or agreed this should normally be regarded as pointing away from those limitations constituting design to ensure that the foreign company does not carry on its trade in the UK for the purpose of corporation tax.

DPT1142 – Section 86 exceptions - companies with limited UK-related sales or expenses There

is also an exception at section 87 where:

- the foreign company's total UK-related sales revenues (subject to conditions in relation to those of connected companies) in a 12-month accounting period are no greater than £10 million; and / or
- the foreign company's total UK-related expenses (subject to conditions in relation to those of connected companies) in a 12-month accounting period are no greater than £1 million.

If the accounting period is shorter the thresholds are reduced proportionately. This exception is discussed in more detail at DPT1155.

DPT1143– Section 86 exceptions- SMEs

Section 86 will not apply where the avoided PE and the foreign company are both SMEs. The same definitions are used as in section 80 – see DPT1110.

DPT1150 – Section 86 – the mismatch condition

The mismatch condition is intended to apply to cases that involve entities or transactions lacking economic substance, and is similar to the rule in section 80 applicable to UK companies. The condition is met if:

- in connection with the supplies of the goods, services, etc., arrangements are in place as a result of which provision ("the material provision") is made or imposed as between the foreign company and another person ("A") by means of a transaction or series of transactions,
- the participation condition is met in relation to the foreign company and A (DPT1170),
- the material provision results in an effective tax mismatch outcome as between the foreign company and A (DPT1180),
- the insufficient economic substance condition is met (DPT1190),
- the effective tax mismatch outcome is not an excepted loan relationship outcome see DPT1110,
- the foreign company and A are not both SMEs. The same definitions are used as in section 80 – see DPT1110.

DPT 1151 – Section 86 - the tax avoidance condition

This condition is met if, in connection with the supply of services, goods or other property, arrangements are in place one of the main purposes of which is to avoid or reduce a charge to corporation tax in the UK.

The legislation does not define what is meant by 'main purpose' or 'one of the main purposes'. These expressions are to be given their normal meaning as ordinary English words. They have to be applied objectively, having regard to the full context and facts.

It will usually be clear whether trying to obtain a tax advantage is 'one of the main purposes' of a particular arrangement. Such would be the case, for example, where the arrangement would not have been carried out at all were it not for the opportunity to obtain the tax advantage, or where any non-tax objective was secondary to the benefit of obtaining the tax advantage.

HMRC would seek to apply this rule if the company has put in place arrangements that separate the substance of its activities from where the business is formally done, with a view to ensuring that it avoids the creation of a UK PE and it is clear that doing so has resulted in a saving of UK corporation tax.

DPT 1152 – Section 86 - application to partnerships

Where the foreign company is a member of a partnership, references in section 86 to a trade being carried on by the company or to a company supplying services, goods or other property include cases where the partnership carries on the trade or makes the supplies. Also, for the purpose of the mismatch condition, any provision made or imposed between the partnership and another person is treated as made or imposed between the company and that other person.

DPT1155 – Section 87 - exception for limited UK-related sales or expenses

<u>UK-related sales</u>

In order to focus the operation of section 86 ("avoidance of a UK taxable presence") on situations where there is a substantial level of economic activity in the UK there is an exception based on the level of a foreign company's sales that are related to activity in the UK. Where those sales revenues of the foreign company taken together with certain sales revenues of connected companies are no more than £10 million in a 12-month accounting period, section 86 cannot apply.

This threshold is reduced proportionally if the accounting period is less than 12 months. In considering "connected" companies' sales, the connection definition follows section 1122 CTA 2010.

Section 87 provides definitions in relation to this exception, starting with "UK activity", meaning activity carried on in the UK in connection with supplies of services, goods or other property made by the foreign company (the supplies that are relevant to section 86). "UK-related sales revenue" means, for the foreign company, its revenues from "UK-related supplies" (see below), together with the trading revenue of connected companies so far as they arise from UK activity and are not taken into account in calculating the profits of those companies for corporation tax purposes.

So, if a company connected with the foreign company makes sales that are included in its corporation tax computation, either because it is UK-resident or is carrying on a trade through a UK PE, these will not be included. This helps the condition focus on the relevant UK activity in cases where a group may already have a substantial taxable presence in the UK in relation to a separate activity.

"UK related supplies" are supplies of services, goods or other property made by the foreign company or a connected company that relate to UK activity.

There may be some doubt as to the extent to which sales revenues of a company connected with the foreign company relate in some way to the activity carried on in the UK in connection with the supplies made by the foreign company in the course of its trade. The wording of the definition of UK activity at section 87(5) mirrors that of section 86(1)(c) and is broad in its scope. However where there is clearly no connection at all between the UK activity taken into account for the trade of the foreign company that is tested for section 86 and the activity that would be taken into account in relation to the revenues of the connected company, the latter would not be brought in by the definition.

Example 1:

Company X in country X heads a group engaged in a diverse range of activities. Its subsidiaries include Company Y in country Y and Company Z in country Z. Company Y sells household goods, under the Y brand name, to UK retailers. It has a subsidiary in the UK that carries on activity in connection with those supplies. Company Z sells specialist building materials, under the Z brand name, to UK construction companies and builders merchants. It has a subsidiary in the UK that carries on activity in connection with those supplies. The operations of Companies Y and Z are completely independent of each other, as are those of their two UK subsidiaries. In testing the UK-related sales revenues of Company Y there is no need to take account of those of Company Z (and vice-versa).

However, even in diverse groups, there may in practice often be considerations such as shared facilities, use of the same brand names or the similarity of the activities and markets that would not support the same conclusion.

The requirement to include the UK-related sales revenues of companies connected with the foreign company is not just aimed at deliberate fragmentation to achieve an amount below the threshold, so there is no motive test. The requirement should also reduce the scope for the exception applying in different ways depending on the detail of particular group structures.

Example 2:

Company A in country A heads a group engaged in the manufacture and sale of perfumes and cosmetics. It has a subsidiary in the UK that carries on activity in connection with supplies totalling £17m in the accounting period in question, well above the threshold for the limited UK-related sales exception.

A group headed by Company B in country B manufactures and sells a similar range of products. However for the last ten years Company B has had two subsidiaries in country C – Company C, which distributes cosmetics and Company P, which distributes perfumes. There is another subsidiary in the UK that carries on activity in connection with supplies totalling £9m of cosmetics for Company C and £8m of perfumes for Company P. In testing the UK-related sales revenues of Company C it is necessary to take account of those of Company P (and vice-versa). So the total UK-related sales revenues for the purposes of testing the application of the section 87 exception to either company, will be £17m.

UK-related expenses There is also an exception from section 86 based on the level of "UK-related expenses". This means expenses that relate to UK activity. The exception applies if such expenses of the foreign company, together with those of companies it is connected with, do not exceed £1m. Again this threshold applies for a 12-month accounting period and is reduced proportionally if the accounting period is shorter. The principles in relation to the requirement to take account of the UK-related expenses of connected companies are the same as for UK-related sales revenues.

For the purposes of the exceptions, both revenues and expenses are amounts that are recognised as such in the company's profit and loss account or income statement in accordance with generally accepted accounting practice (GAAP). GAAP takes its section 1127 CTA 2010 meaning, which is either UK GAAP or GAAP under International Accounting Standards.

If there are no accounts following GAAP, as defined, then the amounts are what would have been recognised as revenues and expenses if such accounts had been drawn up.

DPT1160 - consequences of section 86 applying

There is a distinction between the calculation of the provisional charge and its final determination. The initial estimated charge is calculated in accordance with section 97 by the issue of a charging notice. The tax charged in this notice may not be postponed on any grounds, and must be paid within 30 days after the date the notice is issued (DPT2270). The guidance in the following paragraphs sets out how the ultimate charge is determined. Guidance on the calculation of the initial estimated charge is at DPT1169 and guidance on other aspects of the charging notice is in Chapter 4 of this guidance.

There are three ways in which taxable diverted profits may be determined in a case where the conditions in section 86 are met, covered by three sections in the legislation: 89, 90 and 91. Section 89 sets out how profits are calculated where the tax avoidance condition (but not the mismatch condition) is met. Section 90 applies where the mismatch condition is met but profits are calculated by reference to the actual provision. Section 91 applies where the mismatch condition is met and profits are calculated by reference to the relevant alternative provision.

DPT1162 - Consequences of section 86 applying: section 88: key definitions

Sections 89 to 91 employ concepts that are first introduced in section 88. The key terms are:

- "The notional PE profits": This means-:
  - the profits which would have been the chargeable profits of the foreign company, attributable in accordance with sections 20 to 32 CTA 2009, had the avoided PE been an actual PE in the UK through which the foreign company carried on the trade.—-; and
  - for accounting periods ending on or after 28 June 2016, any amount equal to the total of royalties or other sums which are paid by the foreign company during that period in connection with that trade, in circumstances where the payment avoids the application of Section 906 of the Income Tax Act 2007 (duty to deduct tax).
- "The relevant alternative provision": This means the alternative provision that it is just and reasonable to assume would have been made, rather than the material provision, as between the foreign company and any connected companycompanies had tax on income not been a relevant consideration for any person at any time. The words "at any time" are designed to prevent companies from arguing that current (non-tax) synergies that were not anticipated when the structure was planned or implemented should be taken into account when determining whether the material provision in question would have been undertaken

had tax not been a consideration. In other words, current unforeseen non-tax benefits cannot be used to justify historic and ongoing avoidance. In some cases, had tax not been a consideration, no transactions at all would have been undertaken. The legislation makes clear that this is to be treated as an alternative provision.

- "The actual provision condition" is met if the material provision results in expenses of the foreign company for which (ignoring Part 4 of TIOPA 2010) a deduction for allowable expenses would be allowable in computing what would have been the notional PE profits for the accounting period and the relevant alternative provision would also have resulted in the foreign company having expenses that would (ignoring any transfer pricing disallowance) be allowable in its tax computation and the relevant alternative provision:
  - would also have resulted in allowable expenses of the relevant company of the same type and for the same purpose as the actual expenses, and
  - would not have resulted in "relevant taxable income" of a connected company.

  So, for example, the actual provision condition would be met if the foreign company incurs an actual royalty expense for use of an asset and the relevant alternative provision would also have resulted in the company paying a royalty for the use of the same asset, even if the amount would have differed or not been payable to the same person. In addition, for this condition to be met, the relevant alternative provision must not have resulted in relevant taxable income of a company connected with the foreign company.

- "Relevant taxable income" means income of a company connected with the foreign company which would have resulted from the relevant alternative provision and would have been within the charge to corporation tax less expenses that would have been incurred in earning that income.

DPT1164 - Consequences of section 86 applying: section 89: calculation of profits where only tax avoidance condition is met

Section 89 applies where section 86 applies but the mismatch condition is not met. This means that the tax avoidance condition must be met.

Where section 89 applies, taxable diverted profits will be an amount equal to the notional PE profits.

DPT1166 - Consequences of section 86 applying: section 90: mismatch condition is met: calculation by reference to the actual provision

Section 90 applies where the mismatch condition is met and the actual provision condition is also met (that is, both the material provision and the relevant alternative provision would have resulted in expenses of the same type and for the same purpose and also would not have resulted in relevant taxable income).

Where section 90 applies taxable diverted profits are an amount equal to the notional PE profits.

DPT1168 - Consequences of section 86 applying: section 91: mismatch condition is met: calculation by reference to the relevant alternative provision

Section 91 applies where the mismatch condition is met but the actual provision condition is not met. That is, either the relevant alternative provision would not have resulted in expenses of the same type and for the same purpose or the actual provision condition would have applied but for the fact that the relevant alternative provision resulted in relevant taxable income ~~(or both)~~.

Where section 91 applies the taxable diverted profits are to be determined as if the relevant alternative provision had been made or imposed.

However, if the only reason the actual provision condition is not met is that the relevant alternative provision would have resulted in relevant taxable income, then the taxable diverted profits that arise to the foreign company will be the sum of the notional PE profits and an amount equal to the relevant taxable income.

Otherwise, the taxable diverted profits will be the sum of the following amounts:

- relevant taxable income (if any) and
- what would have been the notional PE profits of the foreign company had the relevant alternative provision been made instead of the material provision.

DPT1169 - Estimating profits for notices - section 86 cases

Section 97 applies for the purpose of estimating the taxable diverted profits to be included in a notice in a section 86 case. The basic rule is that the designated officer is to make a best of judgment estimate of the amount that is chargeable in accordance with section 86.

However, as in section 96 (companies with an existing UK taxable presence), specific rules for determining the estimated charge apply if the "inflated expenses condition" is met. This condition is particularly aimed at "double Irish" –type structures where profits deriving from UK-based sales activity ultimately flow to a territory where little or no tax is paid on them. The existence of these features means that in practice it is very likely that the amount of royalty or other payment flowing through them is inflated above an arm's length rate.

Under these rules there is an upfront 30% disallowance of payments that have been routed through the contrived arrangements and are relevant to the calculation of taxable diverted profits. The inflated expenses condition is met if:

- the mismatch condition is met (DPT1150)
- the material provision results in expenses of the foreign company that would be taken into account as a deduction in computing the notional PE profits for corporation tax purposes, if a UK permanent establishment existed (ignoring any adjustment that would be due under Part 4 TIOPA 2010 (transfer pricing));
- those expenses, or part of them, result in the effective tax mismatch outcome (DPT1180); and
- as a result the designated officer considers that those expenses, or part of them, might exceed an arm's length amount.

If this condition is met, the amount of the relevant expenses that would have been taken into account in estimating the taxable diverted profits in the notice are to be reduced by 30%, without reference to transfer pricing rules. The inflated expenses condition can be applied only if the actual provision condition is met or if the only reason that condition is not met is that the relevant alternative provision would have resulted in relevant taxable income. Otherwise the designated HMRC officer will issue the notice based on a best estimate of the profits arising under the relevant alternative provision. The inflated expenses condition is likely to be met if:

- an expense such as a royalty paid by the foreign company for use of an asset gives rise to tax relief and that asset has been deliberately located in a territory where no or little tax is paid on the royalty income, and
- that asset is essential to the business of the foreign company, such that even if tax had never been a relevant consideration (and in consequence the asset would have been held in a

normal rate tax territory) the foreign company would still have had to pay a royalty for the asset's use.

In these circumstances it's likely that the tax-driven nature of the arrangements would lead the designated officer to conclude that the royalty expense might be inflated. If so then in calculating the estimated profits of the avoided PE 30% of the expense under the actual material provision is disallowed.

The computation of taxable diverted profits would start from the amount of sales generated by the UKbased sales activity. It would normally be expected that if the foreign company had been trading through a permanent establishment in the UK, some part of the payments of the IP royalties would be set against the sales income. However the payments and the arrangements around them would be tested against all the conditions described above. If the conditions are met then the deduction that would otherwise be included in the calculation would be reduced by 30%.

If the activity carried on in the UK was selling products, or providing services, to customers of the foreign company it may be that the price paid to another group company for the products or services includes embedded royalties. If the arrangements around such royalties met the required conditions but those for the rest of the product or service price did not then it would be appropriate to apply the 30% adjustment only to that element of the expense.

For accounting periods ending on or after 28 June 2016, the notional profit also includes any amount equal to the total of royalties or other sums which are paid by the foreign company during that period in connection with that trade, where the payment avoids the application of Section 906 of the Income Tax Act 2007 (duty to deduct tax).

The calculation of the diverted profits can be adjusted during the review period, on the basis of evidence received, by the issue of either a supplementary charging notice or an amending notice. If so then the special rules for making estimated calculations are ignored when computing the amount of taxable diverted profits to be included in such a notice.

DPT1170 – The participation condition

Application of the DPT in the first and second situations (described at DPT1110 and DPT1120) is subject to the participation condition being met in relation to the persons between which the material provision is made or imposed ("C" and "P").

For the purposes of the third situation ("Avoidance of a UK Taxable Presence") (DPT1140) there is no participation condition in section 86 between the foreign company and the avoided PE. However there is a participation condition requirement between the foreign company and "A" (another person) in the mismatch condition (see DPT1150).

So for the purposes of applying the participation condition to the third situation (the section 86 mismatch condition) the "first party" is the foreign company and the second party "A". For the purposes of applying the participation condition to the first and second situations (section 80 and therefore through the relevant adaptation, section 81) the "first party" is "C" and the second party "P".

For the purpose of DPT, the participation condition is worded in a similar way to the condition in the transfer pricing rules at section 148 TIOPA 2010 (INTM 412060). It therefore requires one of the persons to be directly or indirectly participating in the management, control or capital of the other, or a third person to be participating in the management, control or capital of both. There are separate conditions (A and B) relating to financing arrangements and provisions which are not financing arrangements.

Financing arrangements are defined widely as those made for providing or guaranteeing or otherwise in connection with any debt, capital or other form of finance. The condition in relation to financing arrangements considers not only the position at the time the material provision was made or imposed, but also for a six-month period from that time.

The first and second parties are "the relevant parties" for conditions A and B.

DPT1171 - The participation condition A: financing arrangements

The condition is met if at the time of making or imposing the material provision or within a period of ~~6~~six months beginning with the date the material position is made or imposed,

- one of the relevant parties was directly or indirectly participating in the management, control or capital of the other, or
- the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the relevant persons.

DPT 1172 - The participation condition B: non financing arrangements

The condition is met if at the time of making or imposing the material provision,

- one of the relevant parties was directly or indirectly participating in the management, control or capital of the other, or
- the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the relevant persons.

The detail of the meaning of "direct participation" and "indirect participation" is given at sections 157 to 163 TIOPA 2010 (see INTM 412060) and the relevant elements of these sections are brought into the DPT rules.

DPT1180 – The effective tax mismatch outcome

For section 80 or 81 to apply the material provision must give an effective tax mismatch outcome. Such an outcome is also one of the requirements of the mismatch condition at section 86 ("avoidance of a UK taxable presence") see DPT1140. The detail of the calculation of taxable diverted profits in a section 86 case and the relevant section that applies, also depends on whether or not the material provision results in an effective tax mismatch outcome.

References to "first party" and "second party" below relate to the following for each of the situations described at DPT1110/1120.

Situation	First Party	Second Party
UK resident company (section 80)	UK resident company (C)	Another person (P)
UK PE of non-resident company (section 81)	UK permanent establishment (C)	Another person (P)
avoided UK taxable presence (section 86)	Foreign company	Another person (A)

References to "relevant tax" are to corporation tax, oil and gas supplementary charge tax, income tax or any non-UK tax on income. Non-UK tax has the meaning at section 187 CTA 2010.

There is an effective tax mismatch outcome if the material provision results in the following:

- expenses of the first party for which a deduction is allowable for a relevant tax and/or a reduction in income that would otherwise have been taken into account by the first party in computing its liability for a relevant tax, and
- the reduction in the first party's liability to a relevant tax exceeds any resulting increase in the relevant taxes payable by the second party for the corresponding accounting period and
- the above results are not "exempted", and
- the second party does not meet "the 80% payment test".

References in the DPT rules to "the tax reduction" (for example, in the insufficient economic substance condition) are to the amount of the excess of the first party's tax reduction over the second party's increased liability. It does not matter whether this reduction has occurred as a result of different tax rates, the operation of a relief, the exclusion of any amount from a charge to tax, or otherwise.

The rules concerning corresponding accounting periods are at section 113.

Because the test focuses on relevant taxes payable by the second party there are circumstances in which an effective tax mismatch outcome can technically arise although there has not actually been a tax reduction to the group as a whole. This may occur, for example, where the second party is part of a tax consolidation group or where its profits are subject to a particular regime such as the Non-Resident Landlords Scheme (see DPT1360).

However the existence of an effective tax mismatch outcome will not in itself give rise to a charge to diverted profits tax. It is always necessary to consider the interaction between the effective tax mismatch outcome and the insufficient economic substance condition at section 110 (see DPT1190+). The basis of that condition is whether it is reasonable to assume that arrangements were designed to achieve the tax reduction established by applying sections 107 and 108. Such an assumption is unlikely to be a reasonable one where it can be seen that there is no actual tax reduction to the group and there would have been no expectation of such a reduction. (See also Chapter 4 – DPT2310 CFC Charges.)

If there is still any uncertainty around this for any reason it may be useful to move on to consider how the rules concerned with the consequences of sections 80,81 or 86 applying would be expected to apply, should the effective tax mismatch outcome and insufficient economic substance conditions be met.

DPT1181 – Effective tax mismatch outcome - reduction in the income of the first party

In most cases it should be clear whether the material provision results in "expenses of the first party", but it may be more difficult to know whether it results in "a reduction in the income of the first party that would otherwise have been taken into account …" Such a reduction in income may relate to an arrangement to net an expense against income, but also where income itself is diverted~~.~~ and the first party's income is reduced to less than it would receive under arm's length conditions.

A situation that could be in scope would be where a UK company transfers an asset with an established income stream to an affiliate in a low tax jurisdiction and that affiliate, because of its own lack of substance, relies on the UK company to manage the asset. The material provision is not just made by the transfer of the asset but also by the transaction under which the UK provides the functions needed to develop, enhance, maintain, protect and exploit the asset. This of course results in income to the UK company, but less than either; what would have been the case if the asset had not been transferred, or if the transaction had been calculated in accordance with the arm's length principle.

DPT1182 – Effective tax mismatch outcome - exempted payments

An effective tax mismatch outcome is exempt if it arises solely from payments to certain bodies (charities, pension schemes, persons exempt from tax by reason of sovereign immunity, and funds the

investors in which are charities, pension schemes or sovereign-immune persons) where they meet the criteria of the legislation.

These exemptions are meant to ensure that genuine commercial arrangements involving such parties in the circumstances outlined are not impacted. In any cases where these exemptions are exploited in order to facilitate profit diversion HMRC will seek to deny the benefit of the exemption, including where appropriate through use of the General Anti-Abuse Rule (GAAR).

More generally, HMRC would seek to apply anti-avoidance provisions, including the GAAR, to contrived attempts to circumvent the diverted profits tax legislation.

DPT1183 – Effective tax mismatch outcome the 80% payment test

This test ensures that the legislation applies only if the tax reduction resulting from the material provision is substantial. It is met (i.e. there is no effective tax mismatch outcome) if the increase in the second party's liability to relevant taxes is at least 80% of the reduction in the amount of relevant tax payable by the first party.

DPT1185 - Effective tax mismatch outcome - quantifying the tax reduction

The reduction in the first party's liability to a relevant tax is measured by:

A x TR Where:

"A" is the sum of –

- If there are expenses of the first party the lower of those expenses and the amount of the tax deduction secured for them (so any "super deduction" given under , for example, a tax incentive regime is ignored) and
- any reduction in income of the first party.

"TR" is the rate at which those profits would be chargeable to the relevant tax for the accounting period.

The increase in the relevant taxes to be paid (and not refunded) by the second party for the corresponding accounting period is calculated on the assumptions that:

- the second party had income for that period equal to A as a result of the material provision;
- any deduction or relief (apart from "qualifying loss relief" or a "qualifying deduction" (see below)) in determining the second party's actual liability to relevant tax as a result of the material provision is deducted from that income; and
- all reasonable steps have been taken to minimise the amount of tax for which the second party is liable in the country or territory in question (apart from in relation to qualifying loss relief or a qualifying deduction).

The reasonable steps from the third assumption include claiming or otherwise securing the benefit of, reliefs, deductions, reductions or allowances and making elections for tax purposes.

Tax that falls to be paid by the second party is taken to include withholding tax on payments made to it (to the extent that such tax is not refunded).

Tax is treated as refunded to the extent that a repayment or payment in respect of credit for tax is made to any person, directly or indirectly in respect of tax payable by the second party. However a refunded

amount is ignored to the extent that it results from qualifying loss relief obtained by the second party. A "qualifying deduction" is one made in respect of the second party's actual expenditure that does not arise directly from the making or imposition of the material provision. It must be of a kind for which the first party would have obtained a deduction against a relevant tax if it had incurred the expenditure and it must not exceed the amount that the first party would have obtained.

For example, as part of a material provision, the second party acquires IP from the first party and then charges royalties to the first party for its continued use. The second party amortises the amount paid for the IP, which is allowable as a deduction in computing the second party's liability. This is not a qualifying deduction because it arises from the making of the material provision.

"Qualifying loss relief" is any permissible means of using a loss for corporation tax purposes to reduce the amount on which the second party is charged to tax. For a non-UK resident company it is any corresponding means of using a loss to reduce the second party's liability to a tax corresponding to corporation tax. Those losses may either be those of the second party or ones surrendered to it by another company.

Where the second party is a partnership, references to the second party's liability to tax for effective mismatch outcome purposes include liabilities of all members of the partnership to the tax.

The quantum of "the tax reduction" is relevant to the insufficient economic substance condition (DPT1190). Only the increases/decreases in liability that result from the material provision itself are taken into account, not those from separate provisions.

The effect of the rules on qualifying deductions and qualifying loss relief is to give a consistent comparison between the tax positions of the two parties. If the first party pays 100 to the second party for something that costs the second party 95 to provide then the comparison would not be expected to be between the tax effect on the first party of its paying 100 and the tax payable by the second party on a net 5. As long as the 95 costs of the second party meets the criteria of a qualifying deduction the comparison is between two amounts of 100. However if in another situation the second party was only taxed on 50 of the 100 because of some particular relief for 50 given in its country of residence that does not meet the qualifying deduction criteria then the comparison will be between the first party's reduction of tax on expenditure of 100 and what would have been the second party's liability to relevant tax had its taxable income been 50.

Similarly with loss relief, a reduction below 100 in the taxation of the receipt would not be taken into account to the extent that it relates to qualifying loss relief. But a loss is a qualifying one only if it corresponds to a loss for which the first party could have obtained relief, so a loss that could be utilised under the law applicable to the second party but not to the first would not qualify.

If, for example, the first party is a UK company making a payment to a non-UK resident group company that has no resulting increase in relevant taxes because it can set off brought forward losses of other group companies as well as its own against the relevant profits, only the element of loss relief that corresponds to what would be eligible under the UK rules would be qualifying loss relief.

Effective tax mismatch outcome - Example 1

Company X is resident in country X and pays corporation tax on its profits at 15%. It makes royalty payments to another group company, Company Y, in country Y, that holds intellectual property (IP) used by Company X. Country Y does not charge corporation tax on Company Y's profits.

In an accounting period the gross royalty payments total $100m and are subjected to withholding tax at 5%.

As a result of "the material provision" Company X's expenses are increased by $100m. Its liability to tax is reduced by $15m (the increase in expenses multiplied by the rate that Company X's profits would be chargeable, based on the required assumptions). No account is taken of any income that Company X receives as a result of its use of the IP.

The increase in Company Y's total liability for the purpose of the test is the $5m withholding tax that it is treated as having paid.

The tax reduction is therefore $15m - $5m = $10m. Therefore the 80% payment test is not met and there is an effective tax mismatch outcome.

-

Example 2

Company X is resident in country X and pays corporate income tax on its profits at 25%. It makes royalty payments to another group company Y in country Y, that holds intellectual property (IP) used by Company X. Country Y charges corporate income tax at 24% on Company Y's profits.

In an accounting period the gross royalty payments total $100m and are not subject to withholding tax.

As a result of "the material provision" Company X's expenses are increased by $100m. Its liability to tax is reduced by $25m (the increase in expenses multiplied by the rate that Company X's profits would be chargeable, based on the required assumptions). In the same accounting period Company Y has the benefit of losses to cover all of its profits within the meaning of qualifying loss relief. So if Company's Y income for the period is taken to be $100m and no account is taken of the loss relief its increase in relevant taxes payable would be $24m (i.e. 96% of the resulting reduction for the first party, Company X). Therefore the 80% payment test is met and there is no effective tax mismatch outcome.

DPT1190 - The insufficient economic substance condition - overview

The arrangements to which the legislation can apply are ones that lack economic substance and are designed to reduce tax. For example, the legislation may apply where an asset with an existing income stream is transferred by a UK company to an affiliate in a low tax territory, if no income generation activity is performed in that territory.

It is not intended that the DPT legislation will apply purely because a company decides to take advantage of lower tax rates offered by another territory by means of a wholesale transfer of the economic activity needed to generate the associated income.

The central consideration is whether it is reasonable to assume that the arrangements in question were designed to secure a tax reduction established by the tax mismatch outcome condition. Consistent with the interpretation of section 86(1)(e) (see DPT1140), for arrangements to be considered as designed to secure the tax reduction for the insufficient economic substance condition there will be some degree of contrivance. The arrangements will differ in some material way to those that would have been made if not for the opportunity to achieve the tax mismatch outcome.

DPT1191 – The insufficient economic substance - detail

The insufficient economic substance condition is a further condition to be met in order for sections 80, 81, or the mismatch condition in avoided PE cases within section 86, to apply. It refers to "the first party" and "the second party", these terms taking the same meaning as in the effective tax mismatch outcome rules (see DPT 1180). The condition can be met in any one (or more) of three ways. In each of them the starting point is whether it is reasonable to assume that the transaction(s) or the involvement of a person in the transaction(s) was or were designed to secure the tax reduction (as defined through the effective tax mismatch outcome rule). There are two transaction based tests, only one of which needs to be considered depending on whether the tax reduction is referable to a single transaction or to any one or more of the transactions in a series (see DPT1115). The other test is referred to here as the entity based test as it relates to the involvement of a "person" (see DPT1110) in the transaction(s).

The transaction based tests

The first of the two transaction based tests can apply where the effective tax mismatch outcome is referable to a single transaction, if it is reasonable to assume that the transaction was designed to secure the tax reduction.

However the condition will not be met in this way if it was reasonable to assume at the time the material provision was made or imposed, and taking into account all accounting periods for which the transaction was to have effect, that, for the first party and the second party taken together, the non-tax financial benefit of the transaction would be greater than the financial benefit of the tax reduction. It is not necessary to consider this comparison unless it is reasonable to assume that the transaction was designed to secure the tax reduction. However in some cases the considerations around the extent of the non-tax financial benefits in relation to the size of the tax reduction may help with those around "design" and may also point towards what the consequences of meeting the insufficient economic substance test might be in terms of calculating any taxable diverted profits. The level of non-tax commercial benefits will be an important factor in considering any relevant alternative provision (see DPT1132/1138).

The same test is adopted, with the same principles applying, where the effective tax mismatch outcome is referable to any one or more transactions in a series, so that it applies to that transaction or those transactions.

The consideration in relation to the design of the transaction(s) must take into account what would have been anticipated at the outset. If, for example, it was anticipated that a particular transaction would generate substantial additional profits but it turns out to be loss-making, that would not in itself point to the condition being met.

Where arrangements have changed over time since they were originally put in place careful consideration may need to be given to the question of what the material provision is and when it was made or imposed, with reference to the specific facts of the case.

It is not the amount of the transaction, or the value of whatever is bought or sold through it, that is being tested with reference to the amount of the tax reduction. The question is rather what non-tax economic value the particular transaction generates and whether that is greater than the tax reduction. In that sense it is a test of the commerciality of the transaction, the value it adds taking into account both its direct and indirect effects, and whether it is entered into mainly for tax or other, commercial reasons. An example illustration of potential non-tax financial benefits is outlined in Example 1 of DPT1390.

The entity based test

The third test is an entity based rule and applies where there is a person (probably a company in most cases) that is party to the transaction or one of the transactions and it is reasonable to assume that the person's involvement in the transaction(s) was designed to secure the tax reduction. However, the third test will not be met if one or both of two further conditions are satisfied. As with the transaction based tests, it is only necessary to consider these if it is reasonable to assume that the person's involvement in the transaction(s) was designed to secure the tax reduction.

The first condition (section 110(7)(a)) is satisfied if it was reasonable to assume, at the time the material provision was made or imposed, that, for the first party and the second party taken together, the non-tax financial benefit of the contribution to the transaction(s) from the functions or activities of the person's staff would exceed the financial benefit of the tax reduction. This test operates by taking into account, at the outset, all accounting periods for which the transaction(s) will have effect.

For the entity test the functions and activities of the entity's staff include those of externally provided workers in relation to the entity (using the definition in section 1128 CTA 2009, but with references to "company" replaced by "person"). If the entity is a partnership the staff also include any members of the partnership who are individuals.

Apart from these specific inclusions there is no actual definition of staff for the purposes of section 110. The main consideration should be with the substance of the employment arrangements rather than the way in which the employment contracts are written. We are concerned here with the contributions made by the people who are genuinely managed and directed on a day to day basis by the entity.

The second condition (section 110(7)(b)) operates with reference to a specific accounting period. It is met where, in respect of that accounting period, the greater part of the income attributable to the transaction(s) is attributable to the ongoing functions or activities of the person's staff in terms of their contribution to the transaction(s). The income relevant to this test is that deriving from the transaction to the entity whose substance is being tested.

Functions and activities related to the holding, maintenance or legal protection of the asset that gives rise to the income are specifically excluded.

As mentioned above on the transaction based test, in some cases the considerations around the extent of the non-tax financial benefits in relation to the size of the tax reduction may help with those around "design" and may also point towards what the consequences of meeting the insufficient economic substance test might be in terms of calculating any taxable diverted profits. The level of non-tax commercial benefits will also be an important factor in considering any relevant alternative provision. As suggested at DPT1180 it is important to consider the interactions of different parts of the legislation in assessing how it will apply to particular arrangements.

"Transaction" is defined broadly for the purposes of the insufficient economic substance condition to include any arrangements, understandings or mutual practices. So the test would be met if the entity's involvement in any wider arrangement of which the mismatch outcome forms part is designed to secure the tax reduction.

The legislation makes clear that in deciding whether this test is met regard must be had to all the circumstances, including any additional tax liabilities (for example, exit taxes) that become due as a result of the material provision. The legislation also makes clear that something may be designed to secure a tax reduction despite its also being designed to secure any commercial or other objective.

