HM Revenue & Customs

Diverted profits tax

Who is likely to be affected?

Large multinational enterprises with business activities in the UK who enter into contrived arrangements to divert profits from the UK by avoiding a UK taxable presence and/or by other contrived arrangements between connected entities.

General description of the measure

This measure will introduce a new tax on diverted profits. The diverted profits tax will operate through two basic rules. The first rule counteracts arrangements by which foreign companies exploit the permanent establishment rules. The second rule prevents companies from creating tax advantages by using transactions or entities that lack economic substance.

Policy objective

The main objective of the diverted profits tax is to counteract contrived arrangements used by large groups (typically multinational enterprises) that result in the erosion of the UK tax base.

Background to the measure

This measure is newly announced at Autumn Statement 2014 and a Technical Note is published alongside this Tax Information and Impact Note.

Detailed proposal

Operative date

This measure will have effect in respect of profits arising on after 1 April 2015.

Current law

UK resident companies and non-resident companies carrying on a trade in the UK through a permanent establishment, are chargeable to corporation tax on profits. The computation of those profits is subject to:

- the transfer pricing rules (at Part 4 Taxation (International and Other Provisions) Act 2010 (TIOPA);
- the rules on profits attributable to a UK permanent establishment (PE) of a non-UK resident company (at Part 2, Chapter 4 Corporation Tax Act 2009 (CTA 2009)); and
- the rules on whether a non-UK resident company has a PE in the UK (at Part 24, Chapter 2 Corporation Tax Act 2010 (CTA 2010)).

Proposed revisions

Legislation will be introduced in Finance Bill 2015 to establish a new tax – the “diverted profits tax”. The tax will be at a rate of 25 per cent of diverted profits relating to UK activity. The charge will arise if either of two rules applies.

The first rule is designed to address arrangements which avoid a UK permanent establishment (PE) and comes into effect if a person is carrying on activity in the UK in connection with supplies of goods and services by a non-UK resident company to customers in the UK, provided that the detailed conditions are met.

The second rule will apply to certain arrangements which lack economic substance involving entities with an existing UK taxable presence. The primary function is to counteract arrangements that exploit tax differentials and will apply where the detailed conditions, including those on an “effective tax mismatch outcome” are met.

The first rule only applies where the UK person and the foreign company are not small or medium-sized enterprises (SMEs) and the second rule where the two parties to the arrangements are not SMEs (the SME test will apply to the group). The first rule will be subject to an exemption based on the level of the foreign company’s (or a connected company’s) total sales revenues from all supplies of goods and services to UK customers not exceeding £10 million for a twelve month accounting period. The diverted profits tax will not reflect any profits relating to transactions involving only loan relationships.

The legislation will provide that where a designated HMRC officer determines that the diverted profits tax should apply a preliminary notice would be issued explaining, among other things, the reasons the amount of the charge and the basis on which it has been calculated (including the details of the amount of the taxable diverted profits).

The recipient would have 30 days to make representations and the designated HMRC officer may consider certain specified matters within a further 30 day period before either issuing a charging notice on the original or a revised amount, or confirming that no charge arises.

Where specific conditions are met and the designated HMRC officer considers that certain expenses otherwise deductible may be greater than they would have been at arm’s length; the diverted profit charge will initially reflect a 30 per cent disallowance of those expenses.

The charging notice will require the payment of the diverted profits tax within 30 days. Penalties will apply for late payment.

Following the due date for payment, there is a 12-month review period during which the charge may be adjusted based upon evidence. At the end of the review period the business has the opportunity to appeal against any resulting charge. The review period can be brought to a conclusion earlier with the agreement of both parties. There will be no postponement of the disputed tax during the review period or due to any subsequent appeal.

Summary of impacts

<table>
<tr><td rowspan="3">Exchequer impact (£m)</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td></tr>
<tr><td>-</td><td>+25</td><td>+270</td><td>+360</td><td>+345</td><td>+355</td></tr>
<tr><td colspan="6">These figures are set out in Table 2.1 of Autumn Statement 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings documents published alongside the Autumn Statement 2014.</td></tr>
<tr><td>Economic impact</td><td colspan="6">The measure is not expected to have any significant economic impacts.</td></tr>
<tr><td>Impact on individuals, households and families</td><td colspan="6">This measure will not directly impact individuals, households or families. The measure is not expected to impact on family formation, stability or breakdown.</td></tr>
<tr><td>Equalities impacts</td><td colspan="6">There are no impacts on any groups which share a protected characteristic.</td></tr>
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Impact on business including civil society organisations	This measure will have no impact on civil society organisations; business impact is limited to those large business and multinational enterprises that are using contrived arrangements to divert profits.
Operational impact (£m) (HMRC or other)	HMRC will need to makes changes to IT systems to deliver this change, at an estimated one-off cost of £300,000. Additional staff costs are estimated to be in the region of £2.3 million for 2015-16 to 2017-18 and then £1 million thereafter.
Other impacts	Other impacts have been considered and none have been identified.

Monitoring and evaluation

The measure will be monitored to ensure the legislation is operating as intended and kept under review through regular communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please send an email to: divertedprofits.mailbox@hmrc.gsi.gov.uk.