

New Clause 7: Receipts from intellectual property: diverted profits tax

Summary

1. This clause changes the rules in Part 3 of the Finance Act 2015 (FA15) on the diverted profits tax. It revises section 88 FA15 to include within the charge to diverted profits tax 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. Consequential changes are also made to sections 79 and 100 FA15. These changes ensure that no advantages accrue to a person within the charge to diverted profits tax as a result of other changes to the rules in respect of the deduction of income tax from payments of royalties made in Finance Bill 2016 and that the application of the 25% rate continues to disincentivise contrived arrangements.

Details of the clause

2. Subsection (1) of the clause provides that Part 3 of FA15 is amended.
3. Subsection (2) of the clause adds a new subsection (6) to existing section 79 FA15. This new subsection ensures that royalty payments included in taxable diverted profits tax by virtue of the new subsection 88(5)(b) FA15 are charged at a rate of 25% and not treated as banking surcharge profits or notional banking surcharge profits.
4. Subsection (3) of the clause replaces the existing subsection 88(5) FA15 with new subsections 88(5) and (5A) FA15.
5. New subsection (5) of section 88 FA15 provides that "notional PE profits" of an accounting period is now the sum of two amounts.
6. New subsection (5)(a) of section 88 FA15 includes within the definition of "notional PE profits" (NPEP) those amounts that are NPEP under the current subsection 88(5) FA15.
7. New subsections (5)(b) and (5A) of section 88 FA15 include in NPEP of an accounting period an additional amount equal to the sum of certain royalties and other sums in respect of which an obligation to deduct income tax would have arisen under section 906 ITA if an avoided PE had been a permanent establishment in the UK.
8. Subsection (4) of the clause amends the heading of section 100 FA15 as credit under that section can now include amounts for a liability to diverted profits tax arising by virtue of new subsection 88(5)(b).
9. Subsection (5) of the clause inserts new subsection 2A into section 100 FA15. This new subsection ensures that credit is not given for foreign tax paid by the recipient of a royalty that is included within taxable diverted profits by virtue of the provisions of new subsection 88(5)(b).
10. Subsection (6) of the clause inserts new subsections (4A), (4B), (4C), (4D) and (4E) into section 100 FA15.

11. New subsections (4A) and (4B) of section 100 FA15 prevents an amount of profit represented by a single royalty payment being charged to tax twice under different provisions in Part 3 of FA15.
12. New subsections (4C), (4C) and (4D) of section 100 FA15 provide for credit to be given, on a just and reasonable basis, against a company's liability to diverted profits tax arising by virtue of section 88(5)(b) where relief would have been due under either a double taxation arrangement or the EU Interest and Royalties Directive.
13. Subsection (7) of the clause provides the commencement provisions.
14. Subsection (8) of the clause ensures that payments that are accelerated to avoid the application of the changes made to section 88(5) FA15 will be regarded as paid in an accounting period to which the revised section 88(5) applies.

Background note

15. Tax rules in the Income Tax (Trading and Other Income) Act 2005 define the territorial scope of the charge to income tax on royalties and other income from intellectual property. In the case of income arising to a non-UK resident, a charge arises only if the income is from a source in the UK.
16. Other legislation being introduced into the Finance Bill 2016 broadens the scope of payments of royalties and other income from intellectual property that will be considered to come from a source in the UK. This will now include payments made by persons that are non-UK resident person where those payments are connected with a trade carried out by that person through a permanent establishment in the UK. As a result such payments will now be subject to the deduction of income tax at source rules in Part 15 of the Income Tax Act 2007.
17. This measure ensures that no advantages will accrue, as a result of the changes to the source rule, where a non-resident person has an avoided PE within the meaning of Part 3 of FA15 as compared to the situation where a non-resident person has an actual PE in the UK, and that the application of the 25% rate continues to disincentivise contrived arrangements.