HM Revenue & Customs

Diverted Profits Tax: Interim Guidance

This document provides guidance on the Diverted Profits Tax introduced in Finance Act 2015. It replaces guidance published on 10 December 2014.

This new guidance reflects the detailed and considered responses received during consultation on the draft legislation and takes account of amendments made to the draft legislation which was published at Autumn Statement.

It is interim draft guidance and will be reviewed and updated.

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Foreword

At Autumn Statement 2014, the Government announced that it is introducing a new tax - the Diverted Profits Tax - to counter the use of aggressive tax planning techniques used by multinational enterprises to divert profits from the UK. The legislation is included in Finance Act 15, and applies from 1 April 2015.

This guidance note provides further details and interim guidance on the diverted profits tax and should be read alongside the legislation, Explanatory Notes and the Tax Information and Impact Note which were published 24 March 2015.

It explains how the diverted profits tax works by reference to practical examples and has benefited greatly from stakeholder comments on the guidance note issued on 10 December 2014. It supersedes that earlier note and will continue to be updated. It will, in due course, be incorporated into HMRC's International Manual (INTM).

Chapter 1 - Introduction and overview

Chapter Summary

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DPT1000 - Overview

The Diverted Profits Tax (DPT) is intended to deter and counteract the diversion of profits from the UK by large groups that

- seek to avoid creating a UK permanent establishment; or
- use arrangements or entities which lack economic substance to exploit tax mismatches either through the creation of intra-group expenditure or the diversion of income intra-group where it is reasonable to assume that, in the absence of a tax benefit, the expenditure would not have been incurred or the income would have been within the charge to UK corporation tax.

As well as preventing the erosion of the UK tax base, the legislation provides a strong incentive for groups to provide timely information about high-risk transfer pricing transactions. 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 multinational enterprises) that use contrived arrangements to circumvent rules on permanent establishment and transfer pricing.

DPT addresses three situations

- 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 of the arrangements put in place is to avoid UK tax, or a tax mismatch is secured such that the total tax derived from UK activities is significantly reduced
- a UK company uses transactions or entities that lack economic substance in order to exploit tax mismatches
- a foreign company with a UK-taxable presence (a permanent establishment) uses transactions or entities that lack economic substance in order to exploit tax mismatches.

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.

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.

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 arrangements to be recharacterised. Where it is necessary to recharacterise arrangements, the amount of diverted profit is calculated on a just and reasonable basis.

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 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.

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, 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 DPT may be brought into charge by 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 in Chapter 5.

Chapter 2 - Application of Diverted Profits Tax

Chapter summary

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PART 1: Legislation - 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 transactions or entities that lack economic substance.

In these cases the calculation of taxable diverted profits is to be in accordance with sections 82 to 85 while section 96 explains how those profits are initially to be estimated.

Section 86 deals with avoided PE cases in circumstances where provision is made or imposed which involves transactions or entities that lack economic substance or where there are tax avoidance arrangements.

In these cases the calculation of taxable diverted profits is to be in accordance with sections 88 to 91 while section 97 explains how those profits are initially to be estimated.

DPT1110 - Situation 1 - Involvement of entities or transactions lacking economic substance - Section 80

A UK resident company may incur a charge to diverted profits tax 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 transfer pricing rules at Part 4 TIOPA 2010 (see INTM412050). The provision must be made or imposed between a UK resident company (C) and another person (P). "Person" is explained further in INTM412030.

The conditions set out in Section 80 are as follows:

- 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. This is discussed at DPT1180;
- the effective tax mismatch outcome is not an excepted loan relationship outcome;
- the "insufficient economic substance condition" must also be met. This is discussed at (DPT1190);
- C and P are not both small or medium-sized enterprises within the definition of Section 172 TIOPA 2010 (INTM412080).

Exemptions

Small or medium-sized enterprises

Although the definition of SME is based on the EU definition (2003/361/EC) there are some modifications contained in Section 172 TIOPA 2010. 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. It only becomes a large enterprise if it qualifies for two consecutive accounting periods.

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 SME falls within the definition of a large enterprise for a single accounting period it is treated as a large enterprise for that accounting period.

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 company 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. To provide this funding company A injects equity into the group financing company which then on lends the funds to company Z.