Relationship between the transaction and entity based tests

The tests at section 110 are independent in the sense that the insufficient economic substance condition can be met through just one of subsections (4), (5) or (6). However the application of the tests involve judgement, which should be on the basis of a wide view of the arrangements and the relative importance of non- tax commercial and tax considerations in their implementation. The factors taken into account in applying one of the tests are likely to usefully inform the application of the other.

In many situations where there is an effective tax mismatch outcome it may be more likely that there is doubt as to whether the involvement of an entity in a transaction was designed to secure the tax reduction than whether the transaction itself was, in the sense of the required element of contrivance. For example, where tax considerations influence the transfer of economic activity as a whole, including the relevant functions, as opposed to just assets and / or risks it would not be expected that the transactions would need to be designed with an element of contrivance (see example 3 below). The additional condition at section 110(7)(b) relating to the ongoing functions and activities of staff should help avoid unnecessary uncertainty in this sort of circumstance, providing an alternative to the condition at section 110(7)(a).

However it is possible that there will be cases where the section 110(7)(b) condition is clearly satisfied in relation to the involvement of the entity whose substance is being tested, but where it seems that the application of the transaction based test may give rise to a DPT charge. In such cases it will be relevant to carefully consider the transaction based test taking into account the principles underpinning section 110(7)(b) relevant to the ongoing functions and activities of staff in relation to the accounting period in question. It will be important to understand how the analysis showing the section 110(7)(b) condition to be met for that accounting period is consistent with a reasonable assumption that the transaction(s) was

or were designed to secure the tax reduction and in particular how the arrangements differ from those that would have been made if not for the opportunity to achieve that reduction.

As suggested at DPT1180, where there are difficulties and uncertainty around the application of the rules at sections 107 to 110 it may be useful to move on to consider how the rules concerned with the consequences of sections 80, 81 or 86 applying would be expected to apply, should the effective tax mismatch outcome and insufficient economic substance conditions be met.

Example 1: IP held offshore, little economic substance

The example at DPT1185 showed Company X making royalty payments to Company Y, giving a tax reduction of $10m.

Company Y has four part-time staff, two of whom are directors and the others are administrative staff. Functions in relation to the development, enhancement and exploitation of the IP are performed by another group company, which had originated it.

It is clear that the contribution of economic value to the transaction, in terms of the functions or activities of Company Y's staff in the accounting period is less than $10m. As long as it is reasonable to assume that Company Y's involvement in the transaction was designed to secure the tax reduction the insufficient economic substance condition is met.

Example 2: variation on example 1

In order to get round the imposition of withholding tax on the royalties, the same group sets up a new company, Z, in country Z. That country does not impose withholding tax on royalty payments to country Y. Company Y then licenses the IP to Company Z, which in turn enters into a sub-licence agreement with Company X. Company Z retains a $250k difference between the royalties it receives from company X and what it pays to company Y, on which it pays tax of $50k.

Under the terms of the double taxation agreement between countries X and Z there is no obligation for Company X to deduct withholding tax from its royalty payments. As Country Z does not impose withholding tax on the payments to Company Y, the tax reduction is now increased from $10m to $14.95m.

This effective tax rate mismatch outcome is referable to the transactions between Company X and Company Z and between Company Z and Company Y. We therefore first need to ask whether:

- it is reasonable to assume that either, or both of these transactions was designed to secure the tax reduction and / or
- it is reasonable to assume that a person's involvement in either, or both of these transactions was designed to secure the tax reduction.

In the case of either of the transactions and the involvement of either company Z or Y, the assumptions seem reasonable. However the insufficient economic substance condition would still not be met if:

- It was reasonable to assume at the time the material provision was made or imposed that the sum of the non-tax benefits referable to the transactions would exceed the annual $14.95m financial benefit of the tax reduction (for Company X and Company Y taken together, taking account of all accounting periods for which the series of transactions was to have effect);

and

- it was reasonable to assume at the time the material provision was made or imposed that the non-tax benefits referable to the contribution made to the transaction or series of transactions by the staff of Company Z, in terms of the functions and activities that they perform, would exceed the $14.95m financial benefit of the tax reduction (for Company X and Company Y

taken together, and taking account of all accounting periods for which the series of transactions was to have effect);

and / or

- the income attributable to the ongoing functions or activities of Company Z's staff in terms of their contribution to the transactions (ignoring functions or activities relating to the holding, maintaining or protecting of any asset from which income attributable to the transactions derives) exceeds the other income attributable to the transactions.

The non-tax benefits referable to the transactions involving Company Z and the functions and activities of its staff are minimal, so these further conditions will not be of help and the insufficient economic substance condition will be met.

Example 3: central service centre

A UK-based group decides to centralise its technical support activities which had always been carried out by each company on their own behalf. It considers various options for location, including the UK, before deciding on a European country with a corporate income tax rate that is less than 80% of the UK rate. UK companies in the group will be making payments to the new company for the services it provides and these payments will give effective tax mismatch outcomes.

The contractual arrangements between the new company and the UK companies are straightforward in that the latter pay the former for the services it provides based on standard terms and there are synergies from the centralisation. In the circumstances it is not reasonable to conclude that any of the transactions were designed to secure the tax reduction.

However, there were other options for location which gives rise to the question of whether the involvement of the new company, as opposed to another option, was designed to secure the tax reduction. In considering the insufficient economic substance test the UK companies could look test whether either:

- the non-tax financial benefit of the contribution to the transaction(s) from the functions or activities of the new company's staff would exceed the financial benefit of the tax reduction. This test operates by taking into account all accounting periods for which the transaction(s) will have effect. It may for example be possible for the company to show this by providing financial projections showing that at the time the technical support centre was established the productivity and efficiency savings the group expected to achieve by co-locating all support activity in one location were greater than the potential tax savings; or
- with reference to a specific accounting period, the greater part of the income attributable to the transaction(s) is attributable to the ongoing functions or activities of the person's staff. This test may be the simpler one in this kind of circumstance, as long as the technical support activities are run fully from the new support centre. Reassurance on the whether the condition was met might be drawn from functional analysis carried out for transfer pricing purposes showing that the main driver for the profits of the centre are the functions carried out by the centre's staff and benchmarking analysis showing that all payments by other group companies for technical support are arm's length.

DPT1200 - Partnerships

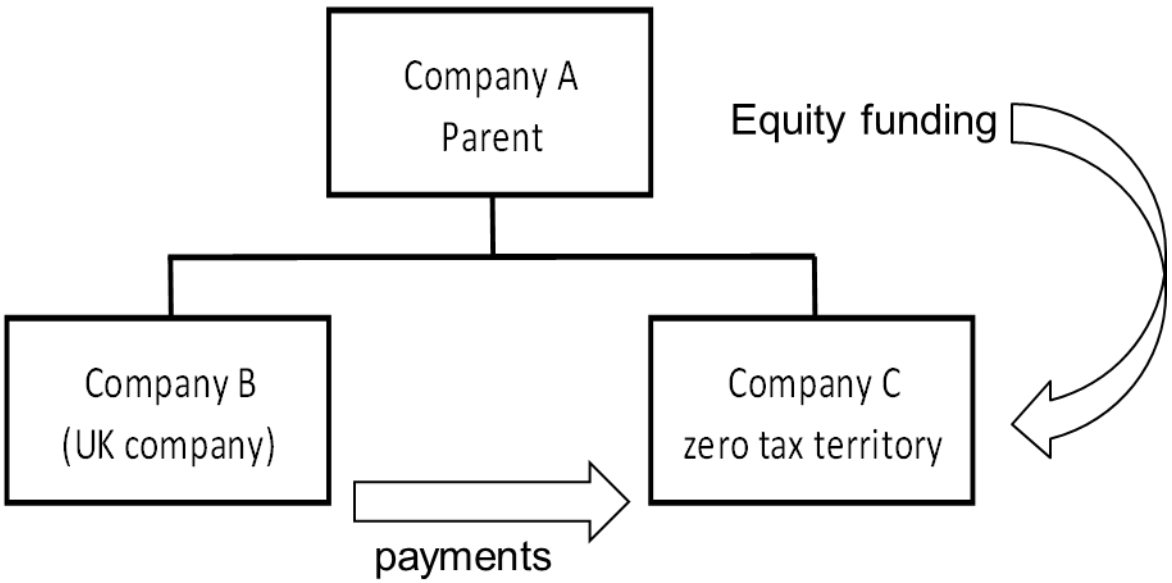
The legislation contains provisions to ensure this Part of the Act applies correctly where a company is a member of a partnership. These provisions ensure that any references to the expenses or income or revenue of the company apply to that person's share of the income etc. as determined by apportioning the amounts between the partners on a just and reasonable basis. This will normally follow the profit-sharing ratios applicable to the relevant companies. The provisions mean, for example, that rules such

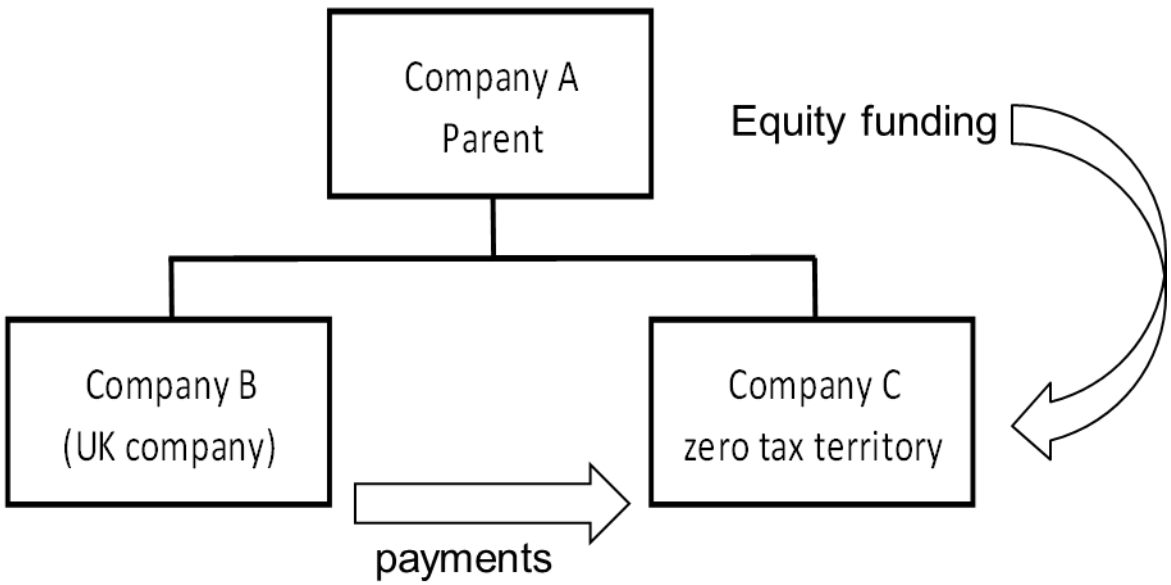
as that relating to the sales revenue threshold apply properly to companies that are members of a partnership, by reference to the proportion of the partnership profits allocated to the company.

PART 2: Examples and particular situations

DPT1300 - Section 80 - Involvement of entities or transactions lacking economic substance (see DPT1110)

Example 1:





Facts

- Companies B and C are wholly owned by company A, so the participation condition is met.
- Company B needs to invest in new expensive fixed plant and machinery (P&M) to carry on its trade in the UK. It enters into discussions with the supplier to set the specifications and negotiate the contractual details.
- The overseas parent company (A) then injects capital into a subsidiary (C) in a zero-tax territory, enabling Company C to purchase the necessary P&M. Company B then enters into an operating lease with Company C. It is clear that the payments under that lease will leave Company B with relatively small profits over the period of the arrangements.
- Company C itself has no full time staff and the only functions it performs are to own the P&M and some routine administration in relation to the leasing payments it receives.
- The material provision between B and C is the provision of P&M under the operating lease and as a result of that material provision, there is an effective tax mismatch outcome (for each of Company B's accounting periods). The payments are allowable in Company B's tax computation but are not taxed in the hands of Company C.
- The transaction that gives rise to the effective tax mismatch outcome is the operating lease. Depending on the particular facts and circumstances of the provision in this case it may be reasonable to assume that both the transaction and the involvement of Company C in it are designed to secure the tax reduction.
- The assumption in respect of the transaction would lead to considering the test of whether it was reasonable to assume, at the time the arrangements were made, that there would be ~~non-~~nontax benefits from the transaction that would exceed the financial benefit of the tax reduction.

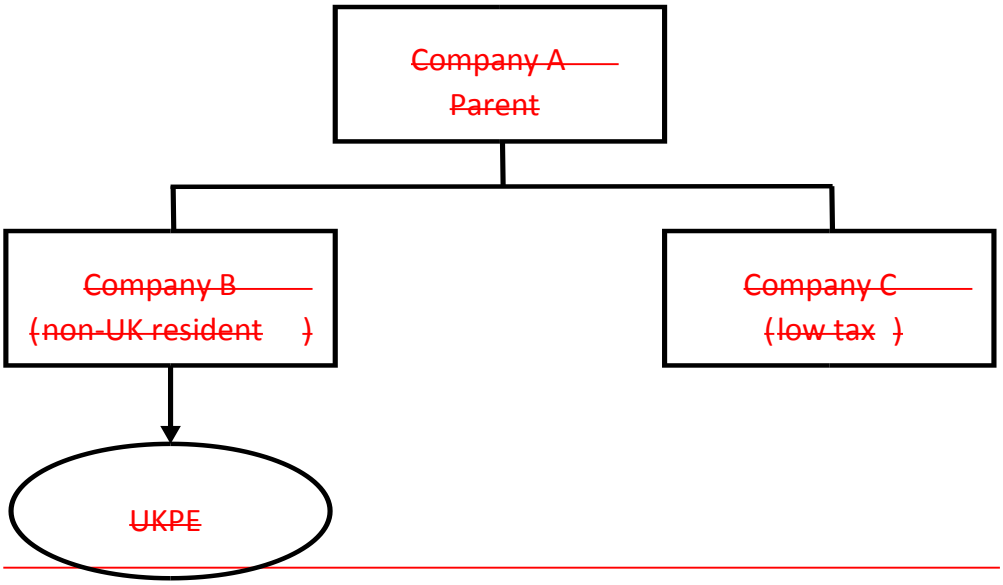
  ~~tax benefits from the transaction that would exceed the financial benefit of the tax reduction.~~ Looking at Company B and Company C together the ownership of the asset by Company C does not create or add economic value.
- The assumption in respect of the involvement of Company C would lead to considering the two tests that relate to the contribution its staff. The first relates to the expectation at the time the arrangements are made and the second to a particular accounting period.
- For the first test it seems clear that any non-tax benefits from the contributions of the staff of Company C will be much less than the financial benefit of the tax reduction throughout the time the asset is used. For the second test it is clear that the income attributable to the ongoing functions or activities of the staff of Company C will not exceed, in any particular accounting period, the other income attributable to the transaction.

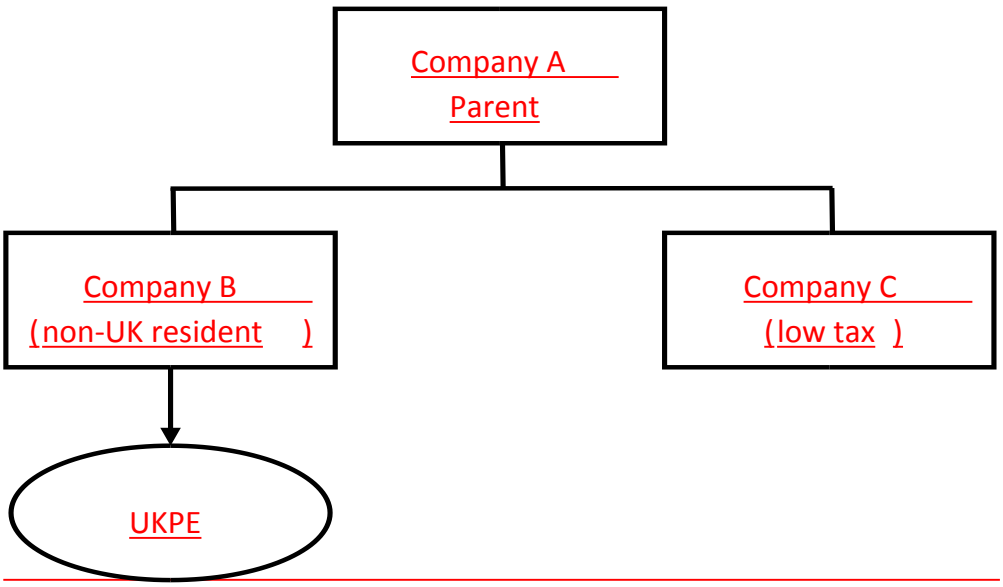
Calculation of taxable diverted profits

In this case, in the absence of further facts and circumstances that may have a bearing, the calculation would be on the basis of the relevant alternative provision as follows. It is reasonable to assume that, if tax on income had not been a consideration, Company B would have purchased and owned the P&M itself. Company C has not incurred any financing costs so there is no reason to assume any for Company B, but it would be recognised that capital allowances would have been available to it.

If the first accounting period to which a DPT charge applied was later than when the arrangements were set up, we would expect capital allowances to be based on a separate pool, using the lower of cost or market value at the beginning of that accounting period (i.e. the first period to which a DPT charge applied). The written down value on that basis would follow through to following accounting periods.

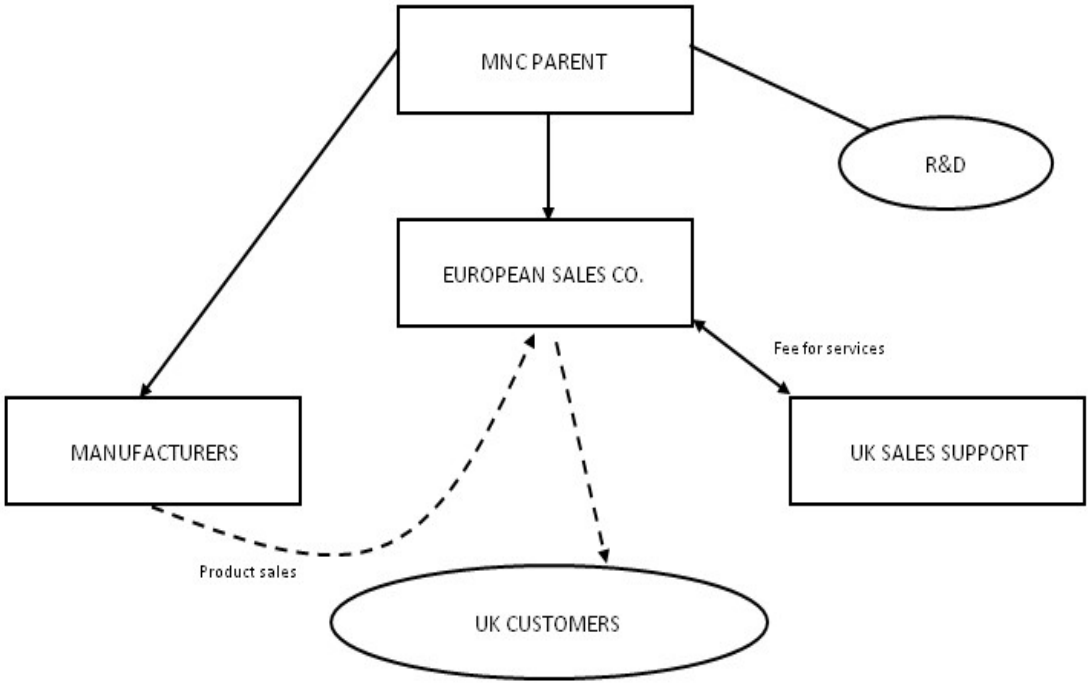
Example 2 – Section 81 - Involvement of entities or transactions lacking economic substance (see DPT 1120)

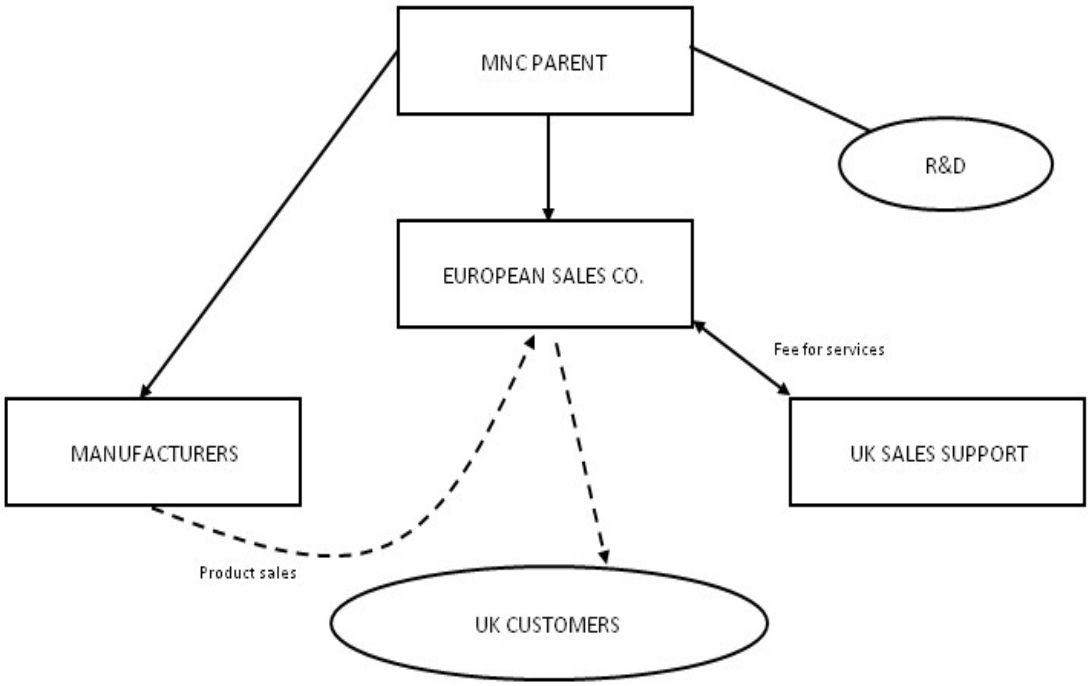




Assume the facts are the same as those in example 1, except that the UK activity is carried on through a UK permanent establishment of Company B rather than a UK resident company. The rules at Section 81 ensure the same result follows as in example 1, with similar analysis to arrive at the taxable diverted profits.

DPT1310 – section 86 - avoiding a UK taxable presence (see DPT1140) Example 1: Company resident in very low tax jurisdiction in international supply chain - tax avoidance condition met





Facts

- An overseas-headed multinational group manufactures and distributes products which have embedded intellectual property (IP).
- In Europe, the multinational group has manufacturing group operations which produce the products and pay a royalty to the parent that generated the IP – those operations are not based in the UK and nor is any R&D done in the UK.
- There is an established wholesale price for the product because, as well as using its own supply chain, the multinational group distributes products through independent distributors.

- Sales within Europe are made by a single principal company (the European Sales Company (ESC)), which is located in a very low tax jurisdiction, but sales support is provided by local distribution companies on the ground in each territory in which sales are made.
- From an examination of the facts and circumstances around the arrangements in relation to customer contracts it is found that there is a contrived separation of the conclusion of contracts from the selling activity and process of agreeing the key commercial terms and conditions. The requirement for ESC to conclude the contracts is intended to limit the ability of the UK to tax the profits arising from the group's activities but there is ~~negligible~~limited value added by the ESC in signing contracts whose existence and key commercial terms are very largely attributable to activities carried on in the UK.
- The evidence also shows that, to the extent the sales are made in the UK market, all the work in negotiating the key commercial aspects of the contracts is done in the UK by the UK sales support company. The person who signs the contract in the jurisdiction where the principal, i.e. ~~the ESC, is located merely checks~~

  the ESC, is located merely checks the terms and makes sure that the contract complies with the general standard form before signing it.
- The evidence shows that the ESC buys the product at the independently validated wholesale price and then pays a commission to the UK sales support company which enables the principal to keep 50% of the distribution profit on the basis that it is taking on contractual commitments.

Analysis and calculation of taxable diverted profits It

is reasonable to assume that:

- The activities of ~~both companies~~the ESC and UK sales support company are designed so as to ensure that the ESC is not carrying on a trade in the UK for corporation tax purposes (that is, through a
  PE),
- No exceptions apply, and

  The arrangements have a main purpose to avoid a charge to corporation tax, so the tax avoidance condition is met.

Section 86 therefore applies and the taxable diverted profits are the profits which would have been the chargeable profits of the ESC for the period, attributable to the avoided PE, had the avoided PE been a permanent establishment through which the ESC carried on its trade in the UK~~.~~; notwithstanding, for accounting periods ending on or after 28 June 2016, consideration would need to be given to whether there are any amounts, where the payment avoids the application of Section 906 of the Income Tax Act 2007 (duty to deduct tax).

In this case the evidence shows that the manufacturers sell the goods to the ESC at an arm's length price. There is therefore no need to consider, for the preliminary and charging notices, the "inflated expenses condition" for the purpose of estimating the profits that would have been the ESC's chargeable profits for corporation tax if it had been trading through a UK PE for the preliminary charging notice.

The amount ~~of the~~chargeable to DPT ~~charge~~ will be equal to the notional PE profits. These are (i) the profits that would have been the chargeable profits of the foreign company, attributable in accordance with sections 20 to 32 of CTA 2009 had the avoided PE been a permanent establishment in the UK through which the foreign company carried on its trade~~.~~ and (ii) for accounting periods ending on or after 28 June 2016, any amount equal to the total of royalties or other sums which are paid by the foreign company during that period in connection with that trade, where the payment avoids the application of Section 906 of the Income Tax Act 2007 (duty to deduct tax).

A detailed examination shows that the functions ~~of~~performed and ~~exposures~~risks assumed by the principal are such that only 2%, rather than 50%, of the distribution profit is properly attributable to the ESC as principal in the very low tax territory.

In determining the amount of the notional PE profits, account would be taken of the fee which is paid to the UK sales support company for its services. As this fee confers 50% of the distribution profit, the profits to be attributed had the avoided PE been an actual PE of the ESC as principal would be 48% of the distribution profit. ~~This would be~~For accounting periods ending on or after 28 June 2016, there may also be an amount equal to the royalties or other sums which are paid by the foreign company during that period in connection with that trade, where the payment avoids the application of Section 906 of the Income Tax Act 2007. These two figures would determine the amount of the taxable diverted profits.

Example 2: Company resident in very low tax jurisdiction involved in international supply chain but with significant substance in European sales hub where contracts are concluded

Facts

The facts are the same as the previous example except the thorough review carried out by HMRC established that the ESC has a large staff of qualified people who carry on material activities in relation to sales such as:

- Having regular contact with the UK sales support staff and providing regular input into their activities;
- Having regular contact and authority to negotiate the key commercial terms of sale contracts with UK and other European customers and actually performing this function.
- Orchestrating sales across Europe by various product promotions, advertising campaigns and sport sponsorship.
- Managing relations with major customers who have a presence in several European countries including the UK.
- Actively managing the local European sales support companies.

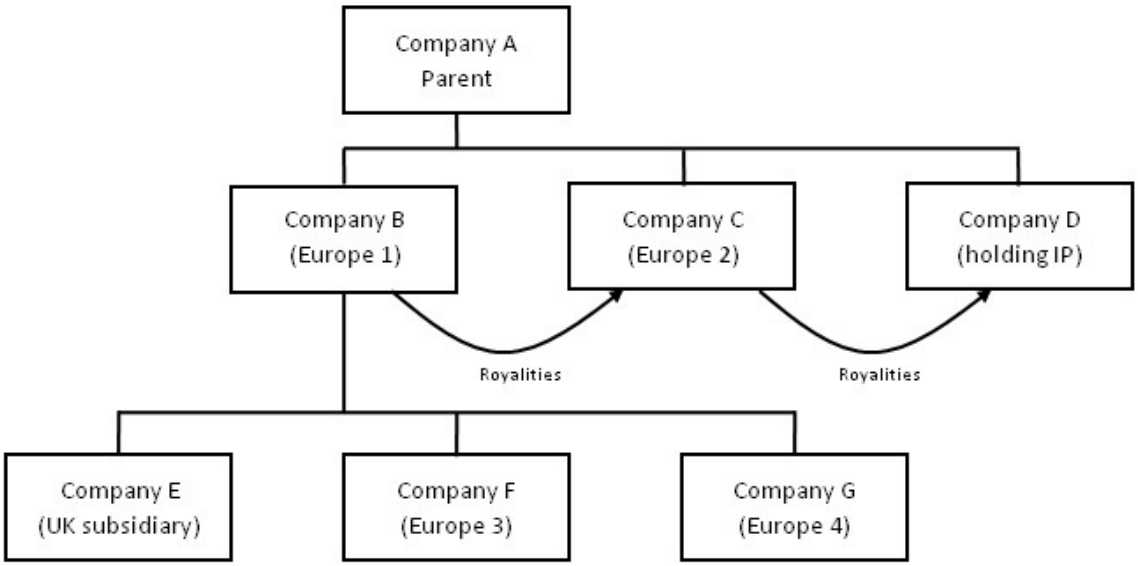
The review also confirmed that it is not reasonable to assume that the activities of the ESC or the UK sales support company, in particular the signing of sale contracts by the ESC, was designed to ensure the ESC was not trading in the UK through a permanent establishment. Rather, the activities of the two companies support their commercial roles within the group.

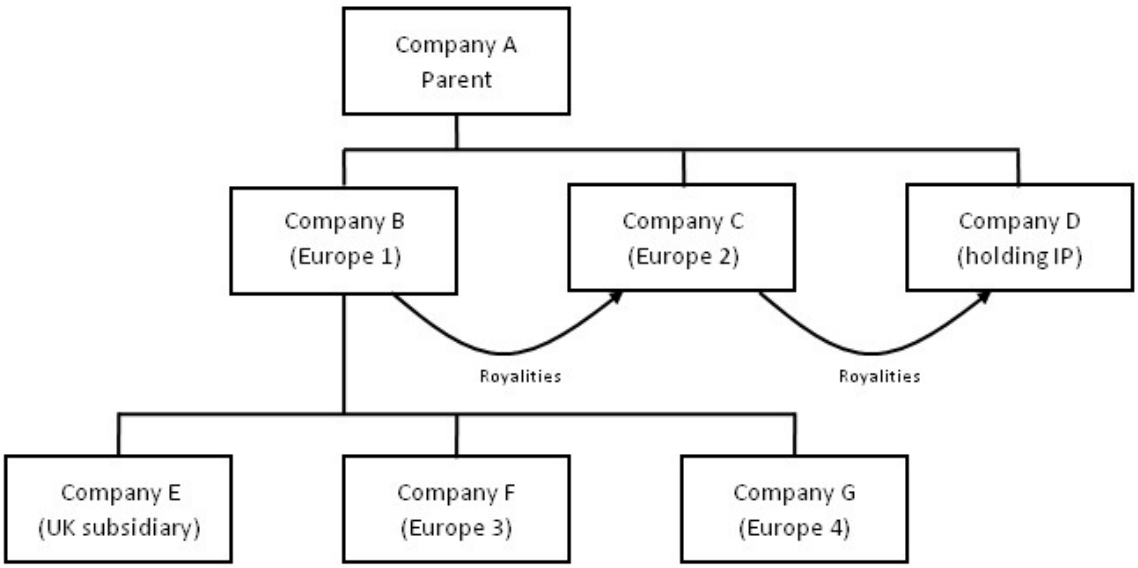
The allocation of profit between the ESC and the UK sales support company reflect their contribution to the generation of profits from activities in the UK.

Analysis and calculation of taxable diverted profits On

the above facts the DPT does not apply.

Example 3: Avoiding a UK taxable presence (see DPT1140)





Facts

- The group generates the majority of its revenue from online services based around valuable intellectual property (IP). All the companies in the group are within the participation condition.
- Company A, resident outside Europe, owns the IP for its own territory and Company D owns the IP for the rest of the world. Although Company D is registered in "Europe 1" it is tax resident in a zero-tax jurisdiction.
- Company D licenses the IP to Company C, resident in Europe 2, which in turn sub-licenses to Company B in Europe 1. Company B is the European sales and service hub, co-ordinating the group's activities in Europe and working closely with its parent, Company A.
- Company E, resident in the UK, has a large, well-remunerated staff who have developed the UK market and engage with UK-based business customers buying online services. Over several years Company E's staff have developed close relationships with these customers, the number of which has been increasing each year. Company E does not own any IP or other assets involved in the generation of revenue and its staff do not complete the sales contracts, which are all finalised online and booked to Company B.

- Company E's activities are described as marketing and customer support services. It receives payments from Company B based on recovery of its costs with a modest margin added, which is taxable in the UK. It has no other revenue. Companies F and G operate in a similar way in their local markets in European countries 3 and 4.

Although Company B has large sales revenues, its profits are relatively small because it pays substantial royalties to Company C for the use of the IP. Company C's profits are also small because it pays nearly all those royalties on to Company D (where they are untaxed).

If the royalties were paid directly from Company B to Company D they would be subject to withholding tax, because there is no double tax treaty between the countries where these companies are resident. However Company C is resident in Europe 2 which does not impose withholding taxes and Europe 2 has a favourable tax convention with Europe 1 so there is no withholding tax on royalty payments from Company B to Company C.

When the detail of the arrangements between Company B and Company E, in the UK, and the activities of the two companies are examined, there is good reason to assume that, notwithstanding that there may be other objects, these activities are designed to ensure that Company B is not trading in the UK through a permanent establishment within the terms of the tax treaty between Europe 1 and the UK.

The mismatch condition and the tax avoidance condition also need to be considered. The most obvious provision to be considered in respect of the mismatch condition is that between Company B ("the foreign company") and Company D ("another person"). Because the royalty flow is untaxed (and Company B's profits are taxed in Europe 1) there is an effective tax mismatch outcome.

The effective tax mismatch condition is therefore referable to a series of transactions and apart from other considerations, the insufficient economic substance condition is most obviously met in respect of the transactions involving Company C – either in terms of their design to secure the tax reduction or in terms of Company C's involvement in them being so designed.

