U.K. Opens Surprise Diverted Profits Tax Compliance Program

by Stephanie Soong Johnston

Multinational enterprises will get a chance to come clean about their outdated transfer pricing policies and avoid the diverted profits tax (DPT) under an unexpected new U.K. disclosure facility, which practitioners are eyeing with caution.

In January 10 guidance that caught many in the tax community by surprise, HM Revenue & Customs announced the profit diversion compliance facility, targeting MNEs that still have outdated transfer pricing arrangements that could fall under the scope of the DPT.

The DPT took effect April 1, 2015, and is levied on profits derived from the United Kingdom by a company that has either structured its operations to avoid creating a permanent establishment or made payments to a related company under an arrangement that lacks economic substance. The DPT is assessed at a punitive 25 percent rate and is subject to more stringent assessment procedures, such as upfront payment within 30 days after receiving a charging notice, compared with the ordinary corporate tax, which may be paid after an appeal and at a 19 percent rate.

Under the program, MNEs with policies that may be out of line with the OECD's transfer pricing guidelines and tax affairs that may be subject to the DPT can review both the design and implementation of their arrangements, amend them if necessary, and submit a report to HMRC under the facility with proposals to settle any extra tax, interest, and potential penalties, according to the guidance.

Participation in the program will allow MNEs to update their transfer pricing affairs "openly, efficiently, and without investigation by HMRC" if their disclosures are accurate and complete, and will give taxpayers greater certainty about their past situation and lower risk for attracting DPT in the future, the guidance says.

MNEs that wish to participate in the facility must determine whether they need to pay extra tax, interest, or penalties; register with HMRC; file a report; and pay what they owe according to their settlement proposal on or before the date the report is filed, according to the guidance.

The document sets out what participating MNEs are expected to include in their reports and outlines the various DPT risk indicators. It also explains some common misconceptions about the DPT and emphasizes that "tackling profit diversion is a priority for HMRC."

"HMRC is conducting extensive research and data analysis and has invested in new teams of investigators," the guidance says, adding that the tax authority has already identified several MNEs across various sectors that may be diverting profits and expects to find more.

"We are planning a program of investigation of the arrangements of these MNEs involving HMRC staff in our Large Business and Midsized Business directorates, and in appropriate cases our Fraud Investigation Service," HMRC warned.

HMRC will also contact MNEs to encourage them to participate in the facility if its analysis indicates a risk of attracting the DPT, according to the guidance. "We are writing to some specific businesses that we believe could be diverting money away from the U.K. and encouraging them to use our new facility," an HMRC spokesperson said. Those letters will start going out soon, the spokesperson told *Tax Notes*.

However, not all MNEs that are identified will receive letters, and HMRC may start investigations without sending letters, the guidance says.

"HMRC hopes businesses will utilize the facility to engage with us on their tax arrangements," the spokesperson said. "If we're not satisfied with what businesses tell us, or if they don't respond to us at all, they risk an HMRC investigation and a DPT charge if DPT applies."

A Wary Reception

Some practitioners told *Tax Notes* that the announcement was rather unexpected and somewhat unusual. It appears to be the first disclosure facility of its kind that targets corporate taxpayers rather than individual taxpayers, according to Heather Self, a partner with Blick Rothenberg in London.

Rhiannon Kinghall Were, head of tax policy at Macfarlanes LLP, said the new facility is "a less painful, but not painless, approach for MNEs to bring their U.K. tax affairs up to date." The facility may be attractive to MNEs at first glance because any additional tax would be subject to the 19 percent corporate tax rate instead of the 25 percent DPT and because companies would avoid the risk of being named and shamed for noncompliance, she said. "But it's not without side effects," she warned.

After all, the information that must be included in an MNE's facility report is wide-ranging. "A cynic might even think it replicates the analysis HMRC would undertake itself in a transfer pricing investigation," Kinghall Were said, adding that the process may also reveal parallel tax risks and uncertainty.

"What is clear is that MNEs will now want to review their position and, if within scope, consider whether the benefits presented outweigh the risks of this new and unusual process," Kinghall Were added.

Certainly, transfer pricing inquiries tend to be resource intensive for the tax authority, so "this is an attempt to get companies to do most of the legwork," Self said.

Tim Stovold of Kingston Smith LLP agreed, noting that HMRC can spend years on an investigation and still conclude it without collecting extra tax. "The profit diversion compliance facility is an attempt by HMRC to catch some low-hanging fruit," he said.

Companies with concerns about their transfer pricing affairs may want to use the facility to have a little more control over the dialogue with the tax authority, according to Stovold. However, "this new facility has none of the generous concessions we have seen in past facilities, so MNEs have no discount from the normal penalty regime applicable," he said, noting HMRC's intention to pass on serious cases to the Fraud Investigation Service.

MNEs have until December 31 to register. "After this date, HMRC will have had the windfall from voluntary disclosures, and the team of specialists working at HMRC in this area will be keen to go on the hunt for those businesses with something to disclose who chose to keep their heads down," Stovold warned.

Ray McCann of Joseph Hage Aaronson LLP and president of the Chartered Institute of Taxation, said it was doubtful that affected companies would fail to come forward. "It is not my experience that larger companies ignore these types of provisions completely, so for many, it might be a case of reviewing previous professional advice, which is likely to have been given by the larger firms," McCann said. "We will have to wait and see."

One thing is for certain for MNEs considering participating in the new facility. "Companies will have to think very carefully, and look before they leap," Self said. ■