There is a tax mismatch outcome as between Company A and group finance company, on the basis that there is a reduction in A's taxable income but no tax is payable by group finance company . However, this tax mismatch arises wholly from a matter (i.e. the intragroup loan) that is within the excepted loan relationship rule. Hence, the excepted loan relationship rule means that this arrangement is not within scope of the DPT.

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, and includes arrangement, 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 parties to the transactions are not the same as those to the arrangements that the transactions relate to; or
- there is a transaction, or more than one, 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.

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

The second situation where a DPT charge may arise is set out in section 81. This is in effect an extension to the first situation, applying where a non-UK resident company ("the foreign company") trades through a UK permanent establishment (referred to as "UKPE"). The section 80 rules are extended and adapted by section 81 so that they can work in the same way as they do in relation to 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 the 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
- If the UK PE were a distinct and separate person under the same control as the foreign company section 80 would have applied to the UK PE as a result of it satisfying the mismatch requirements set out in that section.

Whether the material provision results in an effective tax mismatch outcome (DPT1180) and the 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 exemptions for small or medium-sized enterprises and excepted loan relationship outcomes also apply to this situation.

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. 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. The guidance in the following paragraphs sets out how the ultimate charge is determined.

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, 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 it is by reference to the relevant alternative provision.

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, rather than the material provision, as between the relevant company and any connected company 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 may arise as a result of a structure originally set up to avoid tax cannot be taken into account when determining whether the material provision in question would have been undertaken had tax not been a consideration.

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, 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 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 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 would not also have resulted in relevant taxable income) and either there are no diverted profits or although there are diverted profits 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 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

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 and would not have resulted in relevant taxable income), but the relevant company 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 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.

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, rather than the material provision, had been made or imposed.

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.

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 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 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 UK company is to be taxed as if the relevant alternative provision had been entered into. Taxable diverted profits would be the full royalty payment. If the actual royalty paid were in excess of an arm's length price then the company could, in principle, reduce the taxable diverted profits by making a transfer pricing adjustment in their CT return to the royalty payment during the review period that reduced the tax deduction to an arm's length price. However, the company could not eliminate the DPT charge in full: the minimum notional additional amount would be the full amount of the royalty less any excess element established under transfer pricing rules.

Additional taxable diverted profits would arise where the relevant alternative provision would have resulted in the company being in receipt of relevant taxable income. For example, the 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.

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 expense 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 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, either by the issue of a supplementary charging notice or amending notice (DPT2180 / 2190).

HMRC would apply the inflated expense condition only if either 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. 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 expense condition

A UK resident company is making rental payments for property used by it in the course of its trade to a connected UK company that owns the freehold. The freehold is subsequently transferred to an affiliate in a tax haven, 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. In consequence of those facts, and taking into account the increase in rentals at the time of transfer to the tax haven, it is likely to be reasonable for the designated officer to conclude that the inflated expense 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. If the relevant conditions were met the charge would also include any relevant taxable income diverted to the affiliate company. .

DPT1140 - Situation 3 - avoidance of a UK taxable presence – section 86

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. 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” 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 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

CT purposes. This includes, for example, arrangements involving significant sales activity in the UK, but designed to stop short of the conclusion of contracts.

Section 86 applies where the following conditions are met:

- there is a company, that carries on a trade, (the "foreign company") that is not resident in the UK.
- another person ("the avoided PE") is carrying on an activity in the UK in connection with the supplies of goods, services or other property by the foreign company in the course of its trade. It does not matter if that person is a UK resident.
- the avoided PE and the foreign company are not small or medium sized enterprises, as defined by Section 172 TIOPA 2010 (INTM412080).

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 a trade in the UK (whether or not it is also designed to secure any commercial or other object). In practice, this means that the activity is designed so as to ensure that the foreign company does not have a UK PE.

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.

Exemptions

There is an exclusion for cases 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.

The exclusion in relation to section 1142 CTA 2010 only applies if the foreign company and the avoided PE are not connected, within the meaning of section 1122 CTA 2010, unless the avoided PE is regarded as an agent of independent status through section 1145 (independent brokers), section 1146 (investment managers) or section 1151 (Lloyd's agents) (INTM269010).