The tax avoidance condition may also be met in this case, but it is not necessary to consider that where the mismatch condition is met.

In estimating the taxable diverted profits for the preliminary and charging notices the designated officer would need to consider what the chargeable profits of Company B would have been if it had been carrying on its trade through "the avoided PE". In~~ addition, in~~ considering the appropriate deduction for the IP expense, the inflated expenses condition would need to be considered. Finally, for accounting periods ending on or after 28 June 2016 the quantum of diverted profits will include any amount equal to the total of royalties or other sums which are paid by Company B during that period in connection with that trade, where the payment avoids the application of Section 906 of the Income Tax Act 2007 (duty to deduct tax).

~~In calculating the~~The calculation of diverted profits tax, will be based on whatever provision it is reasonable to assume would have been made had tax on income not been a consideration, Company B would have made some payment in respect of its use of the IP. In this case there is no reason to believe that such payments would have given rise to "relevant taxable income" in the UK. On that basis the calculation of taxable diverted profits would be on the basis of the actual provision and would be equal to the chargeable profits which Company B would have made if it had been carrying on its trade through the avoided PE – Company E (taking the proper pricing of the actual provision into account~~).~~), together with, for accounting periods ending on or after 28 June 2016, any amount equal to the total royalties or other sums which are paid by Company B in connection with that trade, where the payment avoids the application of Section 906 ITA 2007.

~~If~~When estimating the diverted profits for the purpose of the preliminary and charging notices, if there is reason to consider that the actual expenses might be greater than they would have been if agreed between independent parties acting at arm's length then the amount that would otherwise have been allowed in the calculation would be reduced by 30%.

Whether or not this adjustment to the IP expense is ultimately the correct transfer pricing adjustment is a matter to be considered during the review period. The ultimate level of taxable diverted profits should reflect what the chargeable profits of Company B would have been, ~~based on the assumption~~plus (for accounting periods ending on or after 28 June 2016), any royalties or other sums paid by Company B during that period in connection with that trade, based on the assumptions mentioned above.

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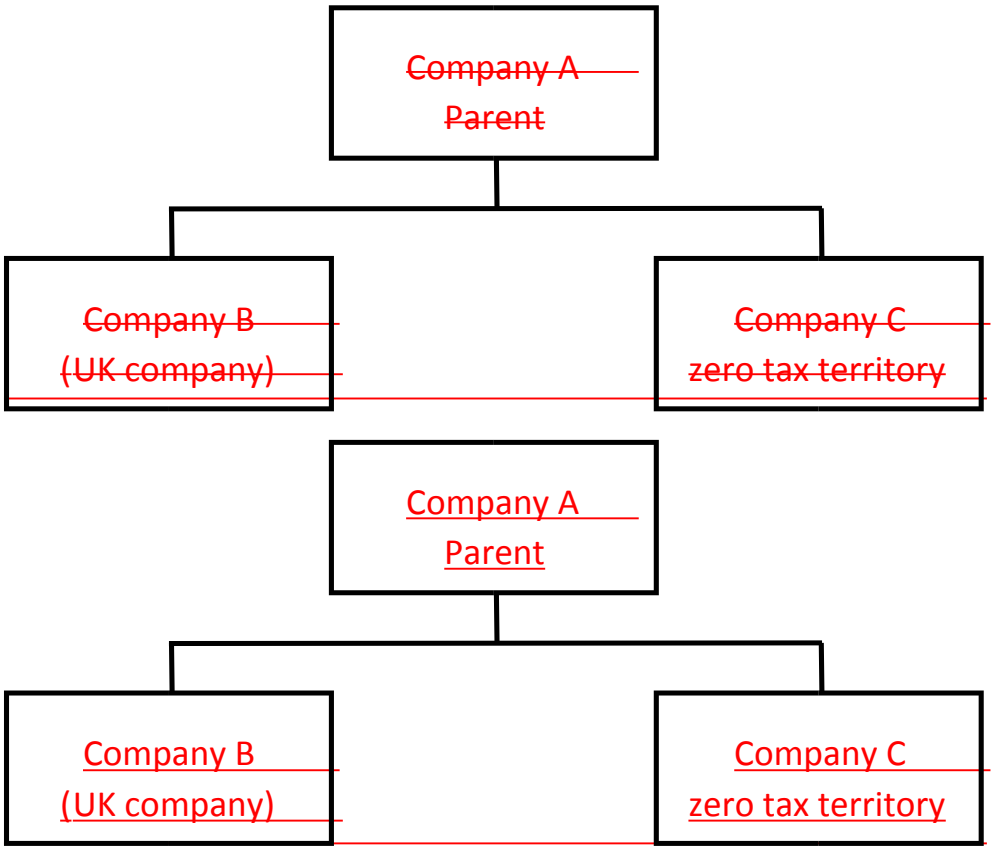
DPT1320 - Section 80 case where there is a transfer pricing impasse



Facts

- Companies B and C are wholly owned by Company A so the participation condition is met.
- The group generates the majority of its revenue from the sale of widgets based around valuable IP. All IP is developed in Company A, through valuable and substantial R&D activities. No R&D is carried out in Company B or Company C.
- B is the UK subsidiary which manufactures and distributes branded widgets in the UK. Company A owns the IP for its own territory and Company C owns the IP for the rest of the world.
- Company C licenses the IP to Company B. Company B pays royalties of £100m per year to Company C for the use of IP in its manufacturing and distribution activities.
- Company C itself has no full time staff and the only functions it performs are to own the IP and some routine administration in relation to the royalty payments it receives.

It is established from the facts that the material provision is between B and C - the provision of IP under the license agreement. As a result of this provision there is an effective tax mismatch outcome for each

of company B's accounting periods. The payments are allowable in Company B's tax computation but are not taxed in the hands of company C. and for the purposes of this example we have assumed that there is no UK withholding tax suffered by Company C on the royalty income.

The transaction that gives rise to the effective tax mismatch outcome is the license agreement. Depending on the particular facts and circumstances of the provision it may be reasonable to assume that both the transaction and the involvement of Company C in it are designed to secure the tax reduction.

The assumption in respect of the transaction would lead to considering the test of whether it was reasonable to assume, at the time the arrangements were made, that there would be non-tax benefits from the transaction that would exceed the financial benefit of the tax reduction.

The assumption in respect of the involvement of Company C would lead to considering the two tests that relate to the contribution its staff. The first relates to the expectation at the time the arrangements are made and the second to a particular accounting period.

It is not demonstrated that Company C or the transaction through which the IP is provided to Company B as opposed to directly from Company A would have been expected to add any significant economic value. Neither will the income attributable to the ongoing functions or activities of the staff of Company C exceed, in any particular accounting period, the other income attributable to the transaction. The insufficient economic substance condition is therefore met.

In the circumstance it is reasonable to assume that Company B would have licenced IP from Company A (and paid a smaller royalty) had tax not been a relevant consideration.

Further examination of the facts and an economic analysis suggests that the arm's length royalty payable by Company B for the IP would be £80m per year.

In this case, in the absence of further facts and circumstances it is reasonable to assume that in the absence of the tax considerations Company B would have entered into a license agreement for the use of IP with company A directly and paid £80m per year in royalties to Company A.

Analysis and calculation of taxable diverted profits

"The actual provision condition" is met because the material provision results in the relevant company having expenses that would (ignoring any transfer pricing disallowance) be allowable in its tax computation and the relevant alternative provision would also have resulted in allowable expenses of the relevant company for the same type and for the same purpose as the actual expenses.

Taxable diverted profits will therefore equal the amount which is chargeable to CT by virtue of Part 4 of TIOPA 2010 (transfer pricing) less any adjustment in respect of these amounts that the relevant company includes in its corporation tax return by the end of the review period.

Company B's tax return is submitted based on the material provision. No transfer pricing adjustment to reduce the deduction in respect of the royalty is included in Company B's return.

Initial discussions proceed on the basis that the dispute is to be agreed by transfer pricing adjustment rather than diverted profit charge. However, during the course of discussions an impasse is reached. The group maintains its position that £100m is the correct figure while HMRC maintains its view that £80m is appropriate. As there is no likelihood of reaching agreement HMRC will issue a preliminary notice, and assuming the impasse remains, a charging notice.

As the inflated expenses condition is met the charging notice will disallow 30% of the royalty giving rise to a DPT charge based on taxable diverted profits of £30m.

As a result of discussions during the review period but before the end of that period Company B submits an amended return increasing its profits by £20m by a transfer pricing adjustment. This is agreed to represent all the diverted profits in the accounting period. HMRC will reduce the charging notice to nil.

DPT1325 – Sufficient economic substance - Section 80 Examples

Example 1: Sufficient economic substance in the low tax and parent jurisdictions for a diverted profits charge not to arise.

Facts

- A UK company (UKCo) manufactures widgets under licence with the related IP being held in a company in a low tax jurisdiction (IPCo). The parent company is located in another third jurisdiction (not a low tax jurisdiction). The IP for the parent company jurisdiction relating to the widgets is held in Parent Co. IPCo owns the widget IP rights for the other countries in which the group operates (RoW IP).
- The group has manufacturing entities in many jurisdictions including the UK and the low tax jurisdiction.
- IPCo charges a royalty, demonstrated to be at an arm's length rate) to UKCo, as it does for the other group manufacturers outside of the parent company jurisdiction.
- In the past, IP for the widgets was owned in numerous jurisdictions including in the UK and the low tax jurisdiction. IP was transferred to IPCo (and Parent Co) in a rationalisation of the IP holding structure for the widgets business line. The group had non-tax reasons for wanting to hold the RoW IP in one place (it is simpler and more efficient in terms of the number of people needed to support the operation). Similarly, the group had non-tax reasons for choosing the low tax jurisdiction as the place where the RoW IP would be held. It was relatively low cost and a source of well-educated staff.
- IPCo continues to develop the IP by undertaking its own R&D activities. It shares that R&D with a UK company in the group (other than UKCo) with the resulting IP being owned by IPCo and Parent Co who fund the R&D activity on a cost sharing basis. The R&D activities that are carried on in both the UK and the low tax jurisdiction are on a similar scale in terms of headcount, but most of the senior personnel in the groups' IP division are employed by IPCo. The UK R&D team typically reports to the more senior staff in IPCo.
- IPCo has a team involved in the management of the IP that includes patent specialists as well as highly qualified engineers in the particular industry who have knowledge and experience to generate new ideas for development. This team collaborates with a team in Parent Co on coordinating R&D activity across the globe for the widgets business line, and on new areas of development. The teams in IPCo and Parent Co and a separate financing team (located in the parent jurisdiction) review the final proposals. All major decisions for the RoW IP are reviewed and concluded by the board of IPCo who are all employed by IPCo.

Analysis

The participation condition is met.

There is provision between the UK resident and IPCo which results in an effective tax mismatch outcome.

But the insufficient economic substance test is not met. In particular from the detailed facts of the arrangements, the cost savings attached to the rationalisation and the projected increased income from new IP can be seen to exceed the tax reduction. In terms of the involvement of IPCo, more than half of its income can be attributed to the ongoing functions of its staff, other than holding, maintaining and protecting the IP. Therefore the insufficient economic substance test is not met.

Example 2: Significant R&D in the UK, and insufficient non tax benefits for a diverted profits charge not to arise Facts

- In this structure, a UK company (UKCo) trades across Europe in the development, manufacturing and selling of widgets. UKCo owns all intellectual property (IP) related to the widget. UKCo jointly develops new patentable IP with a third party company in the UK. UKCo has the opportunity to buy out the third party once the development is completed.
- A group decision is made to establish a new connected company in a low tax jurisdiction (IPCo) and funds are made available to IPCo to acquire the patentable IP which will subsequently be licensed back to UKCo.
- IPCo provides IP protection and management activities in relation to the IP and takes the associated risk of ownership. IPCo then charges a royalty to UKCo for access to the patents.

Analysis

If it were not for the tax reduction that occurs as a result of the patents being owned by IPCo, it is reasonable to assume that the acquisition of the patents would have been made by UKCo.

On the assumption that the other conditions are met, taxable diverted profits would be those that UKCo would have made if it had acquired the IP itself.

DPT1330 - Tangible assets

DPT1300 includes a simple example of plant and machinery held by a group company in a zero-tax territory, when it was acquired for use in the UK by a UK group company.

That example illustrates that in such circumstances it may be reasonable to assume that the involvement of the company owning the asset in the zero-tax territory was designed to secure the tax reduction. It may also be reasonable to assume that in the absence of the effective tax mismatch outcome the provision involving Company C would not have been made.

If the just and reasonable assumption as to the alternative provision that would otherwise have been made or imposed is that the UK company, or perhaps another UK resident group company, would have owned and managed the asset, taxable diverted profits would be calculated on the basis of the additional profits for the accounting period that would follow from that assumption.

However, any such assumption must be based on the detail of the particular facts and circumstances of the material provision. Arrangements through which assets used by a UK company are held in another group company and which give rise to an effective tax mismatch outcome will only result in a diverted profits charge if:

- The insufficient economic substance condition is met; and either
- the transfer pricing of the material provision is not in accordance with Part 4 TIOPA 2010 and that is not corrected before or during the review period; or
- it is reasonable to assume that the material provision would not have been made or imposed in the absence of the effective tax mismatch outcome, and the alternatively structured provision that would have been made or imposed would have given rise to additional profits taxable in the UK.

Close attention needs to be given to all the benefits of such arrangements, which may be linked to the nature of the asset and the way it is used in the group. It is also important to consider where the functions, particularly decision-making functions, related to the design, acquisition, maintenance and exploitation of the asset are carried out. It may also be appropriate to take into account the group's arrangements in relation to other assets of the same type or class, including where the capacity to perform the functions mentioned above are located.

In many cases it may be possible for businesses to establish that the financial benefit referable to the transaction and the financial benefit from the contribution of functions / activities of the asset owner's staff is greater than the financial benefit of the tax reduction. If not, the insufficient economic substance condition would still only be met if it is reasonable to assume the transaction(s) or the involvement of a party to the transaction(s) is designed to secure the tax reduction.

However, if the arrangements are within the insufficient economic substance condition then the rules for determining any charge in a section 80 case depend on whether the material provision would have been structured in the same way had tax on income not been a relevant consideration. The considerations mentioned above, (i.e. all the benefits of the arrangements, the location where functions in relation to the assets are performed, etc.), will again be key to this question as will the substance of the parties to the provision.

If the material provision would anyway have been structured in the same way, or in a different way that would still have resulted in allowable expenses of the same type and for the same purpose (other than where they would have resulted in additional UK profits), then taxable diverted profits would be limited to any additional profits not included in a return before the end of the review period that relate to the correct application of the transfer pricing rules.

If the material provision would have been structured in a different way that would have given rise to additional UK profits, then taxable diverted profits would be calculated by reference to that alternative provision in accordance with section 85. This could follow, for example, from the tax-motivated

separation of the ownership of assets from their use in the UK as well as from the functions related to their design, acquisition, maintenance and exploitation in the UK.

DPT1340 Mobile tangible assets

The factors for consideration suggested above include the nature of the asset and its use of in, or its operation from, the UK. For example, certain types of mobile tangible assets may be expected to be used by more than one group company and/or in more than one country through their useful life. This is likely to be relevant to the assumptions in respect of the design of the material provision and those on whether that provision would have been made as structured, absent the effective tax mismatch outcome.

Such assets may be owned by a group company resident in a low tax jurisdiction that leases, or otherwise makes them available, to the operating company or companies that use them. In that sort of arrangement, evidence that the use of an asset, or assets of the same type, has moved, or is realistically expected to move, between territories would be a strong factor in the consideration of whether similarly structured provision would have been made in the absence of any tax reduction. Specific design features of the asset and considerations around redeployment costs may be relevant factors.

Where such assets are designated to be used exclusively in connection with contracts with unconnected third parties it will be important to consider the length and other relevant terms of those contracts. For example the detail around contract renewal, early termination, provisions for the variation of the contractual terms, etc. are likely to be relevant.

If it was anyway concluded that some alternatively structured provision would have been made, the fact or the realistic expectation of an asset's movement between the UK and other territories may make any assumption that the alternative provision would have resulted in additional UK profits less likely.

DPT1350 Interaction between DPT and the oil contractor ring fence (Part 8 ZA CTA 2010)

The legislation at Part 8 ZA CTA 2010 (see OT50000) operates to restrict allowable deductions for the hire of certain types of mobile assets ('relevant assets') for the purpose of calculating a contractor's ring fence profits (those from its oil contractor activities). The amount of the hire cap is set at 7.5% of the total recognised cost of the asset. Amounts in excess of the cap can be set against profits arising outside the contractor ring fence or by surrender as group relief.

Whether any arrangements for leasing assets that are subject to the hire cap also give rise to a DPT charge will depend on the specific facts and circumstances of each case. The sort of considerations suggested above on all mobile tangible assets will be important in determining this. The tax effect of the hire cap also needs to be taken into account, as can be illustrated by using the example at DPT1300 as if it involved the leasing of an asset that was subject to a restriction of allowable deductions under Part 8 ZA CTA 2010 with the following amounts:

- Total recognised cost of asset: £1bn
- Lease expense between associated persons: £120m
- Relevant percentage at 7.5% of £1bn: £75m
- Available for relief other than against contractor ring fence profits: £45m

(All profits are charged at the main CT rate of 20%)

If the just and reasonable assumption under section 85 is that there would have been no provision between the UK resident company (B) and the asset owning company (C), the annual lease expense of £120m would not have been paid. Company B would have been entitled to capital allowances on its acquisition of the asset. In this case there would be no allowable financing costs as the actual purchase by Company C did not involve any such costs.

For a full 12-month accounting period the maximum taxable diverted profits in relation to the asset would be £120m less the value of notional capital allowances. These allowances would be based on the lower of cost or market value of the asset at the beginning of the first accounting period for DPT (subject to the commencement and transitional provision at section 116).

However the amount of the additional profits in relation to those in the relevant corporation tax return would depend on the extent to which the £45m hire cap restriction has been tax effective.

If the £45m had all been relieved against other profits in the return or surrendered as group relief then the additional profits would be the £120m less notional capital allowances. If £25m had been relieved against other profits in the return or surrendered as group relief then the additional profits would be £100m less notional capital allowances (as £20m has been disallowed in the return).

If none of the £45m could be relieved against other profits in the return or surrendered as group relief then the additional profits would be the £75m restricted charter expense less notional capital allowances.

In more complex circumstances (for example if all or part of the £45m was relieved at a lower rate than that which Company B was subject to on the profits derived from the use of the asset) then it would be necessary to take account of the tax effect of the hire cap restriction through section 100 (credit for UK or foreign tax).

DPT1360 Specific tangible asset examples

Example 1

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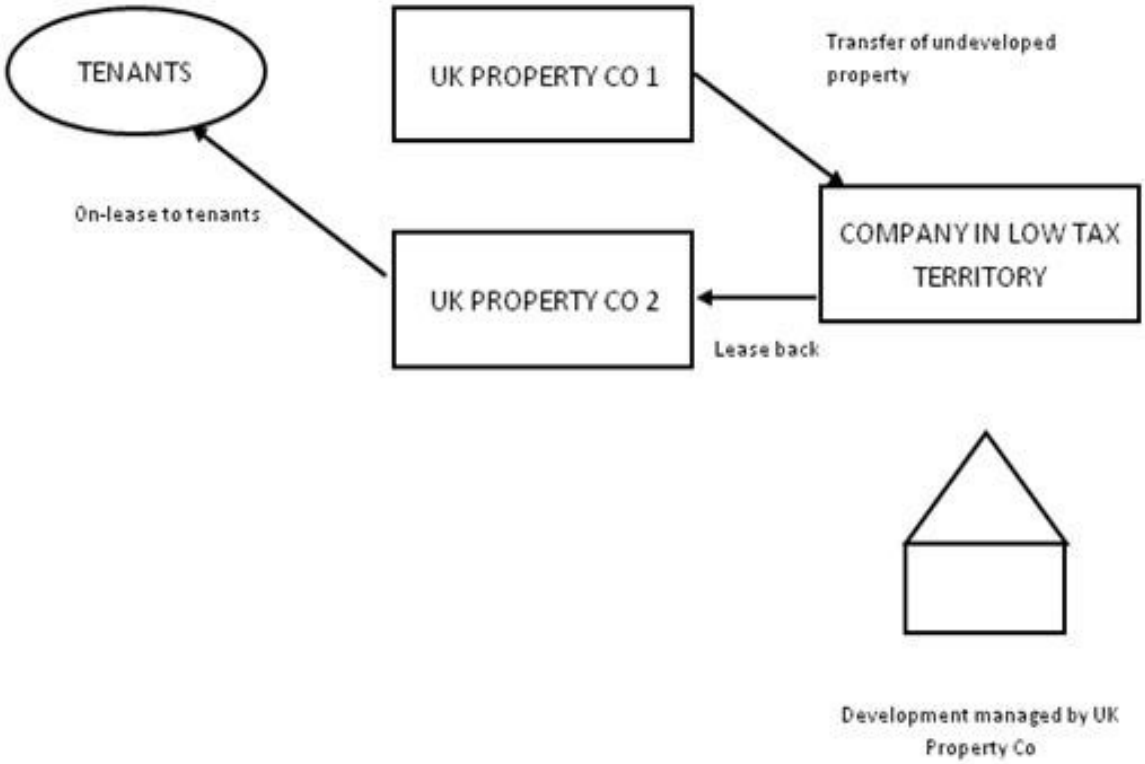

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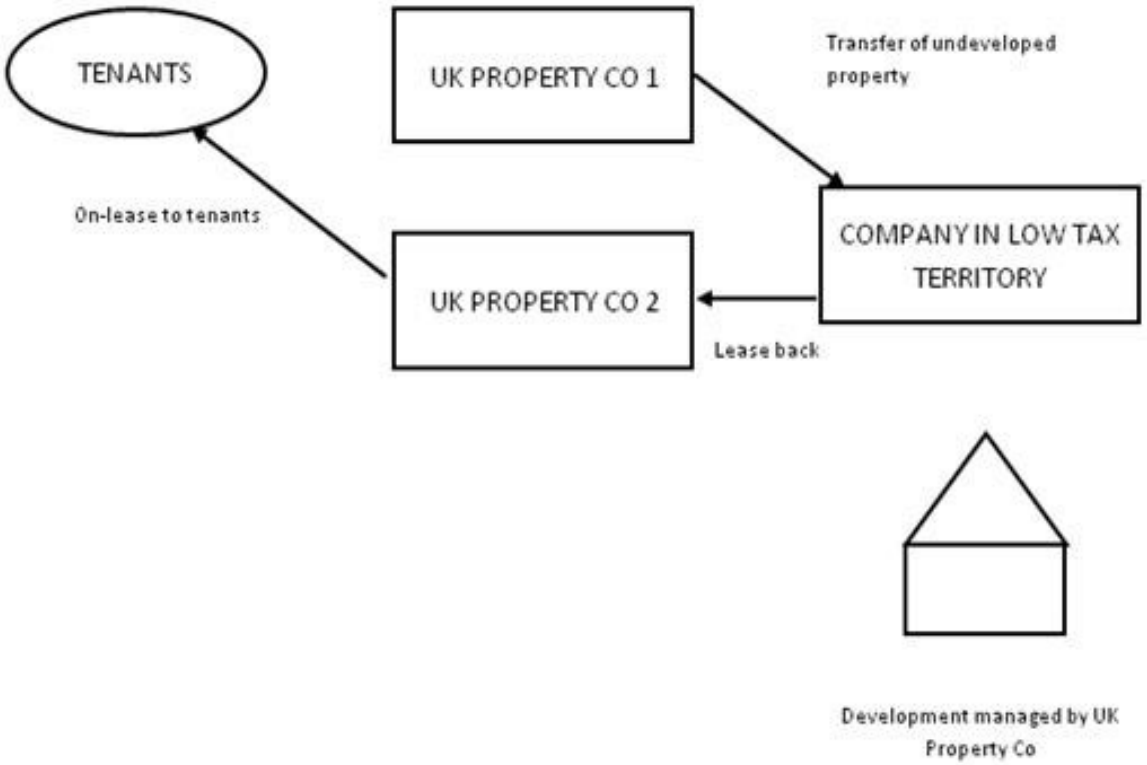


Facts

- A UK company which has traditionally held and managed all its property assets onshore (UK Property Company 1) sets up a company in a very low tax territory with a mixture of debt and ~~transfers ownership of~~equity funding. It then sells a UK property that is in the course of development to that company.
- All costs in relation to the development are incurred by the new company but all the work on the development and all critical decisions are being taken by the management team for the group in the UK.
- When the property is developed, it is leased back to a property subsidiary in the UK (UK Property Co 2) and then on-let to tenants which the UK group finds for the property.
- The rental payments out to the offshore company are set at a level which effectively leaves the UK with only a nominal margin.
- The facts show that the management of the company in the very low tax territory do not have the authority or expertise to do this project on their own or indeed to manage the portfolio – they are effectively acting as conduits.

Analysis

This is a change in the group's normal pattern of holding properties and the profits allocated to the offshore company are very much out of line with its contribution. It has capital but it is really unable to manage that capital itself. The transactions can, therefore, be considered for DPT purposes as amounting to an arrangement where all the offshore company is doing is holding the asset on behalf of a member of the UK group. This could potentially lead to the conclusion that the transactions would not have occurred absent considerations in relation to tax on the income from the asset. It would follow that

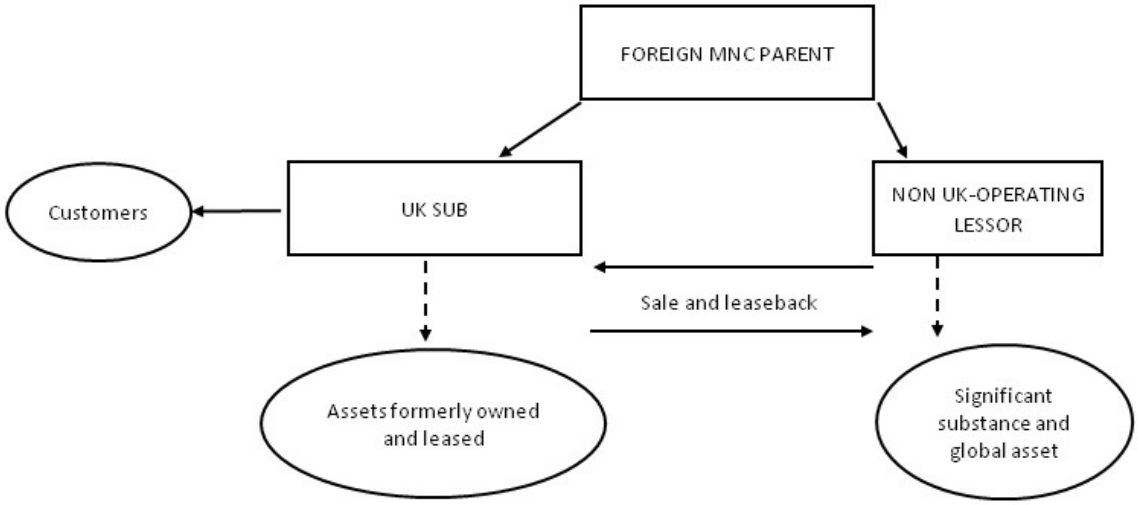
DPT would apply by reference to the relevant alternative provision on the basis that no deduction for the rental payments would be due.

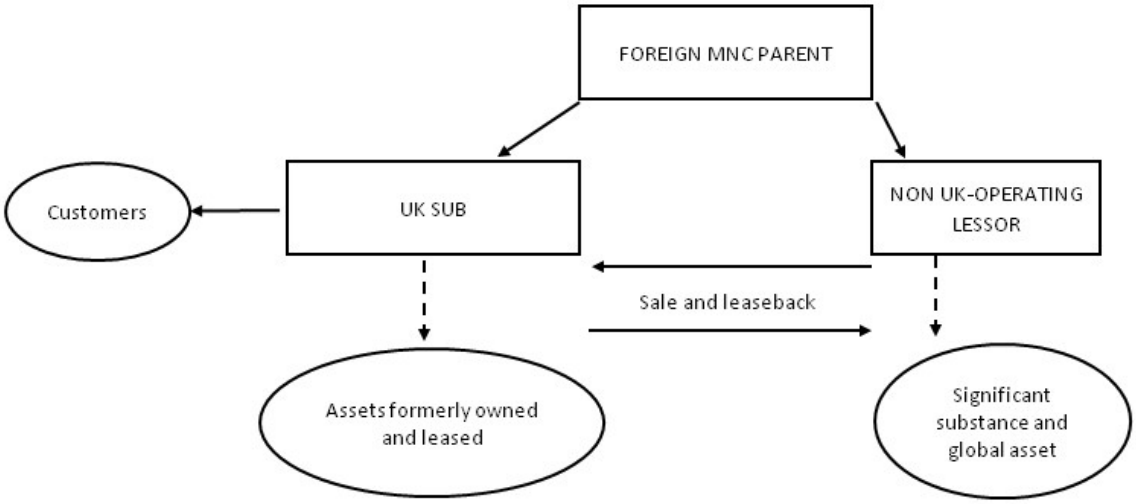
However, because the asset is a rented property it would be expected that the arrangements following the transfer of the property would be within the Non-Resident Landlord Scheme (- see Property Income Manual 4800+). Although the arrangement is one in which all the offshore company is doing is holding the property on behalf of the UK member group, there should not actually be any loss of UK tax as the rental income of the company in the low tax territory is subject to UK income tax, either as a result of withholding tax suffered on the rents paid by the tenant or letting agent, or by direct assessment on the filing of an income tax return ~~under~~by the Non-Resident Landlord ~~Scheme~~.

Technically, an effective tax mismatch outcome can arise in the latter circumstance (i.e. where this is directly suffered by the landlord, and not by way of withholding tax~~).~~), perhaps as a result of non-qualifying deductions being taken into account under Section 108(2)(b) FA15 e.g. interest expense incurred by the overseas company. However, this would not in itself mean that section 80 would apply to potentially give rise to a DPT charge, as the "insufficient economic substance condition" in section 110 must also be considered. As long as there is no real loss of UK tax because of the proper operation of the NRL Scheme, the assumption that the arrangements were designed to secure a tax reduction would not follow and no DPT charge would arise (and therefore no need to provide for a credit to be given for any income tax suffered ~~n~~in computing the liability).

Furthermore, if the computational rules at sections 82 - 85 were to be considered, a relevant alternative provision on the basis that the transactions would not have occurred absent considerations in relation to tax on the income would not follow from the facts (see DPT1180).

Example 2





Facts

- A UK member of a multinational group owns and leases aircraft and other assets to unconnected third party customers in Western Europe.
- The parent company acquires a company with more expertise in acquiring and managing aircraft than the UK company and whose aircraft leasing activities are more profitable, with large leasing contracts across the world.
- As part of a group restructuring, the UK company transfers ownership of its aircraft to the new foreign affiliate at fair market value on the basis that this is a more appropriate home within the group for those particular assets. This leaves the UK company better able to focus on and develop its more profitable activities. Some of its staff who had worked in the aircraft division transfer to the foreign affiliate.
- A few of the aircraft are leased back to the UK company on arm's length terms that allows it to make an appropriate profit for leasing them on. Most are used by the foreign affiliate in the ordinary course of its trade.
- The foreign affiliate has very significant substance behind its activities. The UK company does not have a similar level of capability in respect of aircraft and could not perform all the same functions.

Analysis

The substance of the new affiliate company and its functional capability to acquire, manage and exploit aircraft assets more profitably than the UK company should make it unlikely that the transactions or the involvement of the new affiliate company were designed to secure a tax reduction. However even if that was not clear, the presence of those factors would point away from a conclusion that the transactions would not have taken place at all in the absence of a tax reduction.

DPT1370 - Intangible assets

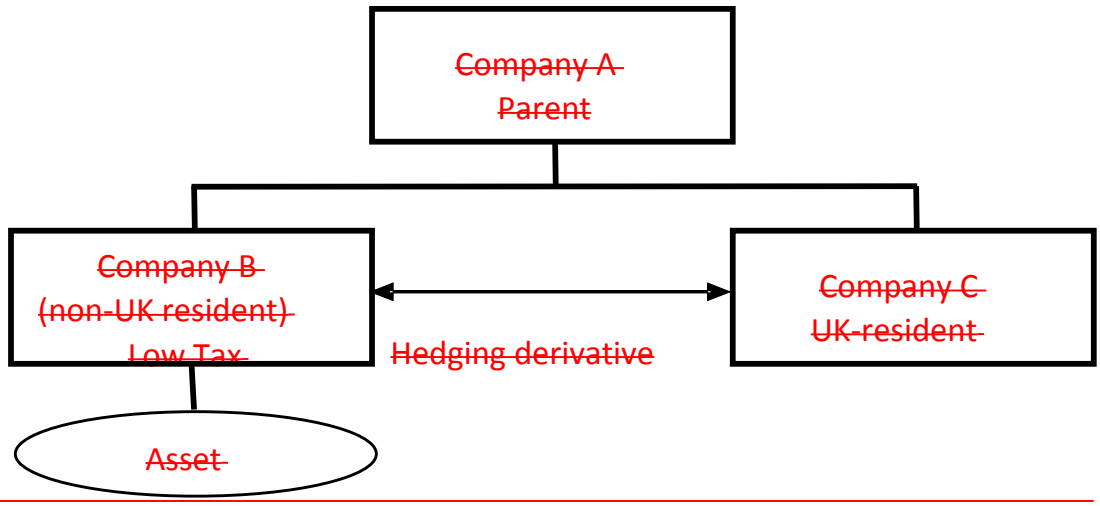
Where IP has been transferred from a UK group company to one subject to a lower rate of tax, the effective tax mismatch condition may either be met in respect of expenses that become payable by the UK company or in respect of income which would otherwise have been taken into account in computing its liability to tax.