Section 86 does not apply if both the avoided PE and the foreign company are small or medium-sized enterprises (see below).

There is also an exemption 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 exemption is discussed in more detail at DPT1155.

Small or medium-sized enterprises (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 and tax avoidance conditions

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),
- that the effective tax mismatch outcome is not an excepted loan relationship outcome;
- the foreign company and A are not both small or medium-sized enterprises.

Exemptions

Small or Medium-Sized Enterprises

The mismatch condition cannot be met where the foreign company and A are both SMEs. The same definitions are used as in section 80 – see DPT1110).

Excepted loan relationship outcome

The mismatch condition cannot be met if the tax mismatch outcome is an excepted loan relationship outcome - see DPT1110.

This exclusion applies specifically to the mismatch condition as the effective tax mismatch outcome is not relevant to the tax avoidance condition.

The tax avoidance condition

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

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 goods, services or other property include cases where the partnership carries on the trade or makes the supplies. Also 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 - Exception for limited UK-related sales or expenses

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 company’s sales that are related to activity in the UK. Where the 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 10 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 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.

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 it 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. 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.

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, 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 it is by reference to the relevant alternative provision.

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.

"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 company 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 may arise to a group as a result of a structure originally set up to avoid tax cannot 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, historic avoidance cannot be used to justify 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 and the relevant alternative provision would also have resulted in the foreign company incurring expenses of a particular type. For example, this condition will be met if there is an actual royalty expense under the material provision and there would also have been a royalty payment under the alternative provision, 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, the both the material provision and the relevant alternative provision would have resulted in expenses of the same type and 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 or would have 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, rather than the material provision, had been made or imposed.

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 sales 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 expense 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 expense 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 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 UK 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.

The calculation of the diverted profits can be adjusted during the review period, on the basis of evidence received, either by the issue of a supplementary charging notice or 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 that 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 purposes of applying the participation condition to the second and third 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 in the management, control or capital of the other. 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.

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 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.

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 –Definition of 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.

	First Party	Second Party
The first situation (UK resident company)	UK resident company (C)	Another person (P)
The second situation (UK PE of non-resident company)	UK permanent establishment (C)	Another person (P)
The third situation ("avoided PE")	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. 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"
- 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.

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.

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.

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.

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 would have been the case if not for the transfer of the asset.

DPT1185 - Quantifying the tax reduction for the effective tax mismatch outcome

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 "superdeduction" 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 it 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 that 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). It is only the increases / decreases in liability that result from the material provision itself that are taken into account, not from other provisions that might follow.

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 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 eligible under the law applicable to the second party but not to the first would not qualify.

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.

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 $100 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.

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 tax haven, 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. To prevent abuse this will not apply where the only activity carried out after transfer is work related to the holding, maintenance or legal protection of the asset that gives rise to the income.

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. 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).

The first two tests are transaction-based tests. The first of these 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 is greater than the financial benefit of the tax reduction.

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

The same test is adopted 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.

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 economic value the particular transaction adds from the perspective of both the first and second parties and whether that is greater than the tax reduction. In that sense it is a test of the commerciality of the transaction, taking into account both its direct and indirect effects, and whether it is entered into mainly for tax or other, commercial reasons.

The transaction-based tests are intended to apply primarily in relation to transactions that are designed to shift profits within a group - for example, a transaction that places risk in another group entity in relation to income or profit already earned. In applying the transaction-based rules, HMRC will take into account the principles underpinning the entity-based rule relevant to the ongoing activities of the company.

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.

The first condition 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 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.

The second condition, on the other hand, 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.

"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.

It may be in some cases that the relative size of the tax reduction and other economic benefits is relevant to the consideration of whether the transaction or involvement of entity was 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.

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 a four part-time staff, two of whom are directors and the others administrative staff. Functions in relation to improving and protecting 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. The amounts payable by Company X to Company Z are only marginally more than Company Z pays on to Company Y.

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 $15m.