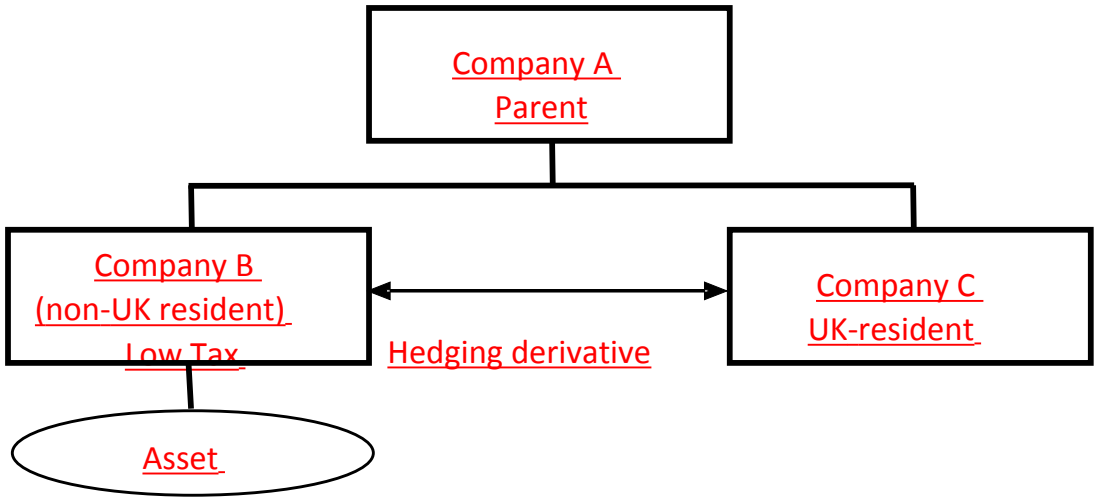
In considering the insufficient economic substance test the following factors are likely to need to be taken into account:

- ~~the~~The use of the IP in or from the UK, in comparison with use in or from other parts of the world.
- ~~whether~~Whether there has been a separation of ownership from the functions needed to properly manage the asset, and if so, the extent to which those functions are performed in the UK.
- ~~cost~~Cost synergies as a result of using a centralisation model (but not those based on the original centralisation having been tax-driven).
- ~~extra~~Extra costs associated with the transfer, including taxes paid on exit.
- ~~whether~~Whether, had the asset remained in the UK, any tax deductible amortisation of the asset would have sheltered UK income (so that no less tax is payable as a result of the transfer than if the IP had been held in the UK).
- ~~any~~Any cost-benefit analysis produced, whether at the time that the transaction was undertaken or subsequently.

The functions needed to properly manage the asset will be those in relation to the development, enhancement, maintenance, protection and exploitation of the intangible property. The fact that IP was originally developed in the UK before being transferred to another group company does not in itself mean that taxable diverted profits will arise, even if the transfer results in payments being made from the UK in respect of that IP. In particular it may be possible to reach a reasonable conclusion that transactions or the involvement of any entity were not designed to secure a particular tax reduction (see DPT1190) with reference to the sort of factors mentioned above.

DPT1380 – Banking / Financial Example 1: Involvement of entities or transactions lacking economic substance - Hedging strategy





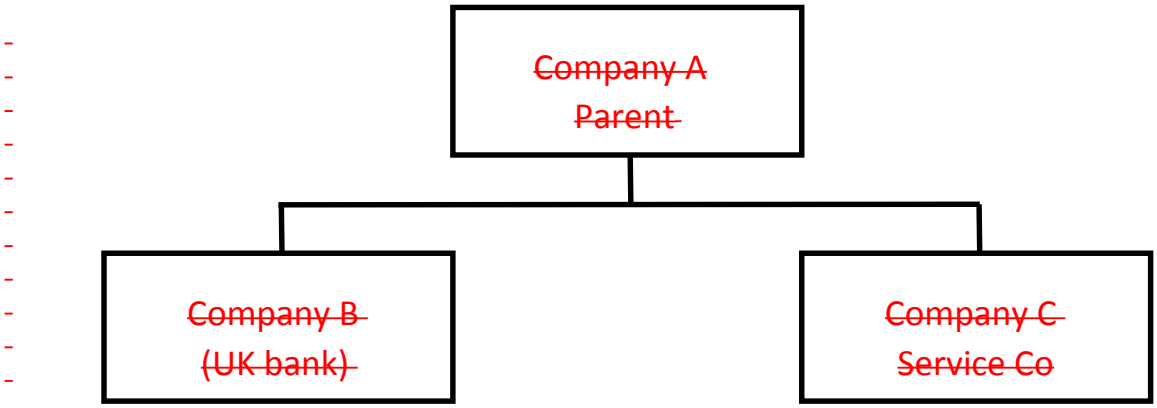
Facts

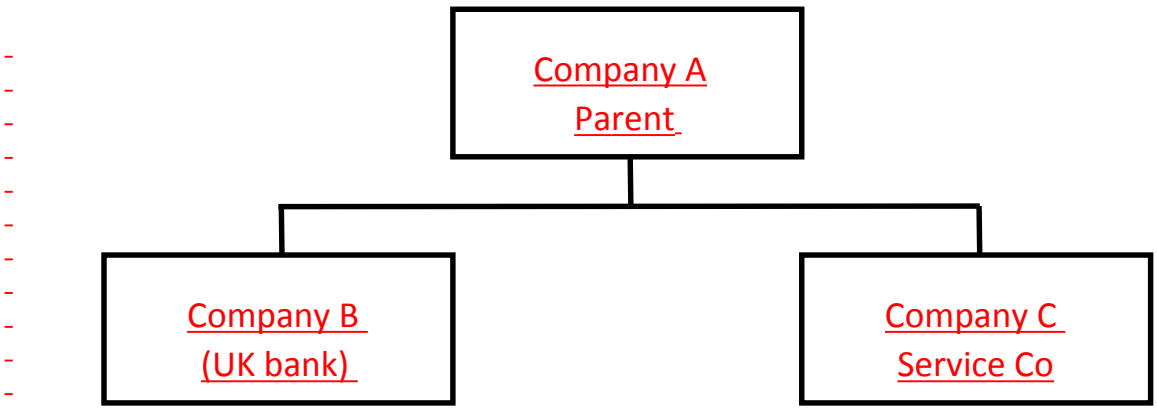
- Companies B and C are wholly owned by company A, so the participation condition is met
- Companies B and C are members of a financial services group and each carries on a financial trade. Company B holds an asset as part of its trading stock and enters into a derivative contract with company C, which fully hedges company B's asset.
- Company B is resident in a jurisdiction which imposes tax at the rate of 5%. Company C is UK-resident and profits and losses arising to it from the derivative contract are taxed as income under Part 7 CTA 2009.

In the accounting period ending 31 March 2017, the value of the asset falls and Company C is required under the hedging contract to pay company B £15m. This gives rise to an allowable expense in Company C, which reduces its CT liability by £15m x 20% = £3m. Company B has a loss on the asset of £15m and a compensating receivable under the terms of the derivative contract of £15m. The loss on the asset is a qualifying deduction within the meaning of section 108, so that the resulting increase in relevant taxes payable by Company B is computed by reference to £15m. The increase in relevant taxes that would be payable by Company B is £15m x 5% = £0.75m, meaning that there is an effective tax mismatch outcome. However, because the derivative contract is a "plain vanilla" hedging instrument ~~which~~it will give rise to either a profit or a loss that is dependent on factors entirely outside of the control of either party. Assuming that the pricing of the contract is at arm's length and there are no other relevant features of the provision, it would not be reasonable to assume that the transaction giving rise to the effective tax mismatch outcome was designed to secure the tax reduction enjoyed by Company C.

In those circumstances, no liability to DPT will arise.

Example 2: Banking Group: shared service centre

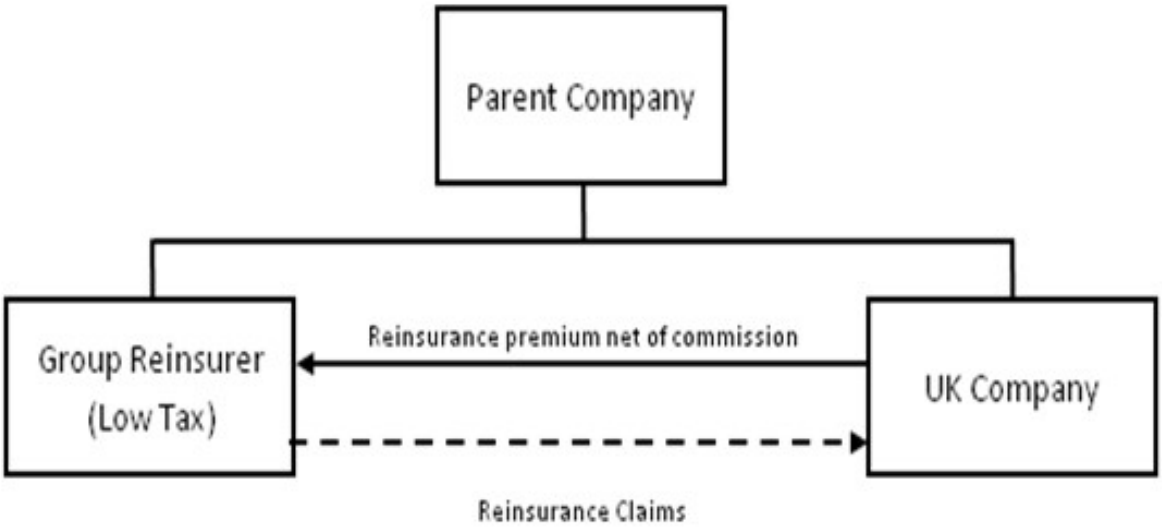


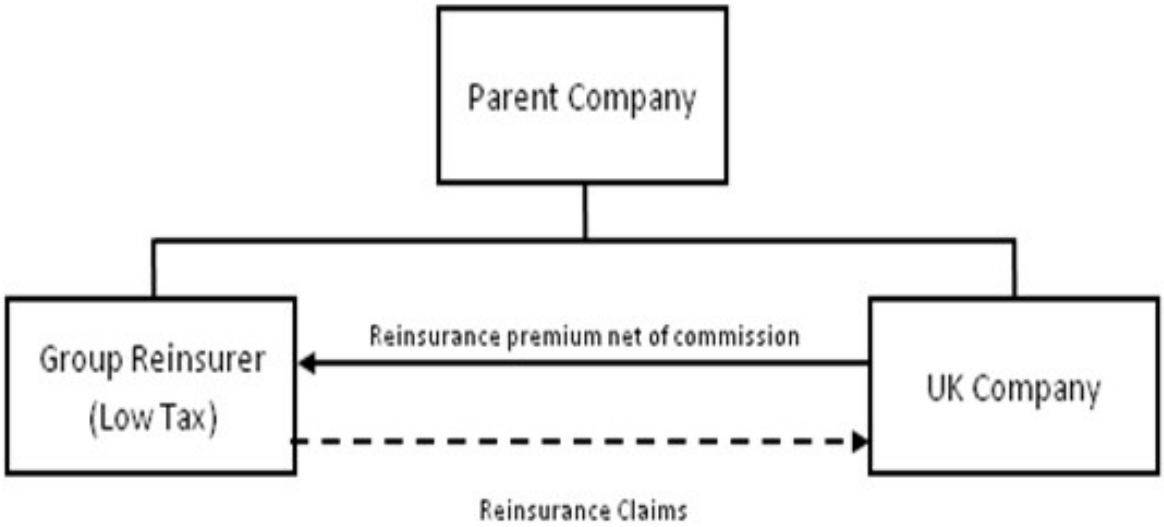


Facts

- As part of "recovery and resolution" planning, a banking group places crucial back-office shared services into a separate service company (Company C)
- The services performed are high value and are performed by staff in the territory of Company C.
- The transaction that gives rise to a tax mismatch outcome is the contract under which Company C provides services to Company B. There is no contrivance in this arrangement and in the circumstances it is not reasonable to conclude that the transaction itself was designed to secure the tax reduction.
- The staff of Company C are performing high value roles in providing the services and it may not be reasonable to assume that its involvement was designed to secure the tax reduction.
- In any case it seems clear that more than half of Company C's income is attributable to the ongoing functions of its staff.
- The insufficient economic substance condition is not met and therefore DPT will not apply.

DPT1390 – Insurance / Reinsurance Example 1: Intragroup reinsurance





Facts

- The group is a large multinational insurer employing over 2000 people worldwide. It has an extensive network of local subsidiary insurance companies across America, Asia and Europe. All of the local insurance companies are licenced by their local regulator.
- The UK company employs 350 people and is one of the largest of the local insurance subsidiaries, it employs its own actuarial and underwriting staff and can write insurance business within generous limits without seeking approval from the parent.
- The UK insurance risk requires £1,000m of capital to support an A credit rating. It reinsures 50% of its written business to the group reinsurer under a standard whole account quota share (WAQS) contract. As a result, the UK company's capital requirement reduces to £500m (also based on an A credit rating).

- The group reinsurer writes 25 WAQS reinsurance contracts with its major subsidiaries including the UK and has a staff of 20 including senior underwriters and actuaries capable of assessing the risks it reinsures from the rest of the group.
- The reinsurer outsources investment management and claims handling functions but the key entrepreneurial risk- taking function of assumption of risk is performed by the officers of the group reinsurer. In calculating its capital requirement the reinsurer gets credit for the geographic diversity of its risks.
- The credit rating agency determines that the group reinsurer only requires £300m additional capital to support the newly acquired risk and maintain its A credit rating. By reinsuring the capital required to support the reinsured UK risk has been reduced by 40% (£500m- £300m)
- There is no UK-resident reinsurer in the group that could be used to achieve the same capital reduction.

Analysis

For the purposes of section 80, the UK company is 'C' and provision has been made between C and the group reinsurer ('P') by means of the transactions under the WAQS contracts. The participation condition is met as between C and P and the material provision results in an effective tax mismatch outcome that is not an excepted loan relationship outcome. Neither C nor P are SMEs. Although there were a number of reasons to set up the arrangements in this way, tax considerations figured heavily in the detail and from the facts it is reasonable to assume that the transaction and involvement of the reinsurer were designed to secure the tax reduction.

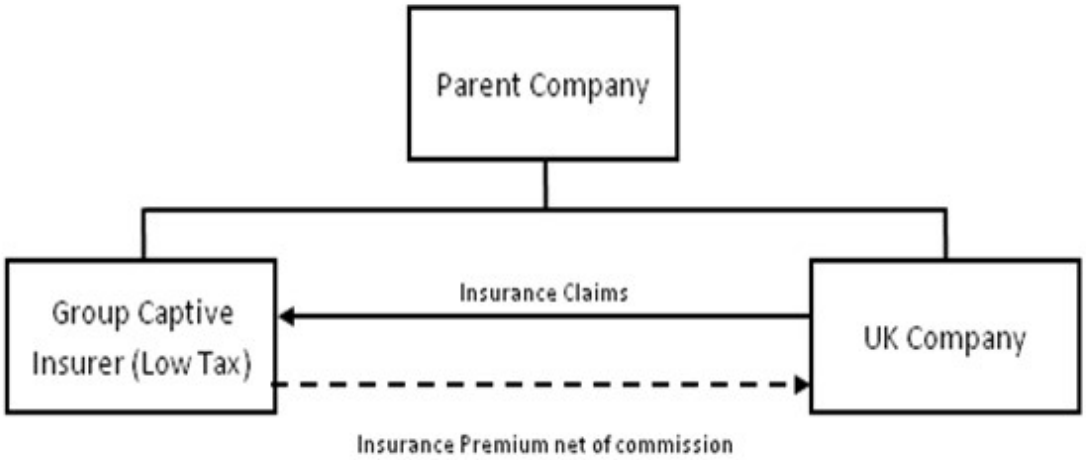
It is then considered whether, at the time of the making of the provision, it was reasonable to assume that the non-tax financial benefits referable to the WAQS reinsurance outweigh the financial benefit of the tax reduction (transaction based test). In this case the more efficient capital structure is a quantifiable non-tax financial benefit and, where the facts show that this would be greater than the tax saving throughout the life of the provision, there will be no DPT charge. In this simple example, the non-tax financial benefit could be calculated by determining the difference between the capital requirements following the diversification credit and the capital requirements absent the diversification credit and then multiplying the resultant figure by the cost of capital to arrive at a figure of non-tax financial benefit.

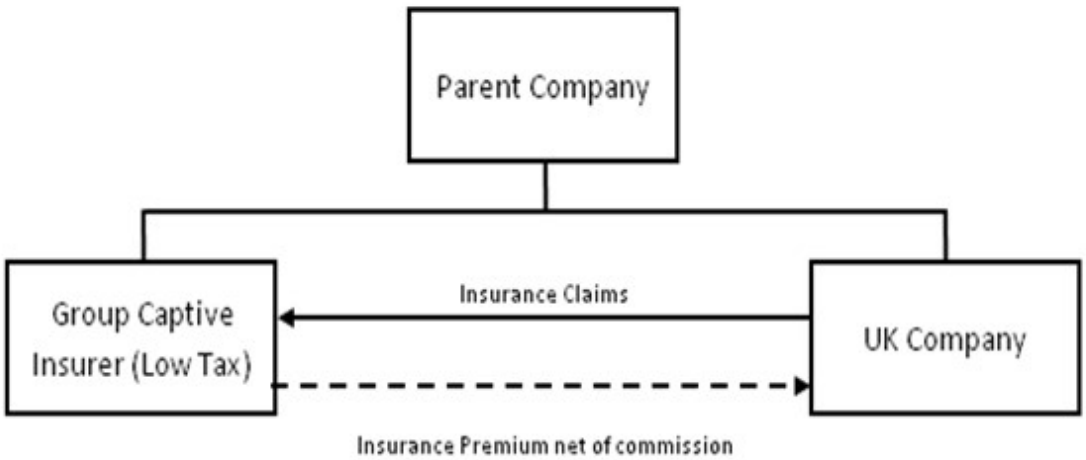
If in this case the tax saving outweighs the non-tax benefits it would then need to be considered whether a DPT charge would arise based on the computational rules at sections 82 to 85. Given the capital efficiency through diversification credit and the lack of a more commercial alternative arrangement within the group at the time the provision was made, there does not seem to be a relevant alternative provision (RAP) in the sense of a differently structured provision. There may still be DPT considerations around the pricing and terms of the arrangements.

In this sort of case the chief potential RAP is usually that the insurance risk would not be ceded by the UK insurer. For a RAP of no reinsurance it would be necessary to assume that the UK has sufficient capital to support the retained risk. While it is possible to hypothesise that the capital held by the reinsurer to support the assumption of the UK risk could have been held by the UK company, it would generally not be reasonable to hypothesise additional group capital.

In this case no other way of achieving capital efficiency through diversification credit has been identified, but if the capital efficiency could be achieved by reinsuring to another UK insurer in the group there would be a RAP and a potential DPT charge depending on the outcome of other tests.

Example 2: Intragroup insurance within a non-insurance group





Facts

- This is a multinational group that manufactures specialist high value plant in a number of European countries. Failure of its products can give rise to significant catastrophic loss. However the group has excellent quality control systems and it has been 15 years since the last customer claim.
- The parent has oversight of group risk and determines insurance policy for the group. It also negotiates a group wide insurance policy for product indemnity with one of the largest insurance multinationals. The policy has a cover limit of €500m in any one year. The parent has determined that further cover ~~should be extended to €550m and the €50m excess~~of €50m is placed with the intragroup insurer, established in a low tax jurisdiction.
- The UK company is one of three major manufacturing centres and manufactures the most technologically advanced products for sale around the world.
- The intragroup insurer employs three people part time including a senior underwriter. Most of the underwriting and actuarial risk pricing is outsourced to a specialist insurance consultancy based in the USA.

- The independent specialist insurance consultancy has produced a full actuarial report on the risk assumed by the captive. The insurance premium is paid at the arm's length rate.

Analysis

For the purposes of section 80, the UK company is 'C' and provision has been made between C and the group insurer ('P') by means of the insurance transactions. The participation condition is met as between C and P and the material provision results in an effective tax mismatch outcome that is not an excepted loan relationship outcome. Neither C nor P are SMEs.

It is established that tax considerations figured heavily in the detail of the arrangements and it is reasonable to assume that the transaction and involvement of the group insurer were designed to secure the tax reduction.

It is then considered whether, at the time of the making of the provision, it was reasonable to assume that the non-tax financial benefits referable to the insurance transactions or involvement of the group insurer outweigh the financial benefit of the tax reduction.

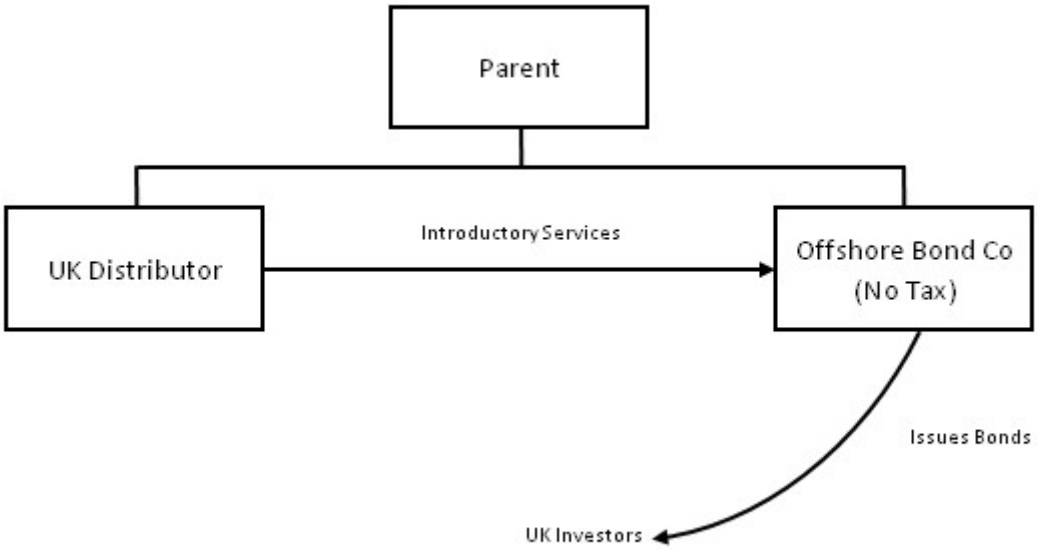
This is not a regulated insurance group and the intragroup insurer is not being used to create capital efficiencies. ~~Indeed the group~~The UK company has sufficient liquid assets to meet ~~any claim over the~~expected potential claims in excess ~~amount. There is no economic benefit directly related to the movement~~ of the ~~insurance risk.~~ cover.

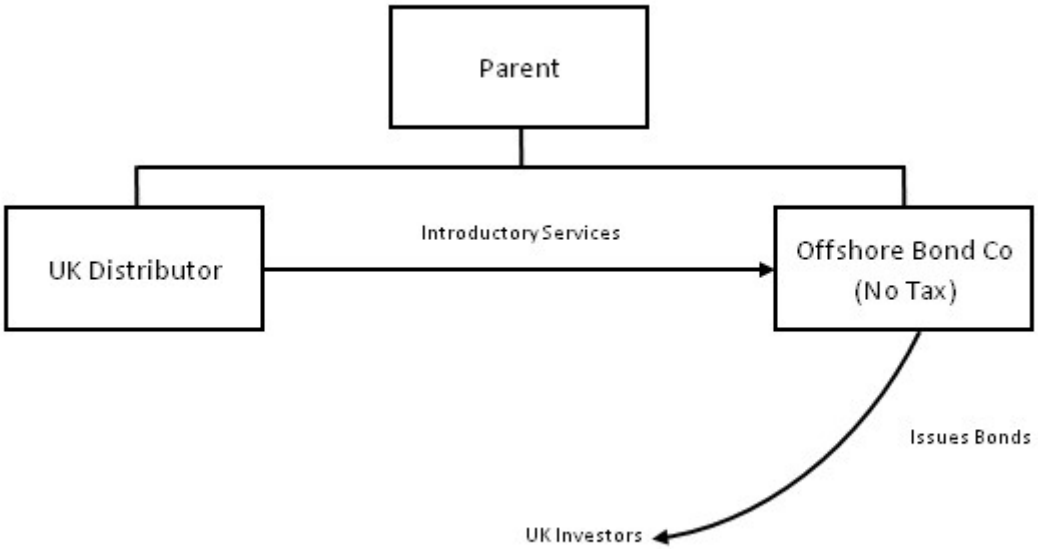
The functions performed by the ~~intragroup~~group insurer are minimal. ~~Assessment and management~~Consequently it is reasonable to assume that the non-tax benefits attributable to the functions of the ~~group's~~group insurer will not exceed the financial benefit of the tax reduction arising from the insurance ~~risk is directed~~transactions between it and ~~performed by~~ the ~~parent.~~ UK company. The premium paid by the UK company is correctly priced but there are no commercial motives for the transaction other than the tax saving. ~~As the group has not insured this risk externally it is reasonable to assume that the UK company could keep the risk on its own balance sheet.~~ It follows that absent the tax mismatch the ~~insurance~~UK Company would not have ~~happened~~insured with the group insurer. The result is that the actual provision condition is not met and the UK company will be subject to a DPT charge on an amount equal to premium net of claims and any expenses related to services provided to the UK company. Certain fact patterns may also support the conclusion that investments funded by the premium would have been held by the UK company or that the funds would have been applied in some other way, for example if the intragroup insurer was applying some part of them to lend back to the premium payer.

The same analysis would apply if a third party fronter had been interposed between the UK company and the group insurer, with the third party reinsuring 100% of the risk it assumes to the group insurer. The provision for the purpose of DPT would be between the UK company and the group insurer. As all of the other facts are the same as in the example the provision is subject to a DPT charge.

There may be genuine non tax commercial reasons for a non-insurance group to use intragroup insurance/reinsurance but there are likely to be very limited circumstances where the specific fact pattern would support the conclusion that DPT is not in point. The reinsurance of a very high proportion of the risk held by the group insurer out to a third party reinsurer may be an indicator that the intragroup insurer has not been set up primarily to achieve tax reductions.

Example 3: Life assurance offshore bond distribution





Facts

- A non UK headed multinational insurance group offers bonds from an overseas subsidiary to investors in the UK. The bonds are sold to customers via independent financial advisors and directly through the UK distribution agent. The offshore company has 20 employees. It employs a team of actuaries and underwriters who design the range of bonds offered by the overseas company. The investment management function has been subcontracted to third party managers.
- The UK distribution subsidiary introduces potential investors to the overseas company who issues the bond to the investors. It provides regular reports on the UK bond market to assist the overseas company in designing bonds that would appeal to UK investors. It also provides marketing and promotion services to independent financial advisors.
- The UK Company charges an arm's length rate for its services

Analysis

When investing, the investor contracts directly with the overseas company. The UK company is acting as an agent of the overseas bond company but it only provides introductory services; it does not commit the overseas company to issue bonds to the investor. As the UK company has not concluded contracts binding the overseas company to issue bonds it has avoided becoming a dependent agent permanent establishment (DAPE) of the overseas company. For the purposes of section 86, the UK company is carrying on activity in the UK in connection with the supply of services made by the non-resident bond issuing company in the course of that company's trade. It is also reasonable to assume that the activity (including any limitation to it) has been designed to ensure that the UK company falls short of being a DAPE of the overseas company. None of the exceptions in section 86 or 87 apply and the arrangement will be within the scope of the DPT if either (or both) the mismatch condition or the tax avoidance condition is met.

The mismatch condition is not met, because there is no provision creating or increasing expenses or reducing income of the non-resident company resulting in a tax mismatch, and a DPT liability can therefore arise only if the tax avoidance condition is met.

If the offshore company were resident in the UK its business would be classed as Basic Life Assurance and General Annuity Business (BLAGAB). The investor's share of profit would be subject to the I-E regime and the shareholder's share would be subject to the normal CT regime. The I-E regime still results in a CT charge so selling the bonds from the offshore company results in a potential reduction in a charge to CT.

A tax reduction will arise if any of the profits of the overseas company would have been attributed to the UK if the avoided DAPE were a UK PE of the non-resident company. To determine whether any profits of the overseas company would be attributed to the UK PE the authorised OECD approach to attributing profit to PEs (AOA) applies. Under the AOA profits are attributed based on the location of the key entrepreneurial risk taking function (KERT). For insurance the KERT is generally the assumption of insurance risk; depending on the nature of the bonds, investment management may be the KERT or may form part of the KERT. In this arrangement the KERT is the design and origination of the bond products which is performed by the overseas company and not by the UK distributor.

There is therefore no additional profit to attribute to the UK activities, over and above the arm's length reward paid to the UK company for its services and no avoidance of UK CT. As no additional profit is attributable the arrangement cannot have had a main purpose of avoiding UK CT so no liability to DPT will arise.

Example 4: Intragroup fronting

Facts

- The group is a multinational insurer with an extensive network of insurance companies around the world.
- A UK company in the group has a substantial insurance business but does not have any expertise or experience in underwriting product X.
- Product X is a core offering of the underwriting company resident in a low tax territory.
- All of the underwriting function for product X is undertaken by the underwriting company.
- The UK company fronts the insurance contracts relating to product X and the risk is 100% reinsured to the underwriting company. The UK fronter undertakes the necessary risk management activities to meet local regulatory requirements and provides contract administration assistance.
- The UK fronter receives an arm's length fronting commission for its activities.

Analysis

For the purposes of section 80, the UK fronter is "C" and provision has been made between C and the underwriting company ("P") by means of the transactions under the fronting arrangements. The participation condition is met as between C and P and the material provision results in an effective tax mismatch outcome that is not an excepted loan relationship outcome. Neither C nor P are SMEs.

The latter part of the economic substance tests in sections 110(4), (5) and (6) do not need to be considered where it is not reasonable to assume that either the transaction(s) or the involvement of a party were designed to secure the tax reduction.

The UK fronter does not have the expertise to underwrite product X business and its function with regard to product X is restricted to the functions required to meet the local regulatory requirements. The fronting arrangement is designed to enable the producing company to underwrite UK risks and not to secure the tax reduction.

For the purposes of section 86, the UK fronter is carrying on activity in the UK in connection with the supply of services made by the underwriting company in the course of that company's trade. There is no wider provision involving another person and the producing company so the tax mismatch condition is not met. None of the specific exceptions in section 86 or 87 apply so the arrangement will be within the scope of section 86 if the tax avoidance condition is met.

In considering whether the main purpose or one of the main purposes of the arrangements is to avoid or reduce a charge to corporation tax it is important to consider what reduction of tax would have been expected. A tax reduction will arise if any of the profits of the non-resident underwriting company would have been attributed if the UK fronter had been treated as its dependent agent PE. The location of the key entrepreneurial risk-taking (KERT) functions is central to the attribution under the authorised OECD approach. In this context the KERT function is generally the assumption of insurance risk which is performed by the underwriting company outside the UK.

On that basis there is unlikely to be any additional profit to attribute to the UK activities, over and above the arm's length reward (commissions) paid to the UK company for its services and therefore no avoidance or reduction of UK corporation tax.

It should be noted that although the specific fact pattern in the above example points to there being no DPT charge, fronting arrangements in general can be put in place for a variety of reasons, some of these will be designed to achieve a reduction of tax or tax mismatch. In particular arrangements where the UK fronter or other UK company provides underwriting services through subcontract arrangements with the non-resident underwriting company can attract a DPT charge.

DPT 1395 – Lloyd's

The commencement provisions in section 116(4) Finance Act 2015 ensure that Lloyd's members are subject to DPT on ~~the declarations basis in the same way as they would be subject to CT. Profits~~ profits declared ~~on 30/04/17 are taxed as profits of the accounting period ending 31/12/17. However the profits are~~ in the 2015 calendar year and subsequent periods. The DPT only applies to profits referable to ~~the underwriting~~periods from 1 April 2015.

The 2013 year of account ~~ending 31/12/14 and are therefore outside the scope of DPT.~~

~~Profits declared on 30/04/18 are taxed as~~will include profits ~~of the accounting period 31/12/18. These profits are referable~~from 2013, 2014 and 2015. The DPT provisions do not apply to ~~the underwriting year of account ending 31/12/15. The~~ profits referable to ~~the period~~times before ~~01/04/15 are outside the scope of DPT but the profits for the period from~~ 1 April 2015, that ~~date~~is, profits from 2013, 2014 and 1 January 2015 – 31 March 2015. Profits referable from 1 April 2015 are within ~~the~~ scope~~. To calculate the~~ of DPT.

DPT may apply to a year of account prior to 2013 if the year of account is in run off and there are profits referable to times on or after 1 April 2015.

Profits within the scope of DPT ~~the profits~~ of ~~the~~a year ~~ended 31/12/15~~of account are allocated to each period on a just and reasonable basis~~ in most cases this a time apportionment of the year's profits will be appropriate~~.

~~Profits declared on 30/04/19 are taxed as profits of the accounting period ending 31/12/19. The profits are referable to the underwriting year of account ending 31/12/16 and are therefore within the scope of DPT.~~

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DPT1400 – Securitisation

A company that meets the conditions of the regulations at SI 2006 3296, including the unallowable purpose rules [see CFM72570], is taxable (in accordance with regulation 14) on the basis of cash retained rather than on its profits as calculated under the normal corporation tax rules [see CFM72610]. Where the participation condition is met [see DPT1170] transactions to transfer assets from the originator (or another company providing securitised assets) to a securitisation company within the requirements of the regulations could be seen as potentially giving rise to an effective tax mismatch outcome In some cases such an outcome may not be within the excepted loan relationship outcome exclusion.

However, the insufficient economic substance condition requires the consideration of whether transactions or the involvement of an entity have been designed to secure the tax reduction identified. Although there would certainly have been careful consideration around ensuring that the arrangements met the conditions for the tax treatment provided for by the regulations to apply, HMRC would not expect that to amount to "design to secure the tax reduction" in the sense of section 110 [see DPT1190 and 1191]. There would be no element of contrivance, nor any material difference between those arrangements and those that would have otherwise been made to achieve the same commercial purposes. As long as the arrangements fall within the regulations it would not be reasonable to assume that such a transaction or the involvement of the securitisation company in it had been designed to secure the tax reduction.

As described at CFM72500 where a company fails to meet the conditions at regulation 11 ('payments condition') and regulation 12 ('unallowable purposes test') the special corporation tax charge in regulation 14 and other modifications provided by the regulations to the normal corporation tax rules do not apply to it. It will still be a 'securitisation company' unless it also falls outside the scope of the definitions in regulations 4 to 10.

Because of the way in which the charge under regulation 14 works it would not be expected that the DPT rules would operate to result in any charge to DPT on a securitisation company that meets all the conditions under the regulations. However HMRC is aware that, particularly in the context of legal advisers providing opinions as to the tax treatment of arrangements, there may be some degree of uncertainty - for example as to whether the participation condition is met in respect of other entities and as to whether transactions could potentially give rise to effective tax mismatch outcomes. In some cases, for example in the context of a whole business securitisation where a securitisation company issues notes and lends the proceeds to the securitised group, it may be clear (other than where debt is issued on a limited recourse basis) that any such mismatch outcomes would arise wholly from something which would produce debits and credits under Part 5 Corporation Tax Act 2009 and would therefore be within the excepted loan relationship outcome exclusion.

However there are many situations where this will not be the case and some transactions between the securitisation company and originator could potentially be seen as having been "designed" to ensure that the conditions of the regulations are met (for example in terms of the timing of payments in order to ensure that the payments condition is satisfied). As long as the securitisation company meets the conditions for the corporation tax charged by regulation 14 to apply, the arrangements should be seen in the context of the securitisation company being within that tax charge. In that context it would not be reasonable to assume that such transactions, or the involvement of the originator (or another company that has provided securitised assets), were designed to secure a particular effective tax mismatch outcome. They would therefore not give rise to any charge to DPT on the securitisation company.

DPT 1410 - Shipping / Tonnage Tax Tonnage Tax

The Tonnage Tax rules substitute a notional CT base geared to ship tonnage for one based on profits (see TTM01010). It follows that the effective tax mismatch outcome test, based on expenses or reduction of income, could not give a mismatch outcome in relation to the taxation of tonnage tax activities within the regime. So to the extent that a UK resident company's activities are properly within the Tonnage Tax ring fence they would not give rise to a DPT charge on that company under section 80.

However transactions across the ring fence with connected companies are capable of giving rise to a charge on the connected company.

Agency Offices and section 86

Shipping companies resident in countries with which the UK has a treaty based on the OECD Model Tax Convention (MTC) will benefit from the equivalent of Article 8 (Shipping, inland waterways transport and air transport) which allocates taxing rights on profits from international traffic to the country of residence or place of effective management.

However it is not unusual for such companies to contract with customers through a connected UK company, usually an agent subsidiary, which will be taxable in the UK on the profits from its activities in providing services to the shipping company. Although such arrangements may have features in common with those targeted by section 86, the intention of the relevant treaty article is to ensure that the shipping company is not treated as trading through a UK PE. No particular arrangements involving any form of contrivance are needed to secure that result. As long as the activities of the agency office are within the relevant article the arrangements would not be considered to be designed so that the shipping company was not carrying on its trade through UK PE. Section 86 would therefore not apply.

Ship management

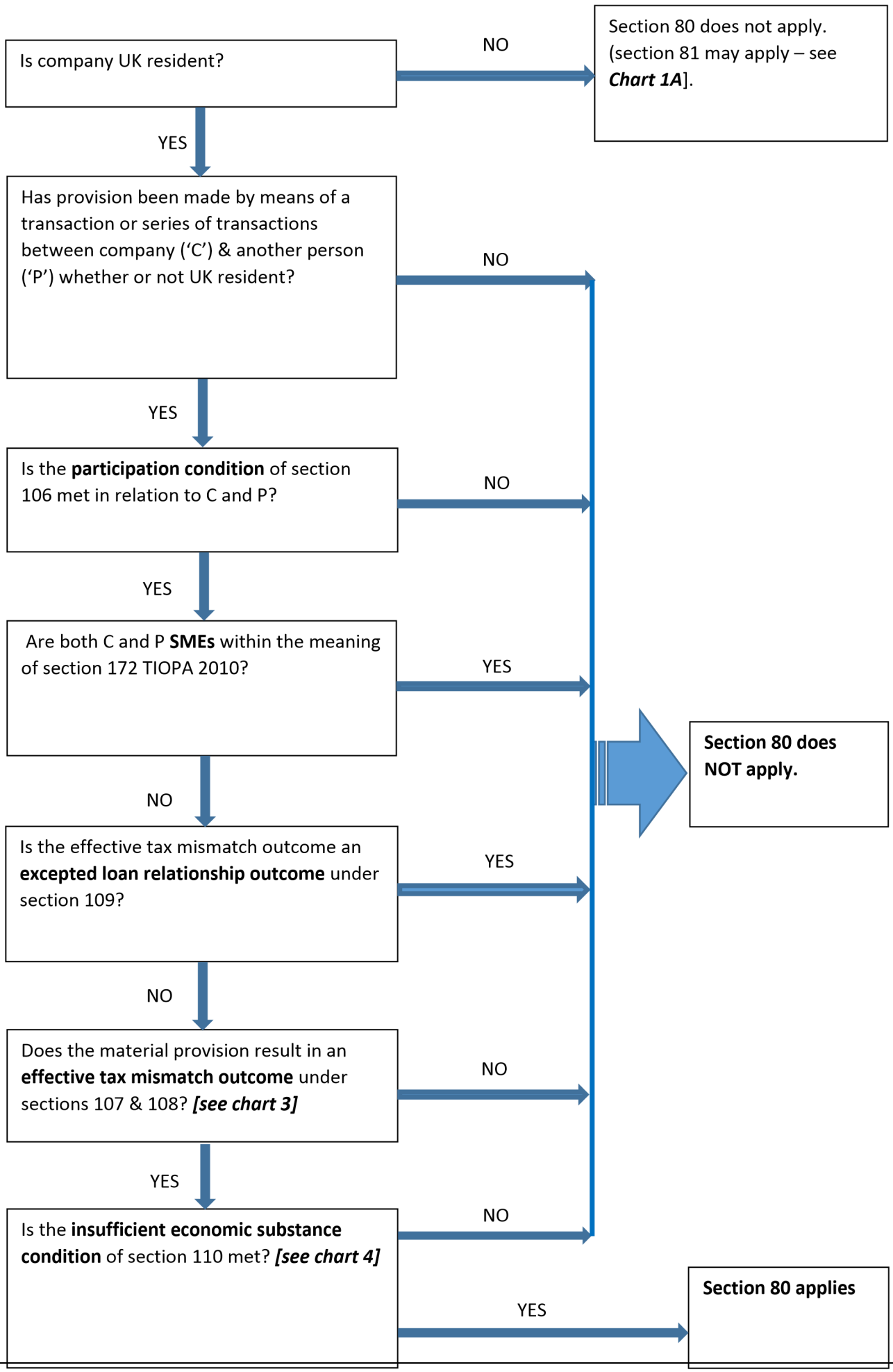
A UK resident company providing services to a number of ship owners that it is not connected with, acting in the ordinary course of its business, would normally be regarded as an agent of an independent status. It would be expected that the exception from section 86 at section 86(5) would apply in relation to any foreign company that the ship management company is not connected with.

PART 3: Flowcharts

- DPT1500 - Chart 1: Section 80: Lack of Economic Substance – UK Company
- DPT1505 - Chart 1A: Section 81: Lack of Economic Substance – Non-UK Company (P.E.)

  DPT1510 - Chart 2: Section 86: Non-UK Company Avoiding a UK P.E.
- DPT1515 - Chart 2A: Section 86(2): The ‘mismatch condition’ DPT1520 - Chart 2B: Section 86(5): ‘Excepted’ Avoided P.E.
- DPT1525 - Chart 3: Sections 107 & 108: ‘Effective Tax Mismatch Outcome’
- DPT1530 - Chart 4: Section 110: ‘Insufficient Economic Substance Condition’
- DPT1535 - Chart 5: Sections 82 – 85: Computation of DPT charge in section 80 or 81 cases
- DPT1540 - Chart 5A: Section 85: Computation of DPT charge in section 80 or 81 cases

DPT1500 - Chart 1: Section 80: Lack of Economic Substance – UK Company



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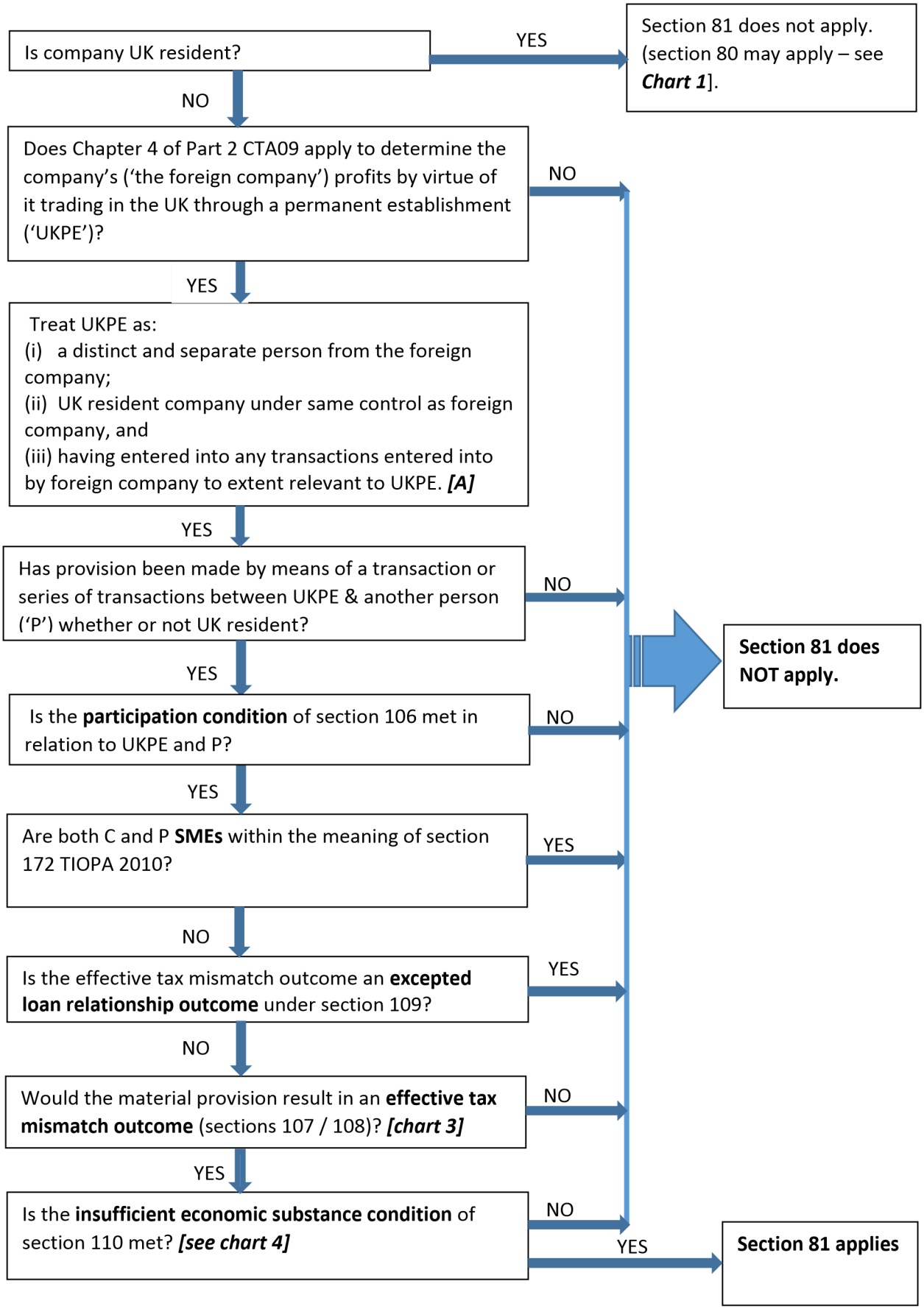
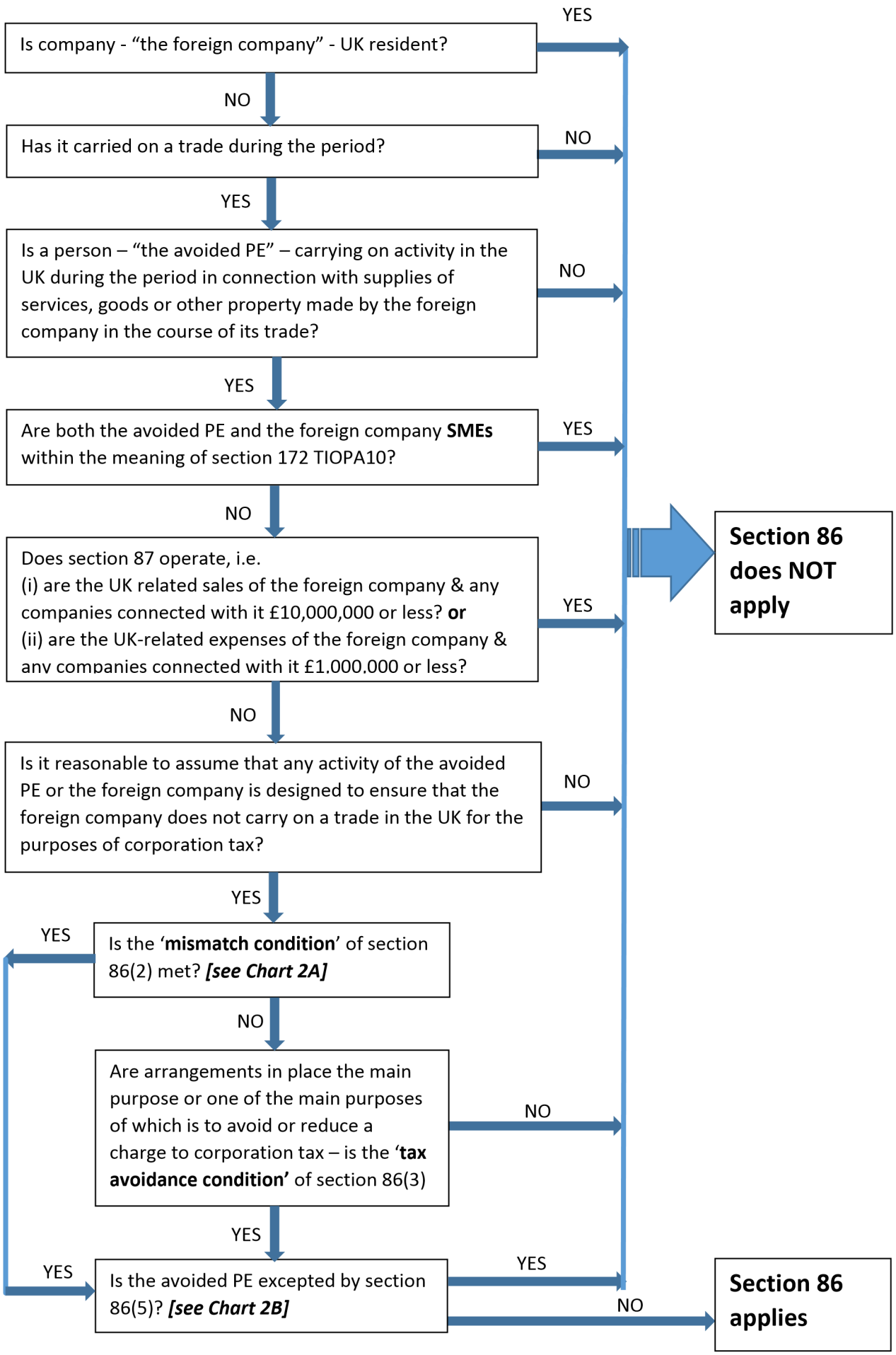
DPT1505 Chart 1A: Section 81: Lack of Economic Substance – Non-UK Company (P.E.)

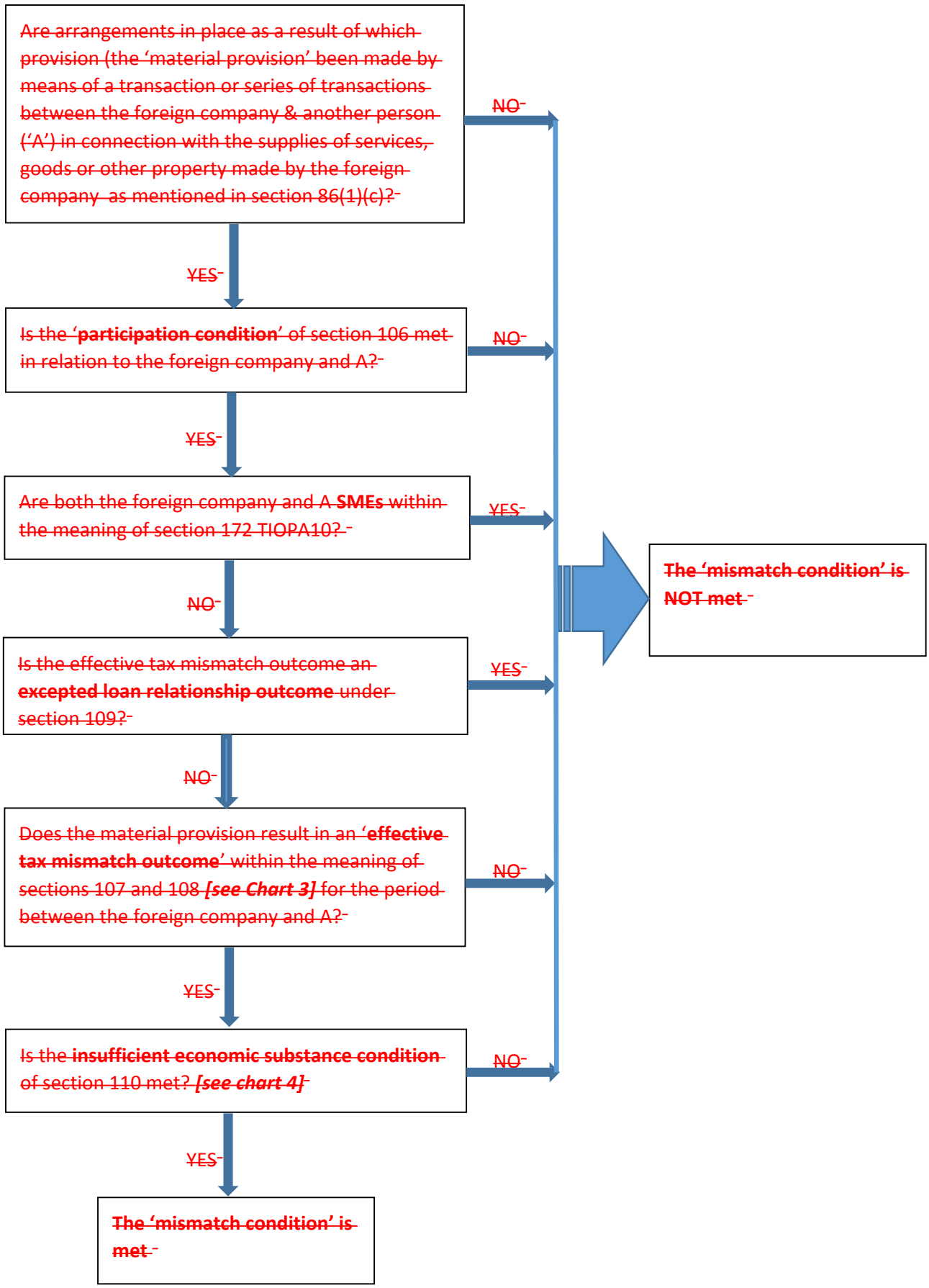


[A] A transaction or series of transactions is "relevant" to UKPE to the extent that it is relevant for corporation tax purposes, when determining the chargeable profits of the foreign company attributable (in accordance with sections 20 to 32 of CTA09) to UKPE.

DPT1510 - CHART 2: Non-UK company avoiding a UK taxable presence (Section 86)



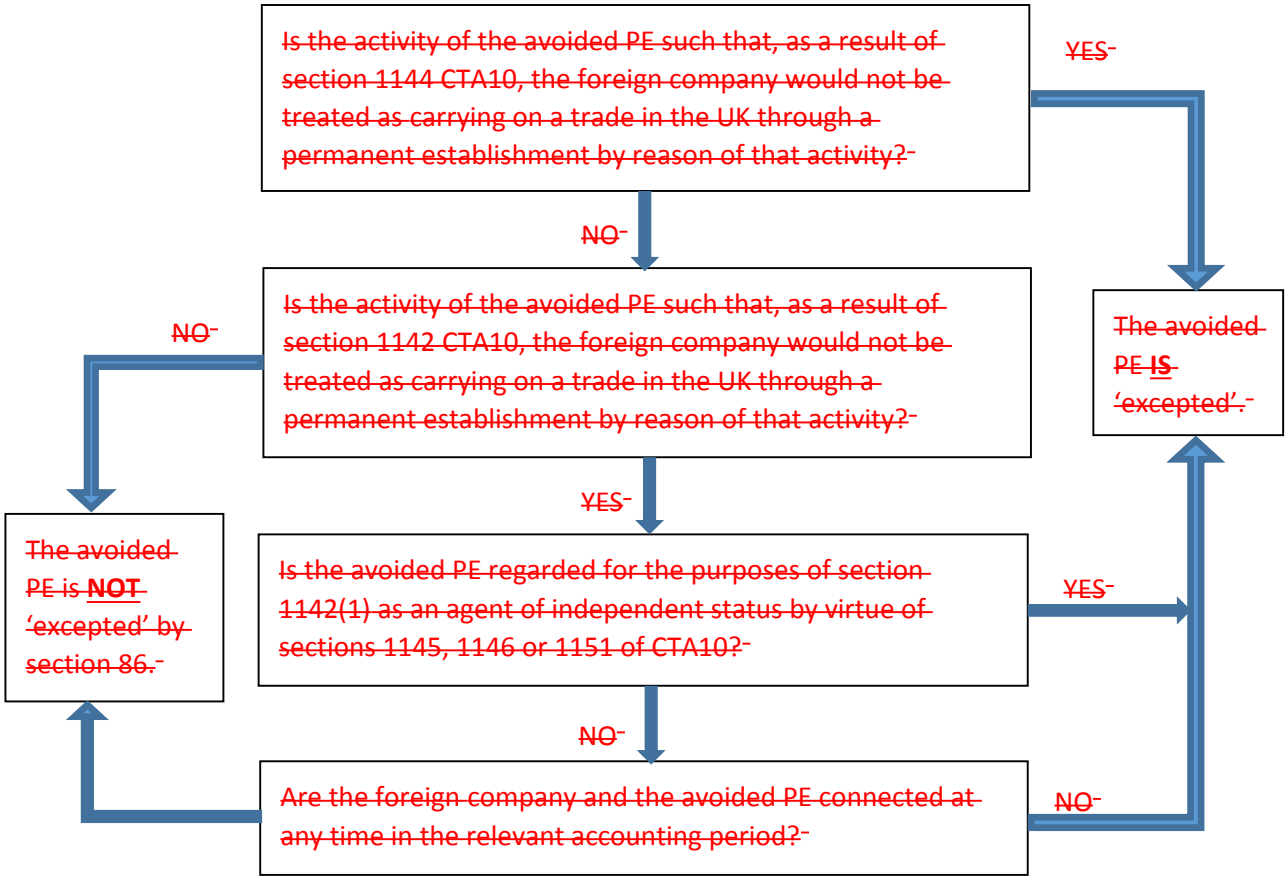
DPT1515 CHART 2A: The 'mismatch condition' (Section 86(2))



DPT1520 – CHART 2B: 'Excepted' Avoided PE (Section 86(5))

'**Avoided PE**' as per section 86(1)(c):

"a person ("the avoided PE"), whether or not UK resident, is carrying on activity in the United Kingdom in that period in connection with supplies of services, goods or other property made by the foreign company in the course of that trade"



1142 Agent of independent status

(1) A company is not regarded as having a permanent establishment in a territory by reason of the fact that it carries on business there through an agent of independent status acting in the ordinary course of the agent's business.

(2) Sections 1145 to 1151 apply for the purpose of supplementing subsection (1) in relation to transactions carried out on behalf of a non-UK resident company by a person in the United Kingdom acting as—

(*a*) a broker (section 1145),

(*b*) an investment manager (sections 1146 to 1150), or

(*c*) a members' or managing agent at Lloyd's (section 1151).

1144 Alternative finance arrangements

(1) Subsection (2) applies if alternative finance return is paid to a non-UK resident company.

(2) The company is not regarded as having a permanent establishment in the United Kingdom merely by virtue of anything done for the purposes of the alternative finance arrangements—

(*a*) by the other party to the arrangements, or

(*b*) by any other person acting for the company in relation to the arrangements.

(3) In subsection (1) "alternative finance return" means alternative finance return within the application of—

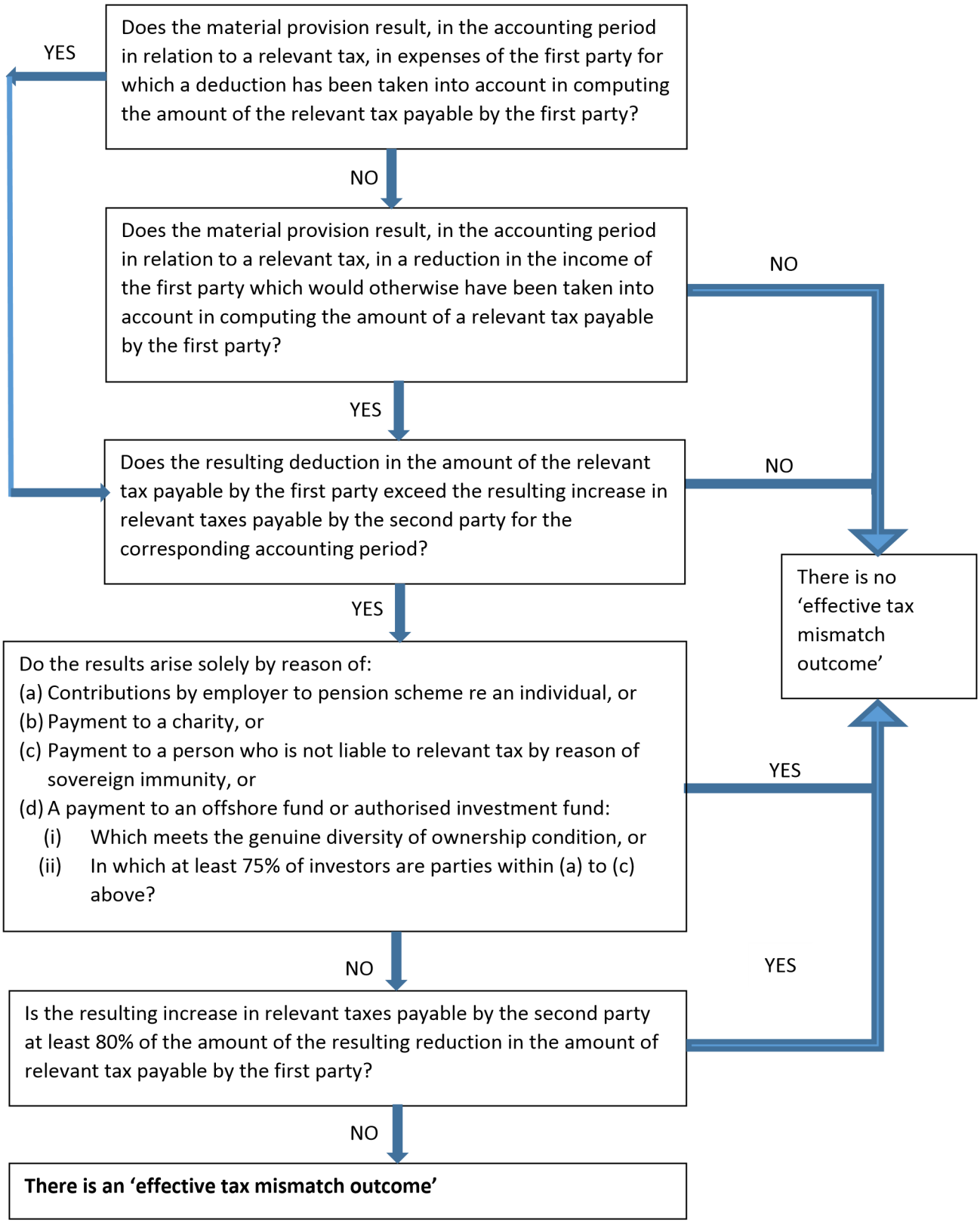
(*a*) section 564I, 564K or 564L(2) or (3) of ITA 2007, or

(*b*) section 511, 512 or 513(2) or (3) of CTA 2009.

(4) In subsection (2) the reference to "the alternative finance arrangements" is a reference to the alternative finance arrangements under which the alternative finance return mentioned in subsection (1) is paid.

DPT1525 CHART 3: Effective Tax Mismatch Outcome (Sections 107 & 108)

"**First party**" = 'C' re section 80; 'Foreign company' re section 86
"**Second party**" = 'P' re section 80; 'A' re section 86
"**Relevant tax**" = corporation tax, ring-fence trade tax, income tax, any non-UK tax on income (per section 107(8)).