The material provision that gives rise to the effective tax rate mismatch outcome is between Company X and Company Y. Looked at from the perspective of those companies (taken together) the $15m financial benefit of the tax reduction is clearly greater than any other financial benefit referable to the transaction between Company Y and Z (or between X and Z). Similarly the contribution of economic value by Company Z is clearly less than the financial benefit of the tax reduction. The insufficient economic substance condition is 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. Assuming that it is reasonable to conclude that the transaction was designed to secure the tax reduction the insufficient economic substance test will be met unless the company can show either that:

- 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 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 collocating all support activity in one location were far 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. It may for example be possible for the company to show that the technical support activities are run fully from the new support centre, a functional analysis may show that the main driver for the profits of the centre are the functions carried out by the centre's staff and a benchmarking analysis shows that all payments by other group companies for technical support are arm's length.

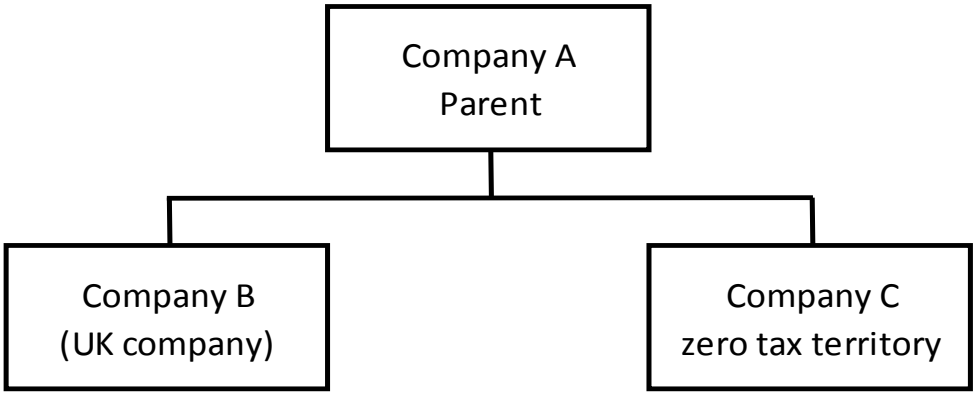
DPT1200 - Partnerships

The legislation contains provisions to ensure the Part applies correctly where a company is a member of 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

DPT1300 - Involvement of entities or transactions lacking economic substance - Section 80

Example 1:



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.
- At the time the P&M is needed the parent company (A) 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.
- This would lead to considering the two tests that relate to the contribution by the staff of C. The first relates to the expectation at the time the arrangements are made and the second to a particular accounting period.

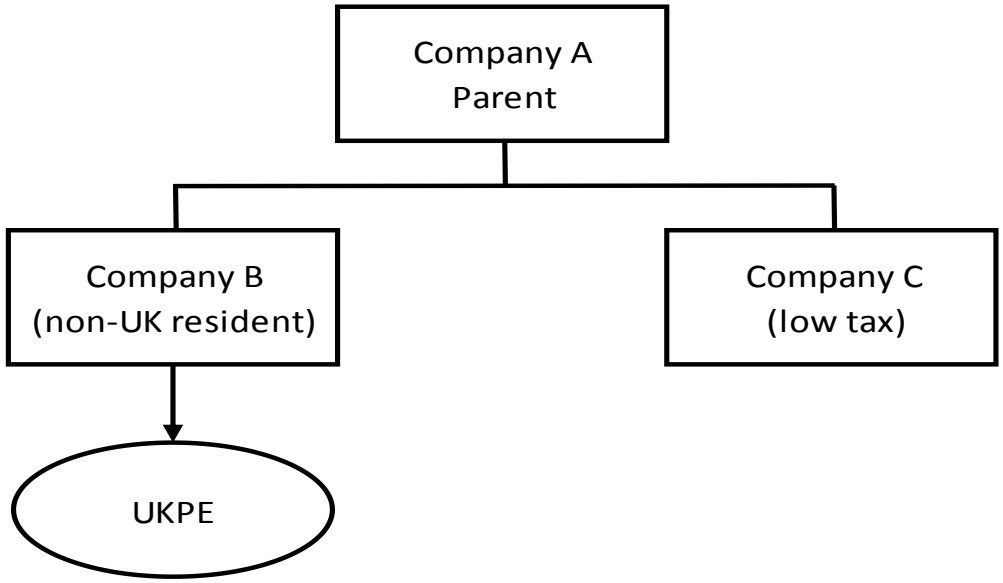
- For the first test it seems clear that any non-tax benefits from the contributions of the staff of Company C will be much less than the financial benefit of the tax reduction throughout the time the asset is used. For the second test it is clear that the income attributable to the ongoing functions 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. 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, capital allowances would be on the basis of a separate pool, using the lower of cost or market value at the beginning of that accounting period. The written down value on that basis would follow through to the following accounting period.