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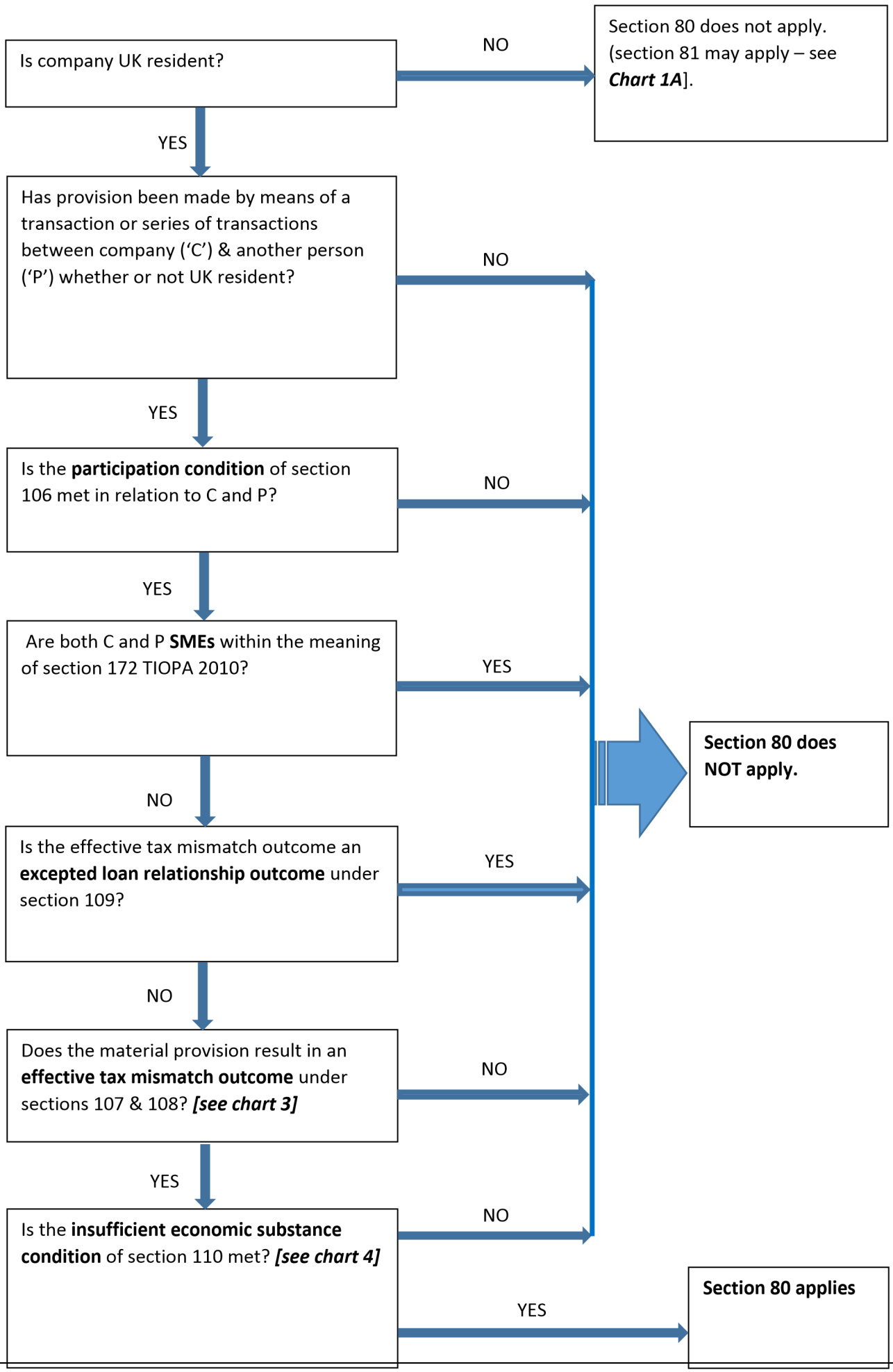
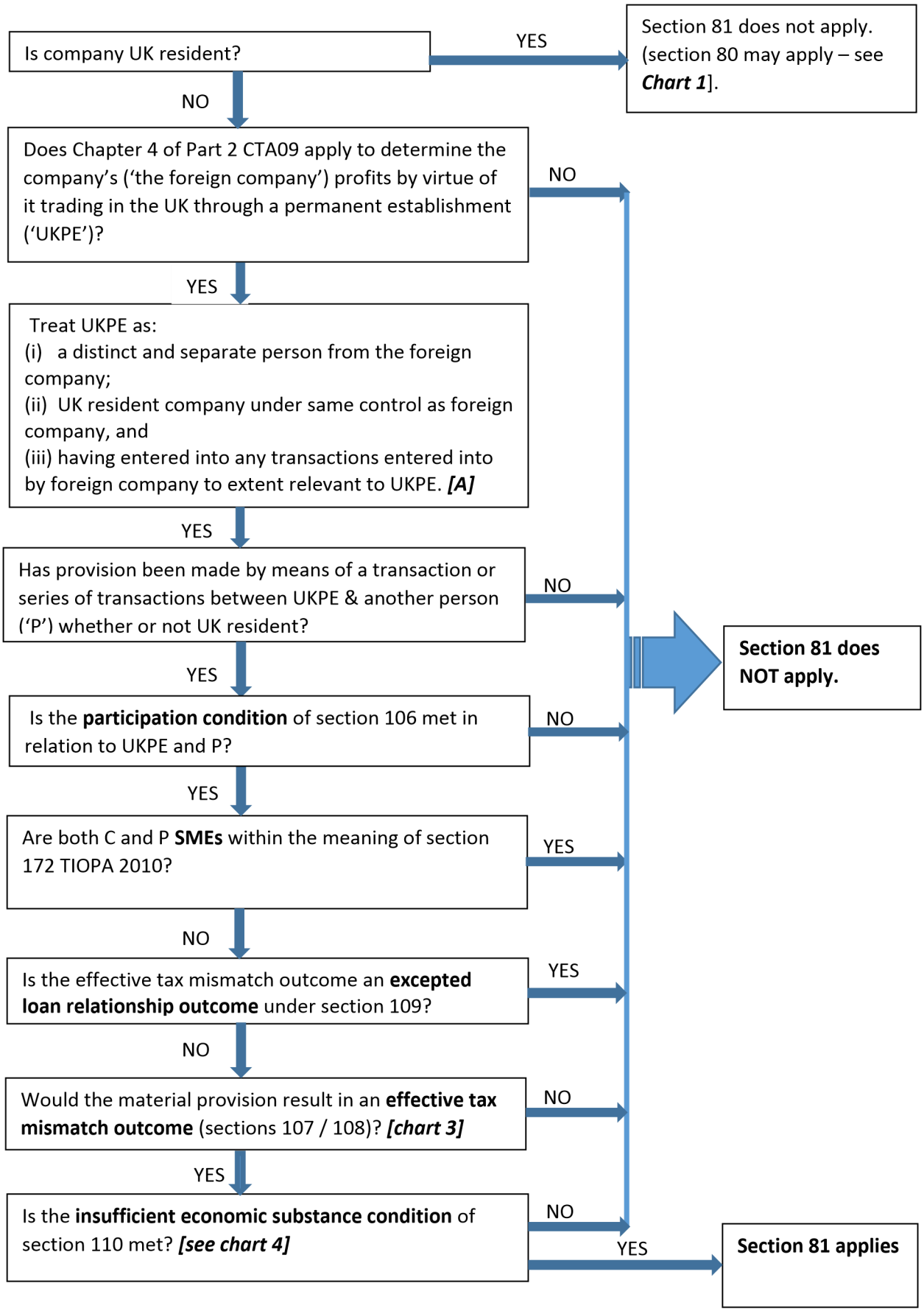
DPT1500 - Chart 1: Section 80: Lack of Economic Substance – UK Company

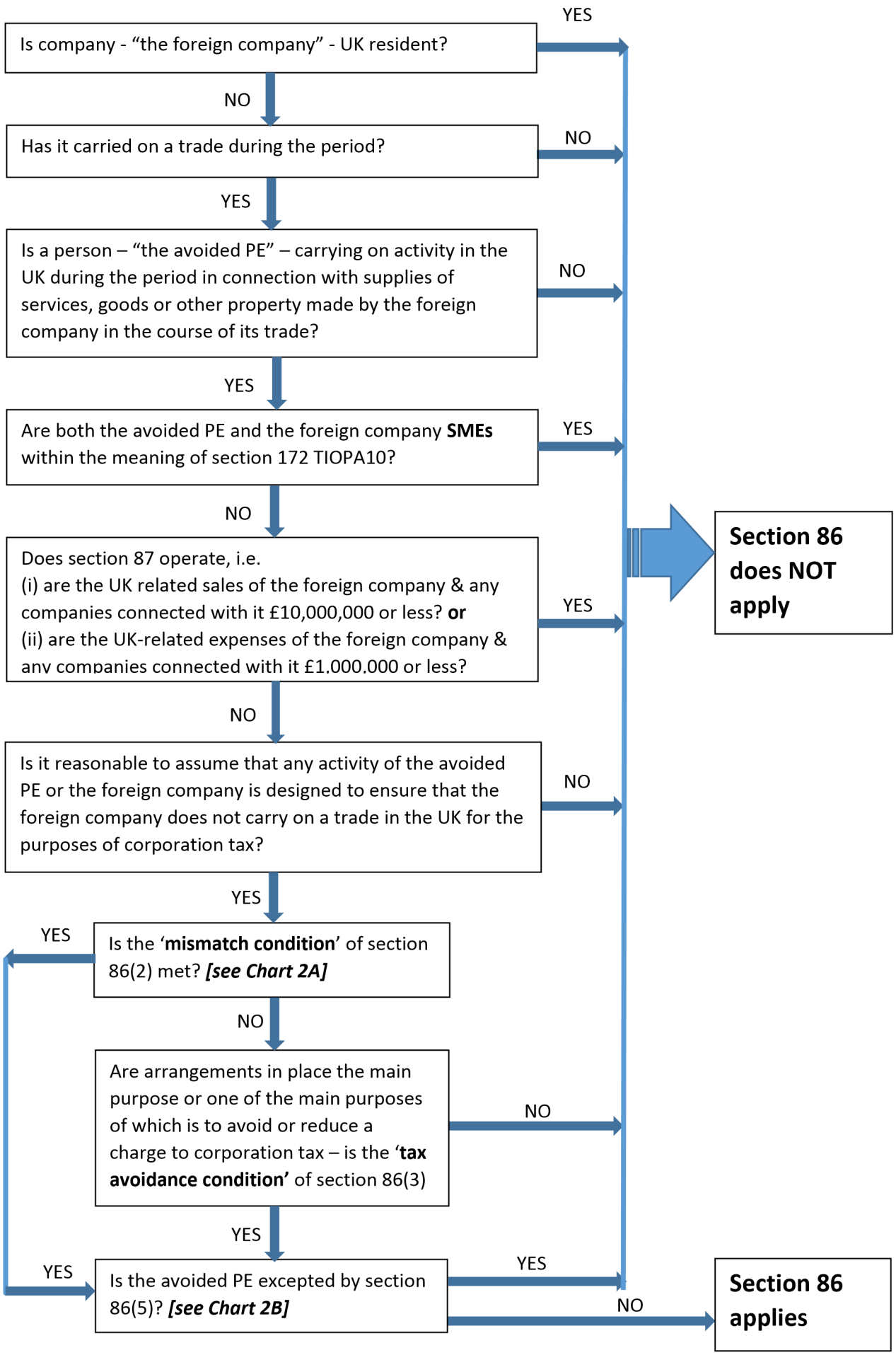


DPT1505 Chart 1A: Section 81: Lack of Economic Substance – Non-UK Company (P.E.)

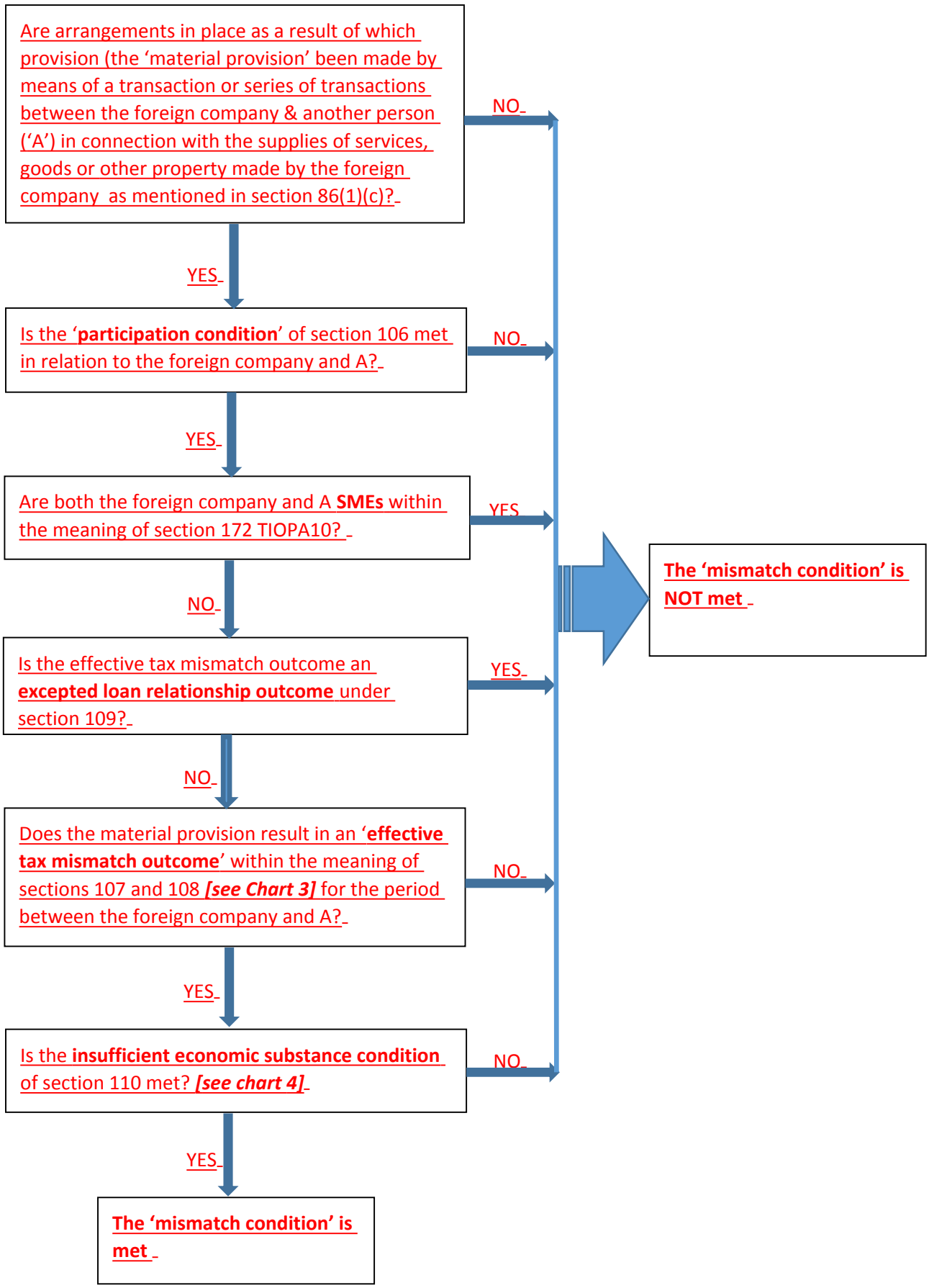


[A] A transaction or series of transactions is "relevant" to UKPE to the extent that it is relevant for corporation tax purposes, when determining the chargeable profits of the foreign company attributable (in accordance with sections 20 to 32 of CTA09) to UKPE.

DPT1510 - CHART 2: Non-UK company avoiding a UK taxable presence (Section 86)



DPT1515 CHART 2A: The 'mismatch condition' (Section 86(2))



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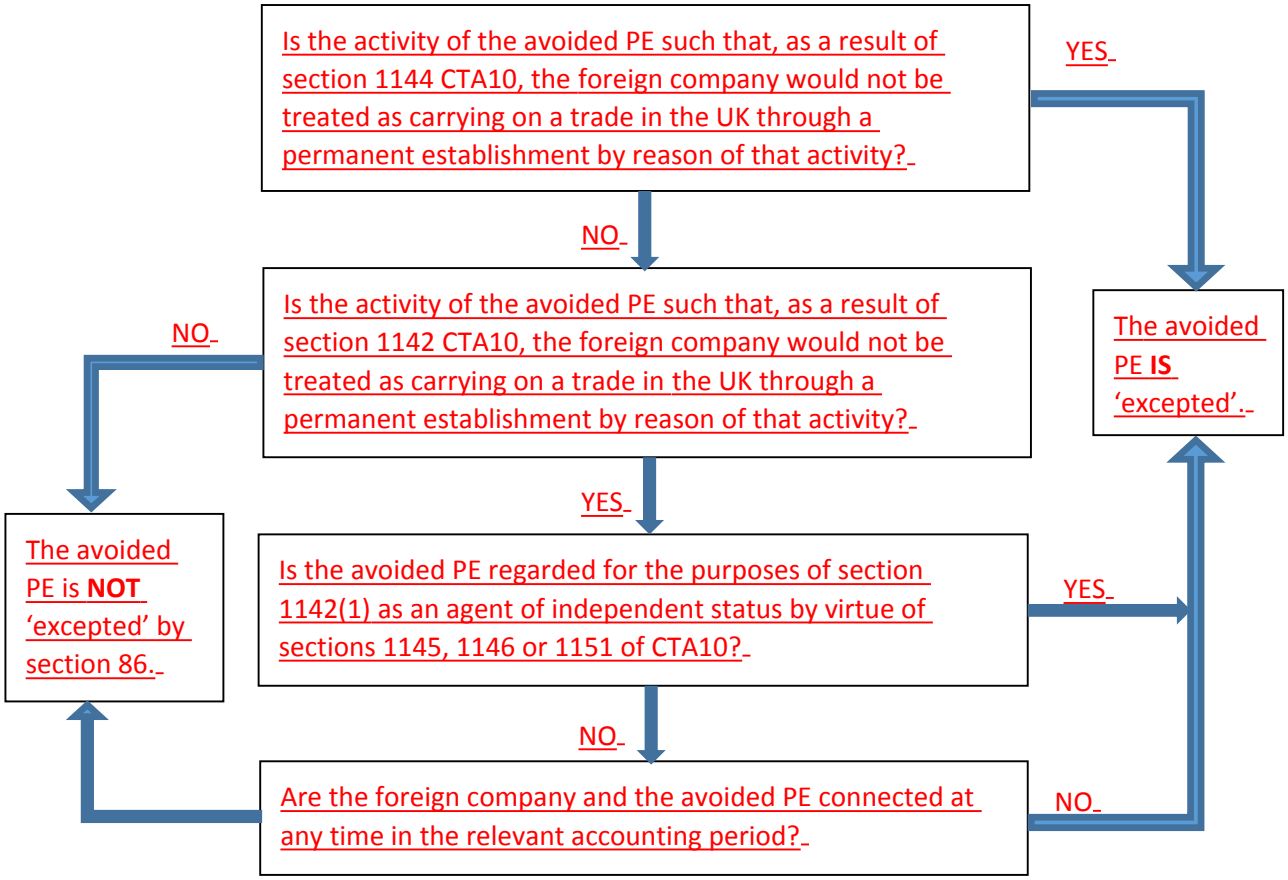

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(1) Subsection (2) applies if alternative finance return is paid to a non-UK resident company.

(2) The company is not regarded as having a permanent establishment in the United Kingdom merely by virtue of anything done for the purposes of the alternative finance arrangements—

(*a*) by the other party to the arrangements, or

(*b*) by any other person acting for the company in relation to the arrangements.

(3) In subsection (1) "alternative finance return" means alternative finance return within the application of—

(*a*) section 564I, 564K or 564L(2) or (3) of ITA 2007, or

(*b*) section 511, 512 or 513(2) or (3) of CTA 2009.

(4) In subsection (2) the reference to "the alternative finance arrangements" is a reference to the alternative finance arrangements under which the alternative finance return mentioned in subsection (1) is paid.

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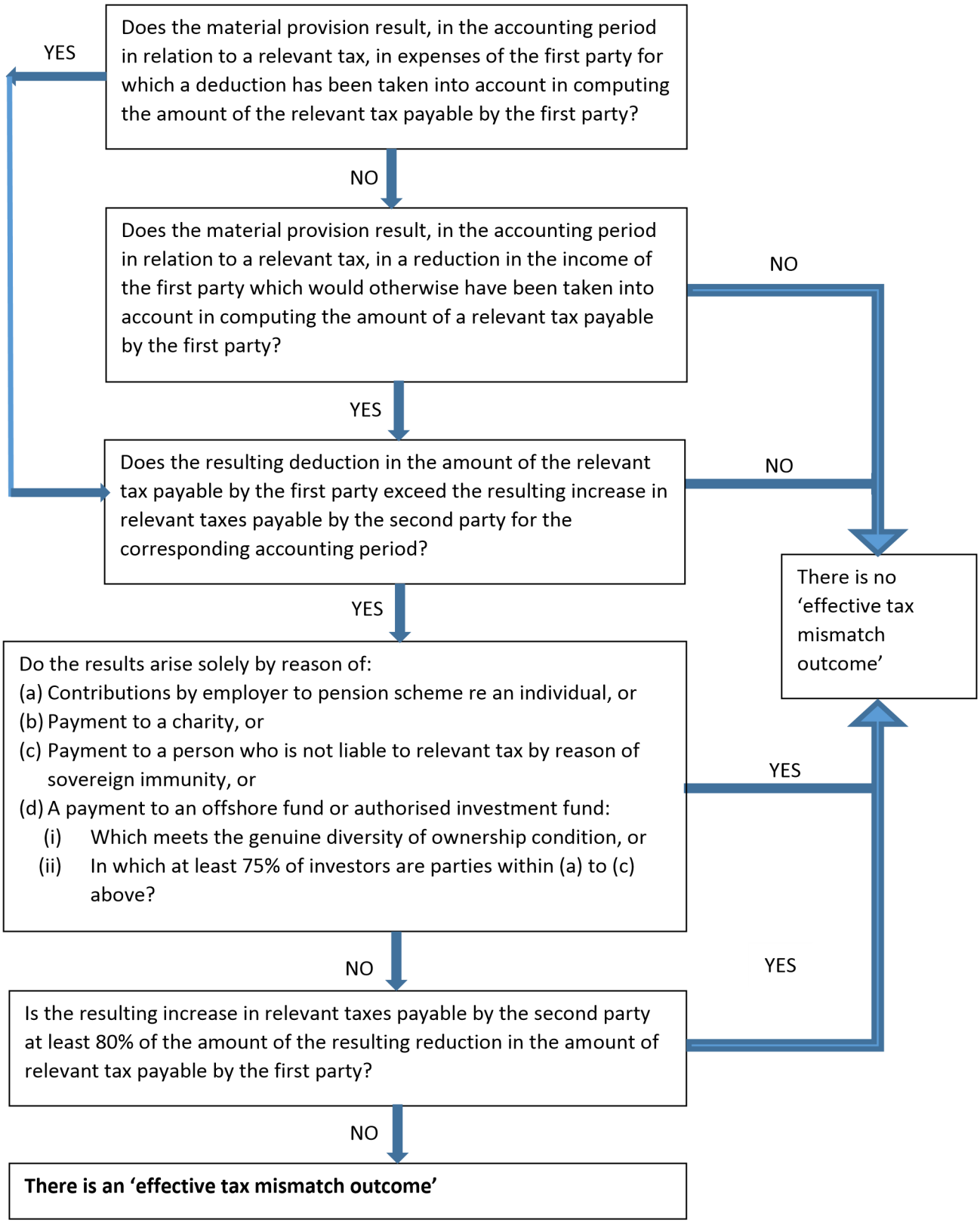
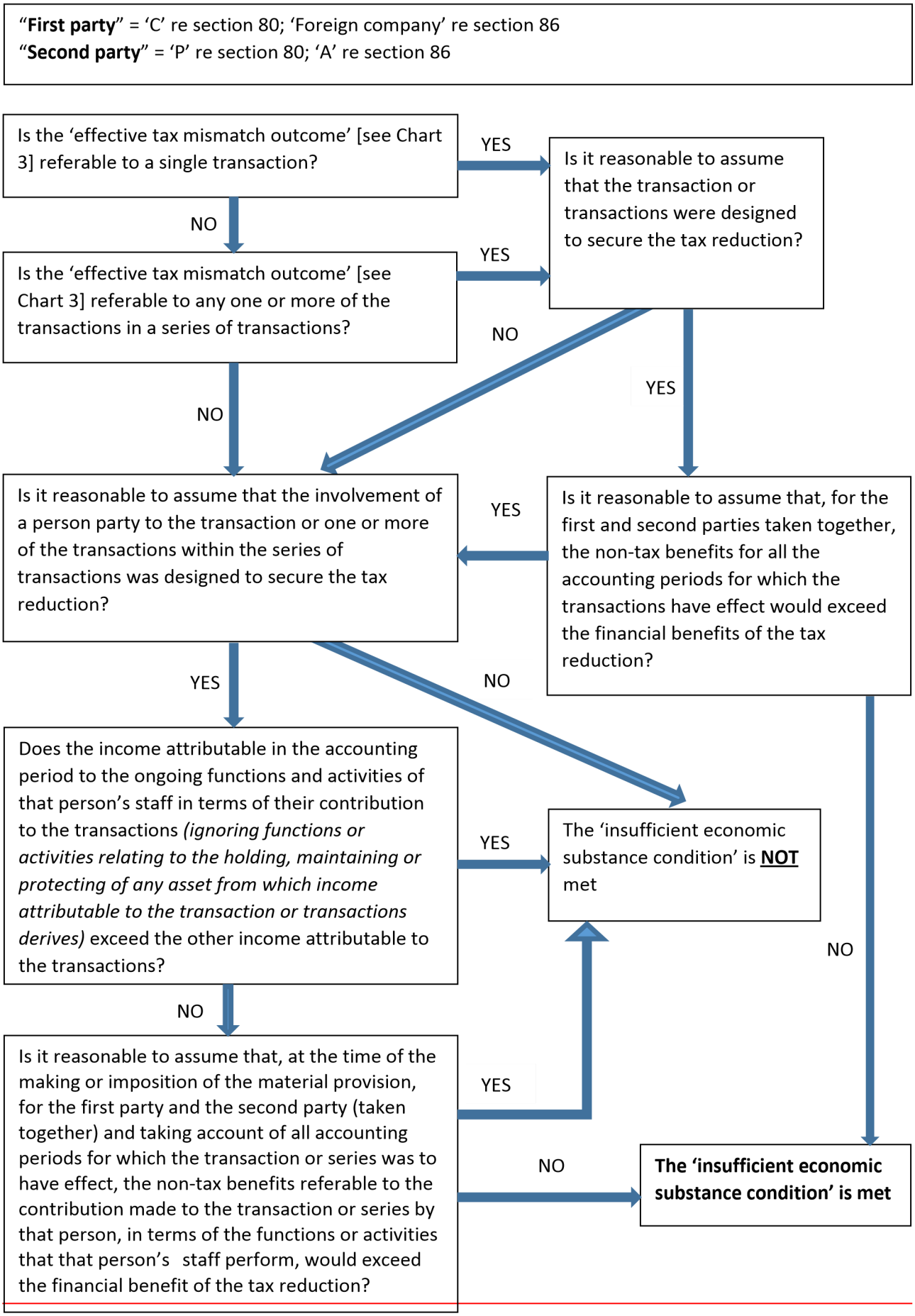
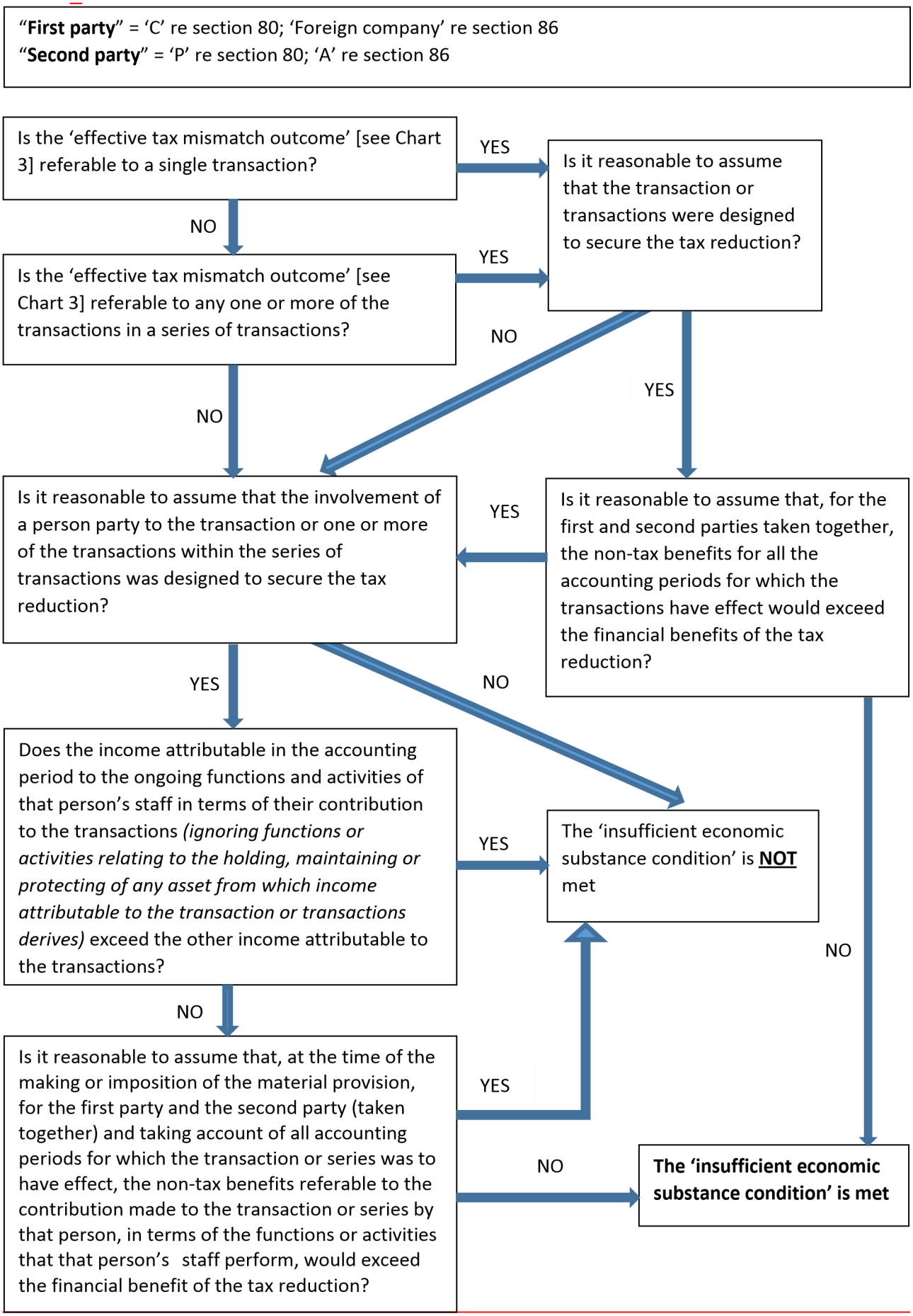


DPT1530 CHART 4: Insufficient Economic Substance Condition (Section 110)





DPT1535 CHART 5: Calculation of Taxable Diverted Profits in Section 80 or 81 case (Sections 82, 83, 84 & 85)

'**Relevant alternative provision**' = the alternative provision that it is just & reasonable to assume would have been made between the relevant company and one or more companies connected with that company, instead of the material provision, had tax (including any non-UK tax) on income not been a relevant consideration for any person at any time. Section 82(5)

'**Diverted profits**' = an amount in respect of which company is chargeable to corporation tax by reason of Part 4 TIOPA10 and which, where section 81 applies, is attributable to UKPE (sections 20 to 32 CTA09)

'**Relevant taxable income'**= income of the company for the period which would have resulted from the relevant alternative provision and regarding which the company would have been chargeable to corporation tax *LESS* the total amount of expenses which is just & reasonable to assume would have been incurred and allowable for the company for the period.

Does the 'material provision' result in expenses of the relevant company for which (ignoring Part 4 TIOPA10) a deduction would be allowable in computing the liability for corporation tax (section 80 case) or its chargeable profits attributable to UKPE (section 81 case)?

NO

YES

Would the 'relevant alternative provision' have resulted in allowable expenses of the relevant company of the same type and for the same purposes (whether or not payable to the same person) as so much of the expenses per the 'material provision' as results in the effective tax mismatch per section 80(1)(d) ***[Chart 3]***

NO

The 'actual provision condition' is met

Section 85
See ***Chart 5A***

YES

Would the 'relevant alternative provision' have resulted in relevant taxable income of a connected company for that company's corresponding accounting period?

YES

NO

The 'actual provision condition' is met.

Section 83: are there either:

(a) No diverted profits of the company for the accounting period, or

YES

No taxable diverted profits arise to the company for that

(b) Has the full transfer pricing adjustment been made? period

NO

The taxable diverted profits for the accounting period in relation to the material provision are the amount (if any)-

(a) In respect of which company is chargeable to corporation tax under Part 4 TIOPA10;
(b) Which, in a section 81 case, is attributable to UKPE;

(c) Which is not taken into account in an assessment to corporation tax included in company's tax return before end of review period for the accounting period. **Section 84(2)**

DPT1540 - CHART 5A: Calculation of Taxable Diverted Profits in Section 80 or 81 case (Section 85)

'**Relevant alternative provision**' = the alternative provision that it is just & reasonable to assume would have been made between the relevant company and one or more companies connected with that company, instead of the material provision, had tax (including any non-UK tax) on income not been a relevant consideration for any person at any time. **Section 82(5)**

'**Notional additional amount'** = the amount by which:

(a) The amount in respect of which the company would have been chargeable to corporation tax had the relevant alternative provision have been imposed, ***EXCEEDS*** (b) The amount:

i. In respect of which the company is chargeable resulting from the material provision as adjusted by Part 4 TIOPA10

ii. Which is attributable to UKPE in a case where section 81 applies,

iii. Which is taken into account in an assessment to corporation tax prior to end of the review period in the company's tax return for the accounting period.

See ***Chart 5***:
Does section 80 or 81 apply in relation to the company ("the relevant company") for the accounting period?

YES

YES

Is the '**actual provision condition**' met? ***[see Chart 5]***

NO

Section 85 applies. Would the 'actual provision condition' have been met but for the fact that the relevant alternative provision would have resulted in relevant taxable income of a company for that company's corresponding accounting period?

The taxable diverted profits of the company are an amount equal to:

(a) The amount the amount (if any)-

a. In respect of which company is chargeable to corporation tax under Part 4 TIOPA10;

b. Which, in a section 81 case, is attributable to UKPE;

c. Which is not taken into account in an assessment to corporation tax included in company's tax return before end of review period for the accounting period.

and

(b) The total amount of any relevant taxable income of a connected company which would have resulted from the relevant alternative transaction.

No charge to DPT

NO

unless section 86 applies

[see Chart 2]

YES

Section 83 or 84 applies ***[see Chart 5]***

NO

The taxable diverted profits of the company are the sum of:

(a) The '**notional additional amount**' (if any) arising from the relevant alternative provision, and

(b) The total amount (if any) of any relevant taxable income of a connected company which would have resulted from the relevant alternative transaction.

Chapter 3 - Customer engagement with HMRC

Chapter Summary

DPT 1600 - Introduction

Government is committed to addressing tax avoidance and aggressive tax planning by multinationals. This commitment is shown by, for example, the leading role taken by the UK in the OECD-G20 Base Erosion and Profit (BEPS) project and the introduction of domestic tax measures such as the Diverted Profits Tax (DPT).

Addressing base erosion and profit shifting is therefore a clear priority for HMRC and is supported by specific Government investment.

~~In 2012 the Government invested in HMRC to enhance capability to tackle avoidance and evasion. This included speeding up work on identifying and challenging transfer pricing arrangements of MNEs, as well as further strengthening HMRC's risk assessment capability across the large business sector.~~

~~Additional funding~~Funding announced in Autumn Statement 2014 ~~is being~~has been used to strengthen HMRC's response to large business tax risks by recruiting additional tax professionals to create a flexible national resource – the Large Business Task Force (LB TF) whose remit includes identifying and assessing international and other tax risks, and working with ~~CRMs~~Customer Compliance Managers (CCMs) and case teams to investigate those risks. ~~The task force~~In early 2018 the LB TF merged with the LB Strategic Risk Unit to form the Large Business National Compliance (LB NC) group. LB National Compliance contains a Diverted Profits Team of around 40 experienced specialists. They are working with ~~CRMs~~CCMs and tax specialists to look across all business sectors and consider whether businesses have used profit shifting structures which HMRC should challenge using transfer pricing, DPT or other legislation.

HMRC committed further resources in 2017 by creating additional national teams. These teams bring together the necessary investigative, technical and leadership skills from various Directorates to

investigate arrangements to avoid UK tax by diverting profits involving businesses in both HMRC's Large Business and Mid-Sized populations which are outside the scope of the SME exemption.

In addition to making the most of information already available, HMRC is also working more closely with other tax administrations to exchange information under the terms of tax treaties, including with its partners in the expanding JITSIC network, to address tax avoidance and aggressive tax planning across borders. ~~HMRC has, for example, collaborated with five international partners in a project focussing on multinational businesses operating in the digital economy. HMRC is using the knowledge gained to identify and challenge the risks that certain multinationals present to the UK tax system whether operating in the digital economy or other business sectors.~~ This will inform HMRC's approach to administering DPT and to applying other countermeasures to profit shifting such as transfer pricing, targeted anti-avoidance rules or other legislation.

What businesses can expect from HMRC.

HMRC values having an open and transparent relationship with customers and encourages them to raise significant compliance issues in real time: this is reflected in its approach to DPT. HMRC will be open with businesses about their tax risks and engage with them to gain a better understanding.

There is no clearance procedure for DPT but it may be possible for HMRC to provide a view on whether transactions are likely to fall within the scope of DPT in certain circumstances covered in the guidance. This will require a considerable amount of resource from the business and HMRC to obtain the necessary assurance about the level of DPT risk. It will only be justified where there are particular reasons for expending the resources.

HMRC will not as a matter of routine ask customers to supply information to demonstrate that they are not within the scope of DPT until an initial risk review has been carried out and there is good reason to consider that they may be chargeable to DPT.

Our engagement with customers with regard to DPT will be in accordance with HMRC's Litigation and Settlement Strategy (LSS). This outlines the framework within which HMRC handles and resolves tax disputes through civil law processes and procedures in accordance with the law. It applies irrespective of whether the dispute is resolved by agreement with the customer or through litigation.

HMRC's risk identification and assessment activities

As with other areas of tax, HMRC uses data profiling and intelligence gathered from other sources across businesses in all sectors to identify customers with features which could indicate profit diversion.

HMRC will carry out an initial risk review of businesses it considers may fall within the scope of DPT. This will form part of a wider risk assessment of transfer pricing and other international risks and will use information already held by the department and public source information. It will also consider any information and analysis provided by the business as a result of real time engagement. HMRC will not usually request information at this stage. These initial risk reviews are considered by experienced specialists who make up the membership of a cross-directorate ~~panel.~~Diverted Profits Panel (DP Panel).

Where the DP Panel determines the business to be 'Low' risk of diverted profits and there is already discussion with the business about the applicability of DPT, HMRC may communicate to the business that no further engagement on DPT is currently planned.

If the DP Panel considers a business is high risk for DPT and decides to authorise opening an investigation, HMRC would then consider whether there are sufficient resources available to progress that investigation at pace to meet DPT deadlines. If not, HMRC would wait until the necessary resources required to investigate the arrangements become available. As in other areas of compliance work, HMRC 'resources to risk' whereby resources are allocated first to the greatest risks. Factors taken into consideration in prioritisation decisions include: the estimated scale of the risk; the behaviours involved;

whether the issue is novel or one which could set a wider precedent; whether there is already a 'dispute' as defined in HMRC's Litigation and Settlement Strategy, and whether there are sufficient resources available to progress that investigation at pace to meet DPT deadlines.

If it cannot be determined whether there is a high or low risk of arrangements being within the scope of DPT, ~~HMRC will ask~~the DP Panel may ask the case team to contact the business for additional information and analysis to establish the position.

Those businesses ~~considered to be high risk for profit diversion~~presenting the greatest risks will require more detailed risk assessment and investigation. HMRC's preference will be to work openly and cooperatively with the business. We will want to evaluate and address other profit-shifting risks at the same time as considering whether the business is in scope for DPT. This is an efficient way for HMRC to deploy its resource while at the same time ~~as~~ considering businesses' compliance costs and providing more certainty than a piecemeal approach.

Uncooperative businesses which appear to adopt an aggressive tax strategy can expect detailed investigation and robust challenges, and early consideration of whether a Preliminary Notice should be issued.

HMRC will consider the DPT implications of any Advance Pricing Agreement ("APA") applications received in respect of the covered transaction.

HMRC governance

When the detailed risk assessment concludes that a preliminary notice should be considered this recommendation will be subject to governance~~ by independent senior officers who are members of a crossdirectorate board (see DPT2740).~~. The LSS applies to all tax disputes resolved through civil procedures and to all decisions taken by HMRC in relation to such disputes. Decisions needed to give effect to the principles of the LSS in individual cases or for issues affecting a number of customers are taken within appropriate HMRC governance arrangements. Furthermore, where the case team wishes to recommend acceptance of a resolution proposal put forward by the customer this will be subject to governance by independent senior officers who are members of a cross-directorate board and potentially other governance boards. Further details on HMRC's governance procedures can be found at DPT2740.

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DPT1605 - Initial contact between customers and HMRC

DPT, where it applies, primarily affects large multi-national groups that operate in the UK. The majority of such groupsMany will be Large Business (LB) customers and have a Customer RelationshipCompliance Manager (CRMCCM), however a significant number will be Mid-size Business (MSB) customers.

For LB customers, initial engagement between a customer and HMRC should be conducted through the business's CRMCCM.

For MSB customers, the engagement with a customer in respect of DPT will be different from general advice or issues handled through the MSB Customer Engagement team via HMRC's website.

For DPT only, MSB customers are able to contact a MSB Diverted Profits technical co-ordinator directly on 03000 545351 or 03000 545557.

The CRMCCM or the MSB Diverted Profits technical co-ordinator should ensure that the appropriate part of the internal advice and support network for DPT is engaged in accordance with the following guidance.

The remit of the Large Business Task ForceNational Compliance includes identifying and assessing international and other tax risks, and working with CRMsCCMs and case teams to investigate those risks. The Diverted Profits Team focuses on businesses which have used profit shifting structures and supports HMRC's customer engagement on DPT, co-ordinates its implementation and investigates whether any other taxes are due.

DPT1610 - DPT - internal advice & support network for case workers and CRMs

An internal advice and support network ensures that CRMs and case workers have a clear route to comprehensive guidance at all stages in dealing with DPT. This supports their engagement with customers and ensures that DPT is administered consistently and effectively. The network includes:

- **Diverted Profits Risk Team** (DPRT**Tax Specialists** (DPTS). To ensure consistency and the correct identification of risks, all cases where there may be potential DPT risk should be referred to the DPRT for an initial risk assessment. This specialist team is responsible for preparing the information that must be sent to the Diverted Profits Tax UnitPanel.
- **Diverted Profits technical co-ordinators**. They are located in both LB and MSB directorates. They provide case workers and CRMs withCCMs with leadership on profit diversion issues and technical support on the application of DPT throughout both the risk assessment and working of the case. They engage with the DPT Unit and, when necessary, with technical and policy specialists in CTISBusiness, Assets & International as well as engaging with customers.
- **Diverted Profits Tax Unit** (DPT Unit). This is a team of operational specialists based in Large Business. They provide advice to case workers and Diverted Profits technical co-ordinators on the application of the DPT legislation. They also oversee the process of issuing DPT notices, supporting the designated HMRC officer and co-ordinating the governance process (further detail on governance is in Chapter 5).
- **International Tax Specialists**. They also provide case workers and CRMsCCMs with advice and support in relation to international tax aspects such as transfer pricing or permanent establishments.
- **Designated HMRC officer**. The designated HMRC officer has statutory responsibility under the DPT legislation for issuing preliminary, notices, considering representations on the preliminary notice, issuing charging notices, estimating profits for preliminary and charging notices and carrying out the review of the charging notice, including any issue of supplementary charging notices under the DPT legislationor amending notices.

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DPT1620 – Informal discussions between HMRC & customers

HMRC values having an open and transparent relationship with customers and encourages them to raise significant compliance issues and uncertainty around complex or significant issues in real time.

Within HMRC, DPT is a specialist area and it is important to ensure that the resources allocated to administer DPT are managed efficiently.

The following guidance sets out how HMRC conducts early, informal engagement about DPT with customers, as well as engagement that may follow from notifications or risk assessment activity.

DPT1630 – When the Diverted Profits Risk Team must be consulted

Engagement between a customer and HMRC on DPT is likely to arise as a result of the following:

- a company notifies HMRC of its potential liability to DPT, or
- DPT is identified as a potential risk as a result of risk assessment work (this may be due to work done by the DPRTDPT specialists, case workers or international tax specialists), or
- a customer contacts HMRC to seek greater certainty on the application of the DPT to their particular arrangements.

Although the first two situations may lead to informal engagement between HMRC and the customer, it is in the third situation that most of the informal engagement is likely to take place.

LB case workers and CRMsCCMs may have an initial discussion with customers about their cross-border transactions in order to understand the customer's position on the potential application of DPT.

For MSB customers, any discussion on DPT should be carried out by MSB Diverted Profits technical coordinators. or Diverted Profits Tax Specialists.

However, unless they are confident that the transactions discussed do not present a risk for DPT, HMRC officers should not comment on the potential application of the DPT rules in any particular case until they have consulted the Diverted Profits Team.

DPT1640 - No formal statutory or non-statutory clearance procedure for DPT

After informal discussions, customers may seek further comfort about their position with respect to DPT.

Any opinion will not be influenced by the customer's overall Business Risk Rating (low or non-low).

However HMRC will not be able to provide a view on whether transactions are likely to fall within the scope of DPT in every case where an opinion is sought. This will require a considerable amount of resource from the business and HMRC to obtain the necessary assurance about the level of DPT risk. It will only be justified where there are particular reasons for expending the resources.

Where HMRC is unable to reach a view because, for example, there are significant issues causing uncertainty which cannot be properly explored within the available timeframe, then it will not be appropriate to provide an opinion. -

HMRC is committed to meeting its international exchange of information obligations. If HMRC provides an opinion on the application of DPT to customer arrangements this may constitute a "ruling" for international taxation purposes, meaning it is very likely to be required to be exchanged with another jurisdiction.

-

For more information, including whether, when, and how HMRC exchange or make a request from foreign fiscal authorities for such rulings: please consult IEIM500000+ onwards.

DPT1660 - What an initial informal discussion should cover

For the purposes of an initial discussion, customers should set out their understanding of the relevant facts and application of the DPT to their circumstances. It is helpful if the customer provides copies of any supporting material they have which will aid understanding, such as presentations and internal explanatory papers and any financial analysis to support their own judgements with respect to any DPT analysis, where relevant (see also DPT 2050 on notification). This information will be passed to the Diverted Profits Risk Team to consider. The CRM or MSB Diverted Profits technical co-ordinator may ask questions to clarify factual matters and obtain further information but unless they are confident that the transactions discussed do not present a risk for DPT they must not give any opinions on the application of the DPT without first consulting the Diverted Profits Team.

DPT1670 - Seeking information from other sources

As described at DPT1600, HMRC will carry out an initial risk review of businesses it considers may fall within the scope of DPT. This will form part of a wider risk assessment of transfer pricing and other international risk using information already held by the department and public source information. It will also consider any information and analysis provided by the business as a result of real time engagement. HMRC will not usually request information at this stage.

Public source information will include published accounts and other public documents (for example US filings such as the SEC 10-K) which can contain useful information about the group's structure and the level of its sales and profits in particular markets. Typically a group filing these will not go down to the level of individual countries outside the USAvery largest markets for the group but information about, for example, the Europe, Middle East and Africa (EMEA) region might help HMRC to make informed estimates of UK salesactivity. Also the accounts of non-UK group companies in regional hub jurisdictions can be read using a commercial database and might provide a useful indication of whether and to what extent any profits have been diverted from the UK.

The Diverted Profits Risk Team will assist with this work when they carry out their review. The Diverted Profits Risk Team's review will seek to identify all tax risks that arise from transactions and structures. This holistic approach should also be adopted by the CRM and other case workers towards information obtained from the customer and other sources.

HMRC's personal information charter sets out the standards you can expect from HMRC when we request or hold information about customers during their dealings with us.

DPT1675 - Detailed risk reviews - Operational approach

As described at DPT1600, businesses considered to be high risk for profit diversion will require more detailed risk assessment which may involve HMRC approaching the business for additional information and analysis.

Prior to deciding whether to issue a DPT preliminary notice, HMRC's preferred approach is to engage with businesses in order to gain an understanding of the global arrangements affecting the global value chain which affects the UK, either directly or indirectly.

We want to work collaboratively to obtain the information we need to establish whether there is a charge to DPT and to reach an agreed resolution of any dispute that arises.

-

We are encouraging businesses to share ~~initial~~ information requested with us during the period prior to the potential issue of a preliminary notice. At a later date, we may wish to interview key staff/customers, make third party approaches and have sight of e-mails and/or other communications.

In a case where a DPT charge could be eliminated by a transfer pricing adjustment (see DPT1134 - 1138) and there is an active process involving full co-operation and disclosure towards resolving the transfer pricing issues, it would not be expected that there would be a need to issue a DPT notice, apart from for considerations around time limits.

In the context of this guidance, an active process involving full co-operation and disclosure towards resolving the transfer pricing issues includes:

- complete transparency over the global arrangements;
- interaction with a realistic prospect of a successful conclusion within a reasonable time frame and not just a continuation of exchanges of views and/or the provision of information and documents from the customer; and
- genuine progression towards agreement on the appropriate quantum of the adjustment in order to settle the transfer pricing issues.

Where a business is not fully cooperating HMRC may consider a Preliminary Notice.

Example of initial information request

Below is an example of the sorts of information HMRC may ask for as part of an ~~initial~~ information and document request in the context of considering a case considered high risk for ~~section 86 of the DPT legislation (avoiding a UK taxable presence):~~DPT:

- Copies of transfer pricing documentation, intercompany agreements, etc.
- Identification of all legal entities that contribute to generating operating profit from sales that UK staff (e.g. sales and marketing staff) may contribute to and quantification of the operating profit recorded for each entity for a specified accounting period(s) as well as other factual details of the entities ~~e.g.~~ including:
  - *(a)* How ~~the relevant entities~~they are treated for tax purposes in ~~relevant~~their respective jurisdictions; *(b)* the number of employees for each entity~~; the transfer~~.
- Transfer pricing policy adopted for each entity~~, etc~~.
- Further information for more senior staff working in the UK and relevant foreign entities that earn a basic salary of greater than a specified threshold amount including:
  - Job Title
  - Role performed (cross referenced to intercompany transactions they contribute to where relevant)
  - Reporting lines (who the individual reports to and their location as a minimum)
  - Basic salary
  - Economic value of bonuses, any type of share based reward and details of how staff are incentivised
- Copies of job adverts and job descriptions for any ~~new~~ jobs advertised by the UK company(ies)~~ in point~~ for a specified accounting period(s).
- In order to allow us to appreciate the scale of business for different sales channels we may ask for revenue details, for example the top 10 UK customers of the group, etc.
- Product lifecycle journeys which facilitate a detailed understanding of the involvement of all entities involved in relevant products from 'cradle to grave'. This may include areas such as: (a) Research & development
  - *(a)* Key milestones
  - *(b)* Manufacture / distribution
  - *(c)* Marketing and commercialisation
  - *(d)* Regulatory requirements
  - *(e)* Sales process including pricing models
  - *(f)* Governance roles and processes including Boards, committees and panels together with those individuals that are members.
- Details of the group's strategy for intellectual property / other intangibles, including arrangements in place between two foreign group entities which affect how the group's commercial activity is carried on in the UK (e.g. a royalty agreement between a group IP holder and a foreign EMEA sales hub entity which books sales to UK customers).

- Details of any internal governance documents outlining the negotiation and sales contract approval process.

The ~~initial~~ information and document request should of course be tailored to the specifics of the business concerned and the sector it operates in. In some cases the relevant value chain will relate to a particular line of business. In other cases there may be more than one such value chain presenting diverted profits risks.

Running Investigations –Typical HMRC Approach

Many contrived arrangements to divert profits use legal structures to shift profits away from where economic value is being added. HMRC wishes to work collaboratively with businesses to understand the arrangements, and what is being done on the ground in the UK and overseas with reference to evidence.

The approach to any particular DP investigation is determined in the light of the level of risks and the nature of the issues being investigated and therefore should be determined on a case-by-case basis.

HMRC in running a DP investigation may consider carrying out the following practices where appropriate:

- Requesting and reviewing relevant transfer pricing documentation and intercompany agreements and seeking clarification from the customer on any areas that appear unclear;
- Holding a meeting with the customer at the outset – involving the CCM or DPTC, in a MSB case, appropriate senior managers and members of the tax team from HMRC and the customer – to outline the potential tax risks, agree a high level timetable for investigation, and the resources that would be required from both HMRC and the customer;
- Encouraging cooperation and agreeing with the customer a joint action plan for carrying out work - discussing regularly progress against the plan, the reasons for any potential slippage and keeping it updated;
- Establishing the facts before getting into detailed technical discussions. Ensuring that the key facts gathered as the investigation progresses are recorded and discussed with the customer. Any narrative provided by HMRC that summarises key facts is not intended to be agreed by the customer as a 'Statement of Facts' – it is HMRC's summary of the key facts. It should not include assertions, argument or conclusions drawn from the facts;
- Not considering just the UK economic activities in isolation but understanding them in the context of the global value chain – HMRC needs to understand the worldwide picture and the totality of the arrangements that are in place to reach a view on whether a DPT charge arises;
- Formulating informal information requests in a format which can be converted easily into a formal request, and having a dialogue with the business about the relevant information and evidence and how it can best be provided. Following that discussion HMRC expects the customer to respond thoroughly and timeously;
- Using information powers promptly, where necessary, to obtain the evidence HMRC considers relevant. Following up failures to comply with formal information notices and considering the application of relevant penalties;
- Promptly reviewing information and documents provided by the customer and then discussing the next steps with the customer;
- Holding regular face-to-face meetings to ensure that the customer and HMRC understand each other's technical analysis and arguments, the key facts on which they are based, and the key differences of view. Agreeing an agenda and where possible circulating papers in advance. HMRC and the customer should both ensure that the right people attend the meeting to discuss the agenda items;

- Considering when appropriate the issue of protective assessments, and Notices to File on overseas entities to protect permanent establishment challenges; and
- Considering recommending the issuance of a Preliminary Notice charging DPT. HMRC should explain its views and plans to the customer in this regard and give them the opportunity to respond before recommending the issuance of a Preliminary Notice through DP governance.

DPT1680 - Notification

Guidance on the notification requirement is set out in Chapter 4, with the recommended procedure and template provided at Appendix A and B. Where a company notifies its potential liability to DPT directly to the CRM or case team the details should be passed to the Diverted Profits Risk Team which will liaise with the DPT Unit and the designated HMRC officer. Case workers and CRMs should acknowledge receipt of the information but must not offer any further response until the Diverted Profits Risk Team has confirmed to them in writing how to proceed.

Where there is no existing engagement with a business, HMRC will not, as a matter of course, respond to a DPT notification. Therefore, if a customer has notified potential liability to DPT but concluded that there is no DPT to pay and has not heard from HMRC, the customer cannot assume that HMRC agrees with their view that they are not within the scope of DPT.

DPT1690 - APAs do not extend to DPT

DPT is a separate, stand-alone charge on diverted profits. It is not income tax, capital gains tax, or corporation tax and is not covered by double taxation treaties. Consequently it is not possible to make it the subject of bilateral Advance Pricing Agreements (APAs).

Part 5 of TIOPA 2010 does not provide for unilateral APAs in relation to the DPT, nor is there any other formal clearance procedure. However it is anticipated that the potential for a DPT charge in relation to the covered transactions will be considered in the APA assessment process alongside transfer pricing and/or permanent establishment issues.

DPT1700 - How APAs in force at 1 April 2015 interact with DPT

For existing APAs which cover periods from 1 April 2015 (when the DPT comes into force) the interaction with the DPT will depend on the terms of the APA, in particular the nature of the covered transaction, and the transactions which give rise to a possible DPT charge.

Each case will be considered on its own merits but, broadly speaking,

- where DPT arises under section 86 from the avoidance of a UK PE then the existence of an APA for specified covered transactions should generally have no effect for the purpose of charging DPT. If a DPT charge arises in respect of an avoided UK PE the charge will be based on profits that would have been attributable to a PE that are over and above the reward attributable to the UK entity(ies) that were subject to the transfer pricing agreement set out in the APA;
- a DPT charge would not normally arise under section 80 or section 81 in respect of covered transactions of an APA. A DPT charge will however always need to be considered if the rules relating to basing any DPT charge on the relevant alternative provision applied. A DPT charge may arise under section 80 or section 81 in relation to a non-covered transaction even if those transactions have been informally discussed during the course of negotiating the APA.

DPT1710 - APAs entered into after the introduction of DPT

For new APAs, HMRC would expect any business entering the APA programme to provide information on the potential for DPT to arise in relation to the covered transactions for the proposed APA. APAs should not be finalised until DPT risk in relation to these transactions has been fully considered. However, the conclusion of an APA does not necessarily mean that a DPT notice will not be issued. HMRC may be willing, where the customer has been open and transparent (including providing a full value chain analysis for all entities that impact the system operating profit that the UK entity contributes to, where relevant) to provide a separate written opinion on the likelihood of whether a DPT notice for a particular period will be issued at the same time, if this is requested.

In cases where it appears that DPT arises in relation to arrangements that would include the proposed covered transactions, HMRC will consider whether it is appropriate to proceed with the APA process. An important factor in considering whether to continue with the APA process will be whether the business intends to leave the arrangements that give rise to the DPT in place and if not, what new arrangements are proposed going forward. Unless the proposed arrangements are aimed at removing features that give rise to the DPT exposure there would be little benefit to the business or HMRC in trying to proceed towards APA on those transactions.

Requests for APAs will continue to be considered on the basis of their particular facts and features, in line with the APA Statement of Practice and with regard to the effective use of HMRC's resources. Where a DPT notice has been (or is about to be) issued in respect of proposed covered transactions, admission of the case into the APA programme is unlikely to be considered appropriate until the DPT position has been reviewed.

DPT1720 - APAs concluded for periods ending before 1 April 2015

APAs concluded solely in relation to periods ending before 1 April 2015 will be unaffected by the introduction of DPT.

DPT1730 - DPT and ATCAs

The DPT exclusion for excepted loan relationship outcomes should mean that in most circumstances Advance Thin Capitalisation Agreements (ATCAs) will not be directly affected by the DPT. Nevertheless in cases where a group's wider arrangements gives rise to DPT risks it will be important to consider whether they also give rise to thin capitalisation issues.

Chapter 4 - Notification, charging & payment

Chapter Summary

- DPT2040 - Accounting period
- DPT2050 - How to notify
- DPT2060 - Raising a DPT charge - overview
- DPT2070 - When a preliminary notice must be issued
- DPT2080 - Issuing the preliminary notice
- DPT2090 - Content of the preliminary notice
- DPT2100 - Representations following a preliminary notice
- DPT2110 - Charging notice
- DPT2120 - Timing
- DPT2130 - Who issues the notice
- DPT2140 - Who should be issued with the charging notice
- DPT2150 - What should be included in the charging notice
- DPT2160 - Review period
- DPT2170 - Designating the end of the review period
- DPT2180 - Amending a charging notice
- DPT2190 - Supplementary charging notice
- DPT2200 - Who should be issued with a supplementary charging notice
- DPT2210 - Content of a supplementary charging notice
- DPT2220 - Payment of tax charged as a result of a supplementary charging notice

  DPT2230 - Amending a supplementary charging notice
- DPT2240 - Who issues the supplementary charging notices and amending notices
- DPT2250 - Appeals against charging notices and supplementary charging notices
- DPT2260 - Information and inspection powers
- DPT2270 - Payment of tax - overview
- ~~DPT2280 - Postponement of tax~~
- ~~DPT2290 - No deduction for DPT against profits or income~~

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DPT2000 Introduction - What businesses need to do

The purpose of the notification requirement is to alert HMRC to situations where there is a significant likelihood that DPT is chargeable and HMRC does not already have a detailed understanding of these arrangements. The onus is on the business to consider whether its provisions and arrangements fall within the scope of DPT and, where they do, to notify HMRC of this. No notification is needed where it is reasonable to assume that the business has already provided HMRC with sufficient information to allow a decision to be made as to whether a preliminary notice should be issued.

The focus of DPT and the Diverted Profits Team is on those businesses that use contrived arrangements designed to erode the UK tax base. There is no need for businesses to notify structures or transactions which are clearly outside that scope. So businesses that have not put arrangements in place aimed either at avoiding the creation of a UK permanent establishment or involving arrangements or entities that lack economic substance (as described above and illustrated in this guidance) do not need to make “protective” notifications.

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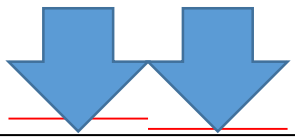
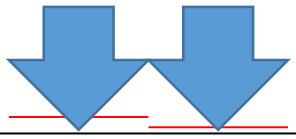
Company must notify it is potentially within the scope of DPT within 3 months after the end of the accounting period (see DPT 2030 for periods up to 31 March 16).



HMRC may issue a preliminary notice of chargeability within 2 years after the end of the accounting period (4 years if no notification)



The company has 30 days from issue of the preliminary notice to make representations

Having considered the representations, HMRC must either issue a charging notice, or confirm that no charging notice will be issued, within 30 days from the end of the representation period

There is a ~~12~~15-month period beginning immediately after the date by which the tax must paid for HMRC to review the charging notice and during which HMRC may issue a supplementary charging notice or appropriate

amending notices increasing or reducing the DPT. Any overpaid DPT must be repaid with interest

~~Charge to tax includes an interest element on the DPT from 6 months after the end of the accounting period to the date the notice is issued (“true up” interest)~~

Charge to tax includes an interest element on the DPT from 6 months after the end of the accounting period to the date the notice is issued (“true up” interest)

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DPT2010 Duty to notify if potentially within the scope of DPT - who must notify

A company must notify HMRC if it is potentially within the scope of DPT. A company

is potentially within the scope of DPT if

- it is a company resident in the UK that enters into a transaction where either the transaction or an entity which is party to the transaction lacks economic substance and that results in a tax mismatch, or
- it is a non-UK company which has a UK-taxable presence (a permanent establishment) that enters into a transaction where either the transaction or an entity which is party to the transaction lacks economic substance and that results in a tax mismatch, or
- it is a non-UK company which has sought to avoid creating a taxable presence in the UK.

But, for the purposes of the notification requirement only, there are modifications to the way these tests apply. These are: in all cases, the "insufficient economic substance condition" is disapplied but in cases where a tax mismatch is a condition to potential liability, there will be deemed to be no such mismatch unless the financial benefit of the tax reduction is significant relative to the other benefits;

- in the case of a non-UK company avoiding a UK taxable presence, instead of the condition which requires there to be a reasonable assumption that any of the activity of the avoided PE and/or the foreign company is designed to ensure that the foreign company is not trading in the UK for the purposes of corporation tax, there is simply a condition that the foreign company is not carrying on a trade in the UK for the purposes of corporation tax;
- in the case of a non-UK company avoiding a UK taxable presence, instead of the tax avoidance condition being that there are arrangements in place which have a main purpose of avoiding or reducing a charge to corporation tax, there is simply a condition that there are arrangements which result in the avoidance or reduction of a charge to corporation tax as a result of which there is an overall reduction in the amount of tax (including foreign tax) payable in respect of the activities carried out in the UK.

DPT2020 - Situations where notification is not required

The notification requirement is intended to alert HMRC to situations where there is a significant likelihood that DPT is chargeable and where HMRC does not already know about the arrangements which give rise to it.

Accordingly, a company is not required to notify HMRC that it may potentially be within the scope of DPT if it falls within one of the specifically exempt situations listed at below:

- it is reasonable to assume that, although a company is potentially within the scope of DPT, no charge to DPT would arise for the current period (see further guidance below). However, the possibility that a company may make a future transfer pricing adjustment is specifically excluded from being grounds to assume that no charge to DPT would arise.
- before the end of the notification period, HMRC has confirmed that the company does not have to notify because either the company, or a company connected with it, has provided sufficient information to inform the designated officer's decision about whether or not to issue a preliminary notice, and that HMRC has examined that information (whether as part of an enquiry into a return or otherwise).
- at the end of the notification period, it is reasonable for the company to assume that either the company, or a company connected with it, has provided sufficient information to inform the designated officer's decision about whether or not to issue a preliminary notice, and that HMRC has examined that information (whether as part of an enquiry into a return or otherwise).

- the company has already notified that it is potentially within the scope of DPT for the immediately preceding accounting period and it is reasonable for the company to assume that there has been no change in the relevant circumstances.
- the company has not notified that it is potentially within the scope of DPT for the immediately preceding accounting period on the grounds that it had provided HMRC with sufficient information as set out in ii. above (or it is reasonable for the company to conclude as set out in iii. above) and, in either case, it is reasonable for the company to assume that there has been no change in the relevant circumstances.
- HMRC may also direct that the duty to notify is removed in other defined circumstances and will publish the details of all such directions, if and when they are made.

It is important to note that these exemptions apply only for the purposes of determining whether or not a company potentially within the scope of DPT must notify HMRC accordingly. They do not mean that a liability to DPT cannot arise. A company that is not required to notify on the basis of these exemptions, including cases where the company has received confirmation from an HMRC officer that no notification is required, may still have a liability to DPT and be subject to the charging and other provisions.

As mentioned at (i) above, it is open for a company to reasonably assume that no charge to DPT will arise. This may be so even though the conditions for a charge, such as the tax mismatch and insufficient substance conditions, appear to be met and the transfer pricing or PE attribution analysis has not been examined by HMRC.

In reaching its conclusion in those circumstances, a company would be expected to have satisfied itself that its transfer pricing or PE attribution analysis is robust and takes into account all relevant matters at the level of detail appropriate to the transfer pricing / PE attribution issues in question.

The company would also be expected to have considered whether, for the purposes of calculating any DPT charge in relation to a particular provision, it would be reasonable to assume that an alternative provision would have been made or imposed if tax on income had not been a relevant consideration for any person at any time (see DPT1132, 1138, 1162 and 1168). The appropriate level of consideration will of course depend on the nature and materiality of the issues in question, following common sense principles of what is reasonable.

DPT2030 - Time limits and penalties

Where a company has a duty to notify that it is potentially within the scope of DPT, notification must be made within 3 months of the end of the accounting period to which it relates. But this period is extended to 6 months for the first accounting periods affected by the introduction of the DPT; that is, to accounting periods ending on or before 31 March 2016. There is a tax-geared penalty for failing to do so.

If a company does not notify HMRC within the time limit that it is potentially within the scope of DPT, the period within which a designated HMRC officer can issue a preliminary notice is extended from 24 months to 4 years after the end of the accounting period.

DPT2035 – Failure to notify penalties

The measure of tax on which the penalty is based is the amount of DPT which would be charged had a notice been issued 6 months after the end of the review period and payable at that time.

The assumption in Para 7(4A) Sch 41 FA 2008 is that the DPT is required to be paid within six months of the end of the accounting period. Therefore six months after the end of the accounting period is the date when the DPT is treated as first becoming unpaid by reason of the failure to notify (FTN) as potentially within scope of DPT for the purposes of Sch 41 FA 2008. In non-deliberate FTN cases, this is the relevant date when considering whether HMRC has become aware of the failure within 12 months of the tax first becoming unpaid by reason of the failure to determine whether the greater penalty reduction applies.

In light of the timing of this guidance, where the FTN is not deliberate, and the DPT would be treated as first becoming unpaid by reason of the failure before 1 January 2019 it will be considered to have first become unpaid on 1 January 2019 and this date will apply for the purposes of Sch 41 FA 2008 in deciding whether HMRC became aware of the failure within 12 months of the tax first becoming unpaid by reason of the failure. Where the DPT first becomes unpaid by reason of the failure after 1 January 2019 the date 6 months after the end of the accounting period will be the date the DPT is treated as first becoming unpaid by reason of the failure for the purposes of Sch 41 FA 2008.

DPT2038 – Interaction with CT penalties

In cases where the case is ultimately concluded by a CT adjustment which replaces the DPT charge wholly or partially, it may be that the company is potentially liable to both a CT inaccuracy penalty and a DPT failure to notify penalty based on the same profits. In such cases HMRC will calculate the penalty liability based on the larger of the two penalties based on the potential lost revenue which arises from the overlapping profits.

DPT2040 - Accounting period

For companies within the charge to UK corporation tax, “accounting period” means an accounting period of the company for the purposes of corporation tax.

A non-resident UK company which is not within the charge to UK corporation tax is assumed to have such accounting periods for the purposes of corporation tax as it would have had if it had carried on a trade in the UK through a UK permanent establishment by reason of the activities of an avoided PE.

DPT2050 - How to notify

A notification must be made in writing. It must state which section of the legislation (section 80, section 81 or section 86) applies and must specify the following:

- Where the company is potentially within the scope of the DPT because it is a company resident in the UK that enters into a transaction where either the transaction or an entity which is party to the transaction lacks economic substance and that results in a tax mismatch, or it is a nonUK company which has a UK-taxable presence (a permanent establishment) and enters into a transaction or entities where either the transaction or an entity which is party to the transaction lacks economic substance and that results in a tax mismatch – ○ the nature of the material provision; and
  - the identity of the other person ("P") that is party to the material provision.
- Where the company is potentially within the scope of DPT because it is a non-UK company which has avoided creating a taxable presence in the UK – ○ the identity of the person carrying on activity in the UK in connection with the non-UK company's trade ("the avoided PE").
  - Whether or not the mismatch condition is met
- Where the company is potentially within the scope of DPT because it is a non-UK company which has avoided creating a taxable presence in the UK and the mismatch condition is met – ○ the nature of the material provision.
  - The identity of the other person that is party to the material provision.

It is recommended that notification should be sent to the DPT mailbox divertedprofits.notification@hmrc.gsi.gov.uk. Companies which prefer not to use email may instead send their notification to Diverted Profits Tax Unit, Large Business, S0791, Newcastle, NE98 1ZZ.

Companies with Customer Relationship Managers (CRMs) are advised to also send a copy to their CRM (see also DPT1680) and other companies in MSB to send a copy to the MSB Diverted Profits technical co-ordinators (see DPT1605).

A recommended template for notification is contained in the appendix to this guidance.

Companies notifying HMRC that they are potentially within the scope of DPT will help to resolve the issue more quickly if they provide additional information with their notification which explains why they consider that the notification obligation applies to them and includes, as appropriate:

- a current worldwide group structure, identifying how relevant entities are treated for tax purposes in relevant jurisdictions,
- a functional analysis of global supply chains and operations relating to the UK,
- a value chain analysis of the complete activity undertaken by the group,
- details of intellectual property and related payments (including royalties) that are connected, directly or indirectly, with activity in the UK,
- a summary of financial and tax data for UK entities and other entities that should be considered in determining whether DPT applies. Specifically, information showing the profitability of all relevant entities, and especially any low tax entities, will be important.

DPT2060 - Raising a DPT charge - overview

There is a flow chart outlining the end-to-end process for raising a DPT charge at the beginning of this chapter.

Before a charging notice can be issued, HMRC must send the company a preliminary notice explaining how the charge is calculated and who must pay it. Having been issued with a preliminary notice, the company may make representations to HMRC but the representations which HMRC can consider at this stage are limited to certain specified issues.

Once the period within which representations may be made has expired, a designated HMRC officer may bring DPT into charge by issuing a charging notice.

The charge to tax will include an interest element ("true up interest") on the DPT, running from 6 months after the end of the accounting period to the date the charging notice is issued.

DPT must be paid within 30 days from the issue of the charging notice and there is no right to postpone the tax.

There is a ~~12~~15 month period beginning immediately after the date by which the tax must paid (the "review period") for HMRC to review the charging notice and issue a supplementary notice or amending notices increasing or reducing the DPT. Any overpaid DPT must be repaid in accordance with HMRC's tax accounting and set-off policies.

The company has 30 days from the end of the review period to appeal or the DPT becomes final.

DPT2070 - When a preliminary notice must be issued

If there is reason to believe that a DPT charge arises for an accounting period, a designated HMRC officer must first issue a preliminary notice to the company for that period before DPT can be brought into charge.

If the company notified its potential liability to DPT within the appropriate time limit, the preliminary notice may not be issued more than 24 months after the end of the accounting period.

However, where HMRC has not received a notification within the appropriate time limit that a company is potentially within the scope of DPT, the period within which HMRC may issue a preliminary notice is extended. In that case, where a designated HMRC officer believes that an amount of DPT that ought to have been charged has not been charged, a preliminary notice may be issued to the company within four years after the end of the accounting period to which the charge relates. This might include, for example, a situation where a notice for the same accounting period of the company had previously been issued in respect of a different material provision.

DPT2080 - Issuing the preliminary notice

The preliminary notice is issued to the company believed to be within the scope of DPT and, in addition a copy must be issued to

- the UK permanent establishment of that company, where the company is non-UK resident and its UK permanent establishment is involved with entities or transactions lacking economic substance,
- the avoided PE in cases concerning a non-UK company avoiding a taxable presence.

DPT2090 - Content of the preliminary notice

A preliminary notice must:

- state the accounting period to which it applies,

- set out the basis on which the officer has reason to believe that the company falls within one or more of the three situations in which the DPT applies (i.e. where a UK company is involved with transactions or entities that lack economic substance, where a non-UK company acting through a UK PE is involved with transactions or entities that lack economic substance, and where a non-UK company avoids creating a UK taxable presence),
- explain the basis on which the charge, and separately any related interest, is calculated, including:

○ how the taxable diverted profits have been determined, ○ where relevant, details of the alternative provision, ○ how the amount of interest comprised in the DPT charge would be calculated.

- state who is liable to pay the tax,
- explain how any late payment interest will be calculated if DPT is not paid, including the period for which it is charged and the rate applied.

If the designated HMRC officer lacks sufficient information to determine any of the matters listed above, they should set them out to the best of their information and belief.

See Chapter 2 for guidance on how profits are estimated and the charge to DPT is calculated in a preliminary notice.

DPT2100 - Representations following a preliminary notice

The company has 30 days from the issue of a preliminary notice to send written representations to HMRC. HMRC may only consider representations made on the following grounds:

- there is an arithmetical error in the calculation of the amount of DPT or the taxable diverted profits,
- there is an error in a figure on which an assumption in the preliminary notice is based,
- the small or medium-sized enterprise requirement is not met,
- that in a case where either a UK company is involved with transactions or entities that lack economic substance, or a non-UK company acting through a UK PE is involved with transactions or entities that lack economic substance:
- the participation condition is not met, or
- the 80% payment test is met, or
- the effective tax mismatch outcome is an excepted loan relationship outcome.
- that in a case where a non-UK company has avoided a UK taxable presence:
- the exception for limited UK-related sales (£10 million or less) or UK-related expenses (£1 million or less) applies
- the avoided PE is excepted because of one of the conditions in section 86(5) related to:
    - section 1142 CTA 2010 – agent of independent status, or ○ section 1144 CTA 2010 – alternative finance arrangements.
- if the preliminary notice states that the mismatch condition is met:
    - the participation condition is not met, or

- the 80% payment test is met, or

- the effective tax mismatch outcome is an excepted loan relationship outcome

All representations on the above must be considered before issuing the charging notice but there is no requirement for HMRC to consider any representations in relation to:

- any provisions of Part 4 TIOPA 2010 related to transfer pricing, or
- any attribution of profits of a company to a permanent establishment (including notional attribution in section 86 cases) unless they fall within the categories of representation set out above.

The representations that HMRC can consider are therefore limited to factual matters that it should be possible to establish relatively quickly. Matters which require more in-depth exploration and detailed analysis, such as transfer pricing and profit attribution, should be considered during the ~~12~~15 month review period following the issue of a charging notice.

DPT2110 - Charging notice

Following the issue of a preliminary notice and consideration of any written representations HMRC must decide whether to either:

- issue a charging notice to the company for the accounting period covered by the preliminary notice, or
- notify the company that no charging notice will be issued for that accounting period.

DPT2120 - Timing

HMRC has 30 days immediately following the end of the period for representations to issue a charging notice or inform the company that a charging notice will not be issued.

The charging notice creates a formal liability to pay the DPT within 30 days of the date the notice is issued. There is no provision for postponement and the notice is not appealable at this stage.

DPT2130 - Who issues the notice

The notice is authorised and issued by the designated HMRC officer. Governance procedures are outlined at DPT2740.

DPT2140 - Who should be issued with the charging notice

The charging notice is issued to the company liable to DPT and, in addition, a copy must be issued to

- the UK permanent establishment of that company, where the company is non-UK resident and its UK permanent establishment is involved with entities or transactions lacking economic substance
- the avoided PE in cases concerning a non-UK company avoiding a taxable presence.

DPT2150 - What should be included in the charging notice The

charging notice must include the following:

- the amount of the charge to DPT imposed by the notice

- the basis on which the officer considers that either section 80, section 81 or section 86 applies
- the accounting period of the company to which the notice applies
- an explanation of the basis on which the charge is calculated, including:

- how the taxable diverted profits to which the charge relates have been determined, and
- how the amount of interest ("true up" interest see DPT2410) comprised in the charge has been calculated
- where relevant, details of the relevant alternative provision by reference to which the charge has been determined

- who is liable to pay the tax
- when the tax is due and payable, and
- an explanation of how interest is applied and calculated if the DPT is not paid.

Chapter 2 contains guidance on how profits are estimated and a charge is calculated in a charging notice.

DPT2160 - Review period

Following the issue of the charging notice HMRC has a further period (the review period) in which it must review the charging notice and make amendments to reduce the amount of taxable diverted profits and the charge to DPT, if appropriate. HMRC may also issue a supplementary charging notice to impose an additional charge if more DPT needs to be brought into charge.

In carrying out the review, there are no limitations to the representations HMRC may consider and the special rules disallowing 30% of expenditure under the inflated expenses condition are disregarded. This means that through the review period, the amount of the DPT charge can be either increased or decreased based on due consideration of the evidence on the level of the adjustment to the relevant expenditure, as well as any other relevant matters.

DPT2170 - Designating the end of the review period

The review period begins immediately after the 30 day period during which the DPT included in the charging notice must be paid and ends ~~12~~15 months later. But the review period may end within the ~~12~~15 months if:

- following the issue of a supplementary charging notice, the company notifies HMRC that it is terminating the review period, or
- the company and the designated HMRC officer agree in writing to terminate the review.

Where early termination of the review period by agreement is in prospect, the case team must make a referral to the DPT Unit – see DPT2690.

DPT2180 - Amending a charging notice

During the review period a designated HMRC officer can amend a charging notice, but only if the DPT liability created by the charging notice has already been paid in full and the officer is satisfied that the taxable diverted profits included in the charging notice for an accounting period are excessive.

In order to make the amendment, a designated HMRC officer issues an amending notice which reduces the amount of taxable diverted profits included in the charging notice and reduces the DPT charged accordingly.

There is no restriction on the number of amending notices that can be issued during the review period.

Where an amending notice is issued, any tax overpaid in relation to the original charging notice or supplementary charging notice is repaid with interest.

DPT2190 - Supplementary charging notice

During the review period a designated HMRC officer can issue a supplementary charging notice if the officer considers that the amount of diverted profits tax charged on the company for an accounting period is insufficient, taking account of additional amounts of taxable diverted profits that HMRC considers should be brought into account and any appropriate credit for UK or foreign tax on the same profits.

The supplementary charging notice has the effect of bringing additional amounts of diverted profits into charge that were not included in the original charging notice and bringing into charge additional amounts of DPT. The supplementary charging notice does not replace the original charging notice.

Only one supplementary charging notice can be issued.

A supplementary charging notice cannot be issued during the last 30 days of the review period.

DPT2200 - Who should be issued with a supplementary charging notice

As for a charging notice, a supplementary charging notice is issued to the company liable to DPT and, in addition, a copy must be issued to

- the UK permanent establishment of that company, where the company is non-UK resident and its UK permanent establishment is involved with entities or transactions lacking economic substance
- the avoided PE in cases concerning a non-UK company avoiding a taxable presence.

DPT2210 - Content of a supplementary charging notice

A supplementary charging notice must cover the same details as a charging notice.

DPT2220 - Payment of tax charged as a result of a supplementary charging notice

Any additional DPT due as a result of the supplementary charging notice must be paid within 30 days from the date the notice is issued.

DPT2230 - Amending a supplementary charging notice

During the review period a designated HMRC officer can amend a supplementary charging notice, but only if the DPT liability created by the supplementary charging notice has already been paid in full and the officer is satisfied that the additional taxable diverted profits included in the supplementary charging notice for an accounting period are excessive.

In order to make the amendment, a designated HMRC officer issues an amending notice which reduces the amount of taxable diverted profits included in the supplementary charging notice and reduces the DPT charged accordingly.

There is no restriction on the number of amending notices that can be issued during the review period.

Where an amending notice is issued, any tax overpaid in relation to the original charging notice or supplementary charging notice is repaid with interest.

DPT2240 - Who issues supplementary charging notices and amending notices

Supplementary charging notices and amending notices are issued by a designated HMRC officer. The case team should send a report explaining the need for a supplementary or amending notice to the DPT Unit which will liaise with the designated HMRC officer.

DPT2250 - Appeals against charging notices and supplementary charging notices

A company may appeal against a charging notice or supplementary charging notice after the end of the review period. The appeal must be given to HMRC within 30 days from the end of the review period.

The appeal must be made in writing and must specify the grounds on which it is made.

Payment of diverted profits tax may not be postponed on any grounds, including any pending appeal.

For the purposes of an appeal, the special rules disallowing 30% of expenditure under the inflated expenses condition must be disregarded when determining whether the taxable diverted profits have been properly calculated.

Appeals may be settled by agreement between HMRC and the company or by the Tribunal. In

determining an appeal, the Tribunal has power to

- confirm the charging notice or supplementary charging notice
- amend the charging notice or supplementary charging notice cancel the charging notice or supplementary charging notice.

DPT2260 - Information and inspection powers

HMRC information and inspection powers in Schedule 36 FA 2009 (information and inspection powers) and Schedule 23 Finance Act 2011 (data-gathering powers) apply to the diverted profits tax. Consideration should be given to their appropriate use – see Compliance Handbook CH2000 and 2800.

DPT2270 - Payment of tax - overview

The full amount of the DPT charged by a charging notice or the additional tax charged by a supplementary charging notice must be paid within 30 days following the date on which the notice is issued.

The company to which the notice is issued is liable to pay the tax. Unpaid DPT may be collected from a UK representative of a non-UK resident company or from a company related to the non-UK resident company.

DPT2280 - Postponement of tax

Once a charge has been raised, payment of the DPT cannot be postponed on any grounds. This means that the tax must be paid regardless of whether a review of the amount of diverted profits tax charged is in progress or whether there is an open appeal.

DPT2290 - No deduction for DPT against profits or income

DPT is a separate tax from income or corporation tax. Any payment of DPT is ignored in its entirety for the purpose of calculating income, profits or losses. Therefore:

- no deduction or relief is allowed in respect of DPT paid by the company;
- no amounts paid (directly or indirectly) by anyone in order to meet or to reimburse the cost of DPT are to be taken into account. Any such amounts are not to be treated as a distribution for the purposes of corporation tax.

DPT2300 - Taxes that can be credited against DPT Where a

company has paid

- corporation tax; or
- a non-UK tax which corresponds to corporation tax on profits that are also subject to a DPT charge, a credit for those taxes can be allowed against the DPT liability of that company, or of another company in relation to the same diverted profits, where and to the extent that it is just and reasonable to allow such a credit. But no credit can be given for taxes which are paid after the end of the review period.

Rather than operating through a set of complex rules to try to cover every eventuality the principle behind section 100 is to allow credit to the extent is just and reasonable to do so. For example it would not be just and reasonable to do so where a company had paid tax on the same profits which was subsequently refunded.

For the purposes of allowing credit, where payments are made subject to withholding tax, the tax withheld is treated as corporation tax paid by the person receiving the payment (provided it has not been refunded, directly or indirectly) and not the person making the payment.

Example:

Company A, a non-resident company supplying services through a UK intermediary in a way designed to avoid the creation of a UK permanent establishment, enters into arrangements that divert profits attributable to the UK activity to a connected company, Company C, resident in a zero tax jurisdiction, by making inflated expense payments to that company through another connected company, Company B, resident in a normal rate jurisdiction with a favourable double tax treaty.

Profits of 100 are diverted from the UK “avoided PE”, but part of these profits “stick” in Company A and Company B. Of the 100, 10 is subject to non-UK tax equivalent to corporation tax at 10% in Company A, and 3 is subject to non-UK tax equivalent to corporation tax at 33% in Company B. These non-UK taxes are paid by Company A and Company B before the end of the review period for the relevant accounting period.

Company A has a DPT liability of 100 x 25% = 25

Company A has paid non-UK taxes on part of the same diverted profit of 10 x 10% = 1

Company B has paid non-UK taxes on part of the same diverted profit of 3 x 33% = 1

The remaining 87 has been diverted to Company C and is untaxed

The maximum just and reasonable credit that can be allowed against Company A’s DPT liability is 2 and Company A must pay DPT of 23.

DPT2310 - CFC charges

A DPT liability can arise in relation to a transaction or transactions with a CFC, although where the resulting material provision produces an effective tax rate mismatch outcome that is matched or exceeded by a CFC charge in the parent company in relation to that provision and it was known that the charge would arise at the time the provision was made or imposed, it's unlikely that that the provision would have been designed to secure a tax reduction (see DPT1180). Where a DPT liability does arise, a company may be given a just and reasonable credit for any CFC charge (or a non-UK tax which is similar to a CFC charge) against that DPT liability where both the DPT liability and the CFC charge arise by reference to the same profits. But no credit can be given for a CFC charge which is paid after the end of the review period.

The DPT legislation is not designed to apply where a non-resident company, other than one that has a UK PE or an avoided PE, diverts profits to another non-resident company, but it is conceivable that such a company may be a CFC of a UK company and that the diversion of profits results in a liability to tax in the second non-resident company that is less than 80% of the CFC charge that would otherwise be payable by the UK parent company. Although this scenario is not addressed in the DPT legislation, if a company sought to employ such arrangements to avoid a liability to DPT HMRC would consider those arrangements to be potentially within the scope of the General Anti-Abuse Rule and would seek to apply it.

DPT2320 - Process for collecting tax

As DPT is not a self-assessed tax, a charge will be raised on the Strategic Accounting Framework Environment (SAFE) when a charging or supplementary charging notice is issued by the DPT Unit.

Any amendments to the charge should also be dealt with through SAFE.

DPT2330 - Collection of tax from a non-UK resident

The rules in Chapter 6 of Part 22 CTA 2010 apply to the assessment, collection and recovery of DPT, or interest on DPT from a non-UK resident company. These rules mean that tax and interest can be collected from a permanent establishment (PE) in the UK through which a non-UK resident carries on a trade. They also apply to an avoided PE for the purposes of the diverted profits tax. The permanent establishment or the avoided PE is treated as the UK representative of the non-UK company in relation to the taxable diverted profits arising to the non-UK company.

DPT2340 - Collection of tax from a related company

Any amount of DPT due from a non-UK resident company (the taxpayer company) which remains unpaid after the due and payable date can be collected from a related company.

A company is related in this context if, at any time in the relevant period, it was a member-

- of the same group as the taxpayer company;
- of a consortium which at the time owned the taxpayer company; or
- of the same group as a company which at the time was a member of a consortium owning the taxpayer company.

The relevant period means the period beginning 12 months before the start of the accounting period to which the unpaid DPT relates and ending on the date that the tax becomes payable. The taxpayer company and the related company are members of the same group if

- one is the 51% subsidiary of the other, or
- both are 51% subsidiaries of a third company.

The definition of consortium takes its meaning from Part 5 of CTA 2010.

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DPT2350 Serving a notice on the related company

A notice to pay the unpaid DPT liability of the taxpayer company (or, in the case of a consortium, the appropriate proportion of unpaid DPT) must be served on the related company. The designated HMRC officer will decide whether a notice should be served.

The related company has 30 days from the date the notice is served to pay. Interest is payable on any DPT paid late.

The notice must state:

- the amount of DPT charged on the taxpayer company for an accounting period that remains unpaid;
- the date when it first became payable; and
- the amount of DPT to be paid by the related company on which the notice is served.

The notice must be served on the related company before the end of the three year period commencing on the date the charging notice or supplementary charging notice was issued to the taxpayer company.

Until the tax is paid, enforcement action may be taken against either the taxpayer company or the related company, or both.

DPT2360 - Appeals by a related company

A related company which is served a notice to pay unpaid DPT may appeal against the notice in the same way as the company which received the original charging or supplementary charging notice.

DPT2370 - Amount of DPT paid by a related company in a consortium case

In a consortium case, the related party may not be required to pay the full amount of DPT due and payable by the taxpayer company. The related company will be required to pay DPT in the following proportions

- Where the related company is a member of a consortium that owned the taxpayer company the proportion of unpaid DPT to include in the notice will correspond to the share which the related company has had in the consortium for the relevant period.
- Where the related company is in the same group as a company that was a member of a consortium owning the taxpayer company, the proportion of unpaid DPT to include in the notice will correspond to the share that the group companies have in the consortium.
- In a case where both situations apply, the proportion of unpaid DPT to include in the notice will be the greater of the two amounts calculated.

The member's share in the consortium over the relevant period for which the notice applies is the lowest percentage of the following:

- the percentage of the ordinary share capital of the taxpayer company which is beneficially owned by the member;
- the percentage to which the member is beneficially entitled of any profits available for distribution to equity holders of the taxpayer company; and
- the percentage to which the member would be beneficially entitled of any assets of the taxpayer company available for distribution to its equity holders on a winding up.

If the above percentages vary over the relevant period an average is taken of the percentages over the relevant period.

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DPT2380 Related company's right to reimbursement

A related company that receives a notice and pays DPT may recover that sum from the non-UK company to which the original charging or supplementary charging notice was sent.

DPT2390 - No tax deduction for DPT paid by a related company

A related company that receives a notice and pays DPT cannot deduct the amount paid when calculating income, profits or losses for any tax purposes.

DPT2400 - Interest

There are two types of interest which apply to DPT – "true-up" interest and late payment interest.

DPT2410 - True Up Interest Although computed in the same way as late payment interest, by reference to the amount of DPT, "true up interest" is in fact a component of the tax charge. Its purpose is to ensure broad equity between cases in which notices are issued promptly after the end of the relevant accounting period, on one hand, and cases in which the issue of notices may be delayed for whatever reason.

Because a preliminary notice may be issued up to 24 months from the end of an accounting period or up to four years from the end of an accounting period in discovery cases, and because DPT does not become payable until 30 days after the issue of a charging notice (which follows the 30 day period for representations against a preliminary notice and a further 30 days for consideration of those representations and issue of a charging notice), the potential interest disparities that might arise could be significant. The "true up interest" component of the tax charge is designed to offset this.

For example, assuming a 12 month accounting period ending on 31 December 2017, the position in two comparable cases could be:

- **Case A:** Preliminary notice issued 31 March 2018. Following representations and HMRC consideration, charging notice issued 31 May 2018. DPT due and payable 30 June 2018.
- **Case B:** Preliminary notice issued 31 March 2019. Following representations and HMRC consideration, charging notice issued 31 May 2019. DPT due and payable 30 June 2019.

In both cases, late payment interest (see below) will run from the due and payable date and, absent any further provision, the company in Case B would obtain a 12 month interest advantage over the company in Case A.

"True up interest" mitigates or eliminates this advantage in all affected cases because it is calculated by reference to a notional period that begins six months from the end of the relevant accounting period and ends on the day that the charging notice is issued. In case B, this would mean that "true up interest" would run from 30 June 2018 to 31 May 2019 and form part of the tax charge included in that notice.

DPT2420 - Late payment interest

Where DPT charged in a charging notice or supplementary charging notice remains unpaid after the 30 day due and payable date, late payment interest will be charged in accordance with section 101 Finance Act 2009 (CH140000). Late payment interest is also charged when DPT due from a related company or a UK representative of a non-UK resident company is paid late.

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DPT2430 Penalties

Penalties under Schedule 56 Finance Act 2009 for failure to make payments on time may be charged in respect of DPT.

Chapter 5 - Imposing a charge: procedure and governance

Chapter Summary

DPT2600 - Overview

A charge to DPT is imposed for an accounting period by a designated HMRC officer issuing a charging notice or a supplementary charging notice.

The guidance in Chapter 4 sets out the statutory requirements for issuing notices and raising charges (including the process for appeals) which must be followed.

This chapter contains guidance on the HMRC process for imposing a charge.

DPT2610 - Identifying potential DPT cases

The majority of potential DPT cases will notify their liability to DPT to the DPT Unit or be identified by the Diverted Profits Risk Team (DPRT) during the risk assessment process. If a case worker or CRM believes that a company they deal with is potentially liable to the DPT they should inform the DPRT and the DPT Unit. To ensure that time limits for issuing preliminary notices are not missed this action should be treated as urgent.

Guidance on customer engagement is in Chapter 3 but in essence case workers and CRMs should not raise DPT issues with their customers until they have contacted the DPRT and received guidance on how to proceed. The DPT legislation provides a framework for working DPT cases that is outside of the normal CTSA enquiry procedure. Notices must not be sent without the approval of the designated HMRC officer.

It is important that the time limits and other statutory requirements are strictly adhered to by everyone working a DPT case.

DPT2620 - Time limits within the DPT legislation

The DPT legislation provides time limits for the issue of preliminary notices; two years if a company notifies its potential liability and four years if not. HMRC and customers may wish to enter into initial discussions during this period and HMRC officers will gather relevant information from other sources to inform a decision on whether to issue a preliminary notice.

The DPT legislation provides a structured process which includes strict time limits. This is described in more detail in Chapter 4 but the position can be summarised as follows:

Action	Time Limit
Preliminary notice issued by HMRC.	Two years from the end of the accounting period (in which the diverted profits arise) if the company notifies liability, otherwise four years.
Representations from company.	30 days from issue of the preliminary notice.
Charging notice issued by HMRC.	30 days from the end of the period for representations.
Payment of tax.	30 days after the charging notice is issued.
Review period.	~~12~~15 months beginning immediately after the latest day for payment of the DPT (the review can be for a shorter period if there is agreement by both sides or if the company notifies that it is terminating the review following a supplementary charging notice – DPT 2690).
Appeal by company.	30 days from end of the review period.

Once a preliminary notice has been issued the company has 30 days to submit written representations. The company can make any representations it wants but the designated HMRC officer can only consider a restricted number of objective and easily verifiable matters (see Chapter 4). Consequently unless there has been a straightforward misunderstanding a preliminary notice will usually be followed by a charging notice and the 12-month review period.

DPT2630 - Engagement during the review period

HMRC expects that customers will want to work collaboratively during the review period as they have to pay the DPT upfront and will want to obtain certainty and have any excess DPT repaid. Although the company cannot postpone the DPT and must pay it in full, HMRC can issue amending notices during the review period to reduce the DPT charged and repay the resulting overpayment.

If a group does not collaborate with HMRC during the review period, the required information can be sought using formal powers in Schedule 36 FA 2008 (see DPT2260).

DPT2640 - Preliminary notice

The designated HMRC officer will issue a preliminary notice to a company if they have reason to believe that a DPT charge arises.

Before a notice is issued to a company the DPRT will set out the basis on which a preliminary notice should or should not be issued. This will be passed to the DPT Unit which will consider it, liaise with other HMRC officers where necessary and, if appropriate, draft a preliminary notice for consideration by the designated HMRC officer.

The designated HMRC officer is an officer with an appropriate level of seniority who is authorised to sign and issue the preliminary notice.

DPT2650 - Representations following a preliminary notice

The company has 30 days from the issue of a preliminary notice to send written representations to HMRC. If a case worker or CRM receives written representations they should immediately forward them to the DPT Unit along with their comments which should include the views of all relevant stakeholders such as the DPRT and Diverted Profits Technical co-ordinators. Given the tight timescale for responding to the written representations it is imperative that these matters are dealt with urgently.

DPT2660 - Charging notice

HMRC has 30 days immediately following the end of the period for representations to either

- issue a charging notice to the company for the accounting period to which the preliminary notice refers, or
- notify the company that no charging notice will be issued for that accounting period pursuant to that preliminary notice.

The charging notice creates a formal liability to pay the Diverted Profits Tax (DPT) within 30 days of the date the notice is issued. There is no provision for postponement and the notice, at this stage, is not appealable.

The notice will be issued by the designated HMRC officer supported by the DPT Unit who will arrange for the charge to be entered on SAFE. The guidance in Chapter 4 sets out the information that the notice should contain and who copies should be sent to.

DPT2670 - Process for collecting tax

All DPT will be collected by raising a charge on the Strategic Accounting Framework Environment (SAFE).

Where amounts remain unpaid after the due date, further notifications may be issued which will also include late payment interest and late payment penalties.

DPT2680 - Review period

Following the issue of the charging notice HMRC has a further period, the review period, in which it must review the charging notice - see DPT2160.

DPT2690 - Designating the end of the review period

The review period begins immediately after the 30 day period during which the DPT included in the charging notice must be paid and ends ~~12~~15 months later. But the review period may end within the ~~12~~15 months if:

- following the issue of a supplementary charging notice, the company notifies HMRC that it wants to terminate the review, or
- the company and the designated HMRC officer agree in writing to terminate the review.

Before proposing to terminate the review, the case worker must adhere to HMRC's governance processes and make a referral to the DPT Unit who will liaise with the designated HMRC officer and other senior officers who make up the membership of the cross-directorate board. This submission should set out the findings of the review and include the case worker's recommendation.

DPT2700 - Supplementary charging notices and amending notices

Chapter 4 contains detailed guidance on issuing supplementary charging notices and amending notices (see DPT2180/2190). During the review period HMRC can issue a supplementary charging notice if it considers that the amount of profits included in a charging notice for an accounting period is insufficient. HMRC can issue an amending notice if based upon the evidence the designated HMRC officer considers that the profits included in the original charging notice for an accounting period are excessive.

Where an amending notice is issued, any part of the tax paid against the original charging notice (or supplementary charging notice) that has become an overpayment is repaid with interest, provided that the tax charged by the earlier notice has been paid in full. The repayment will be in accordance with HMRC's tax accounting and set-off policies.

Supplementary notices and the amending notices are issued by the designated HMRC officer. The case worker should send a report explaining the need for a supplementary or amending notice to the DPT Unit which will liaise with the designated HMRC officer.

DPT2710 - Appeals against charging notices and supplementary charging notices

A company may appeal against a charging notice and/or supplementary charging notice after the end of the review period. The appeal must be made in writing within 30 days from the end of the review period. If a case worker or CRM receives an appeal against a DPT charging notice they should contact the DPT Unit who will acknowledge its receipt and liaise with the designated HMRC officer and other relevant stakeholders.

See DPT2250 for more information about the appeals process.

DPT2720 - Information & inspection powers

See DPT2250

DPT2730 - Interaction with other legislation

The General Anti-Abuse Rule (GAAR) applies to DPT. The GAAR should not be raised with a taxpayer or their advisors until Counter-Avoidance have been consulted and given their express approval.

The definition of tax advantage at CTA 2010 s1139 has been widened to include the avoidance or reduction of a charge to DPT. This means that various targeted anti-avoidance rules such as the loan relationship unallowable purpose rule at section 441 of CTA 2009 can apply in relation to DPT.

DPT2740 - Governance

New procedures for diverted profits governance provide a single process that takes in all tax risks (not only DPT) that arise from arrangements identified as potentially within the scope of the DPT legislation. It works alongside other HMRC business level governance procedures, including those for transfer pricing.

At the risk assessment level there is a three-stage process beginning with an Initial Risk Review aimed at determining whether the arrangements present low or high risk. This review will be conducted by the DP Risk Team working with other stakeholders, before its conclusions are presented to members of a panel of experienced officers, including at least one from the CTIS ~~BI~~BAI Transfer Pricing Team.

If it is not clear from the initial risk review presented at this point whether the issues considered present high or low risk that the business is potentially subject to DPT, the DPRT will need to carry out further work which may need to include seeking further information from the business to establish the position. A transfer pricing enquiry must not in any circumstances be opened or settled unless approval to do so has been obtained under the appropriate governance procedure. The initial risk review will need to be resubmitted once this further work is completed.

Arrangements that are agreed by the experienced officers to be high risk will require a detailed risk review. This will be expected to involve significant engagement with the business. In relation to DPT it will be aimed at reaching a recommendation as to whether a Preliminary Notice should be issued. The completed documents are passed via the DPT Unit to senior officers from various HMRC directorates, including the designated HMRC officer mentioned in the legislation, who make up the membership of a board. They will decide whether it is appropriate for a Preliminary Notice to be issued and, if so, when and in what amount. As mentioned above, any related transfer pricing enquires into returns must be explicitly authorised.

It is important that risk reviews consider other challenges to structures that divert profits from the UK, particularly for periods before the DPT applies. This could involve Permanent Establishment (PE) and transfer pricing challenges outside the DPT legislation. Case workers or ~~CRMs~~CCMs should not, for example, accept that sales into the UK do not give rise to a UK PE without making thorough enquiries and checking with the DP Risk Team.

Where the issue of a Preliminary Notice is agreed, it will be signed by the designated HMRC officer and the DPT Unit will issue it and receive any representations. The designated officer will consider any such representations in accordance with the legislation before deciding whether to issue a charging notice and in what amount, within the 30-day period allowed.

A similar process to the issue of the Preliminary Notice will apply if the case team considers that an amending or supplementary notice should be issued during the review period. However if an amending notice has the effect of eliminating the DPT charge, or it is otherwise anticipated that it will have the effect of resolving matters, the governance procedure for resolution will apply.

At the conclusion of the review period the case team will make a report to the board of senior officers. Where the report recommends continuing the dialogue with the business following receipt of an appeal against the charging notice it should include a commitment to resubmission with a progress report at a specified future date or when settlement proposals are made, if earlier. Otherwise the senior officers will review the risk(s) and decide on the recommendation to be made to the appropriate dispute resolution board(s).

Appendix A - Notification template guidance

Guidance on the notification requirement and related processes can be found in Chapter 4.

Where customers consider they need to notify HMRC of being potentially in scope to diverted profits tax, they should email their notification to divertedprofits.notification@hmrc.gsi.gov.uk .

If a customer is within the HMRC Large Business population and has an allocated Customer Relationship Manager (CRM), HMRC recommends the CRM is copied in to the notification email to HMRC.

If a customer is within the HMRC Mid-Size Business population, it will not have a CRM, but please copy the notification email to Jeremy Hawkins (jeremy.hawkins@hmrc.gsi.gov.uk) and Clare Walsh (clare.walsh@hmrc.gsi.gov.uk). If the customer does not have an allocated HMRC CRM or does not know whether their tax affairs are dealt with HMRC Mid-Size Business, the notification should be sent only to the main email address above.

If the customer is unable to submit the notification electronically, or wishes to also submit the notification in hardcopy, the notification should be sent to the following address, again sending a copy to the CRM or to Jeremy Hawkins / Clare Walsh:

Large Business:	Mid-Size Business:
Diverted Profits Tax Unit	Diverted Profits Tax Team
Large Business	Mid-sized Business and Wealthy Compliance
S0791	SO793
Newcastle	Newcastle
NE98 1ZZ	NE98 1ZZ

Appendix B - DPT suggested notification template

Dear Sirs,

Notification of potential liability to Diverted Profits Tax

[Company Name] ('Company'):

[Registered Office Address]:

[HMRC reference numbers, if applicable]:

In accordance with section 92 Finance Act 2015, I hereby notify HMRC that:

- the Company is potentially within the scope of diverted profits tax in respect of the accounting period –

  _ _ / _ _ / _ _ _ _ to _ _ / _ _ / _ _ _ _ (DD/MM/YYYY);

- the Company is potentially within the scope of diverted profits tax by virtue of section 80, 81 or 86 Finance Act 2015 (as modified by section 92(5) Finance Act 2015) applying, as indicated below –

section 80 ☐

section 81 ☐

section 86 ☐

- where section 80 or 81 applies –

  Description of the material provision:

  Identity of the parties between whom the material provision has been made or imposed:

- where section 86 applies –

  Identity of the "avoided PE":

  Is the mismatch condition potentially met? ____ (Yes or No)

  If Yes –

  Description of the material provision:

  Identity of the parties between whom the material provision has been made or imposed:

Yours faithfully,

[Authorised Officer of Company] [Company]

Signature _____ / Date _____