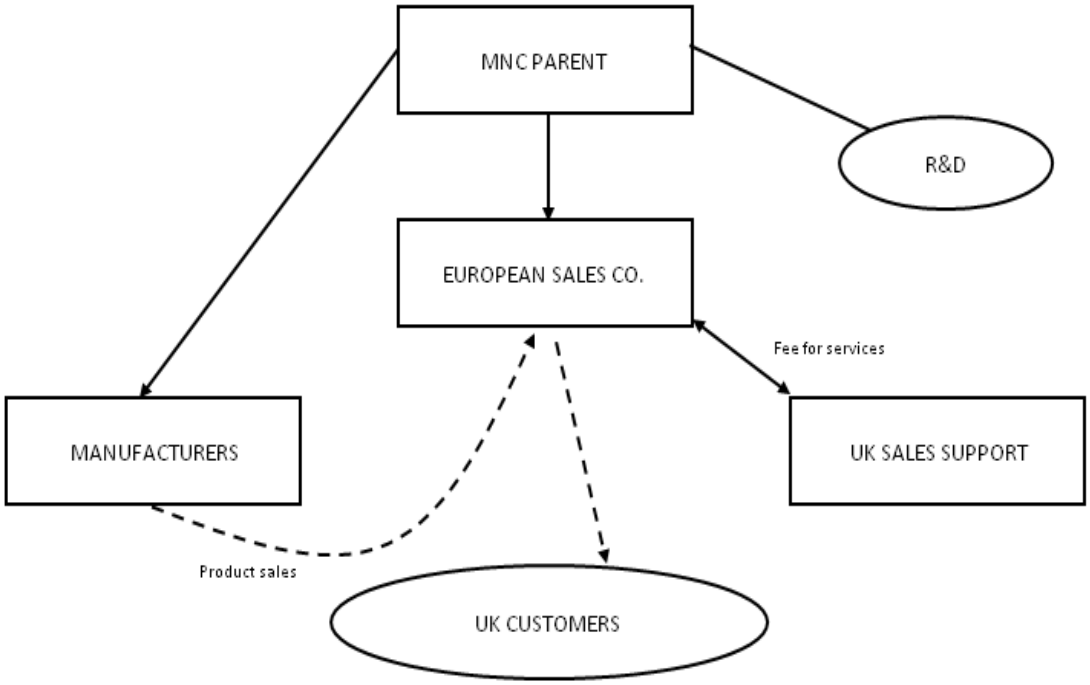
Example 2 – Involvement of entities or transactions lacking economic substance - Section 81



Assume the facts are the same as those 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 - Avoiding a UK taxable presence

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 terms and conditions. The requirement for ESC to conclude the contracts is deliberately intended to limit the activity which takes place in the UK.

- The evidence also shows that, to the extent the sales are made in the UK market, all the work in negotiating 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 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 are designed so as to ensure that the European Sales Company is not carrying on a trade in the UK for corporation tax purposes (that is, through a PE),

- No exemptions 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 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.

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 expense condition" for the purpose of estimating the profits that would have been 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 DPT charge will be equal to the notional PE profits. These are 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.

A detailed examinations shows that the functions of and exposures assumed by the European sales principal are such that only 2%, rather than 50%, of the distribution profit is properly attributable to the European principal in the very low tax territory.

In determining the amount of the notional PE profits account would be taken of any arm's length fee for the services provided by UK Sales Support Co. If this price were 50 then the profits to be attributed had the avoided PE been an actual PE of the European sales principal would be 48. This would be 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 European sales company has a large staff of qualified people who:

- Have the authority to negotiate the terms of sale contracts with UK and other European customers and actually perform this function.
- Orchestrate sales across Europe by various product promotions, advertising campaigns and sport sponsorship.
- Manage relations with major customers who have a presence in several European countries including the UK.
- Actively manage the local European support companies.

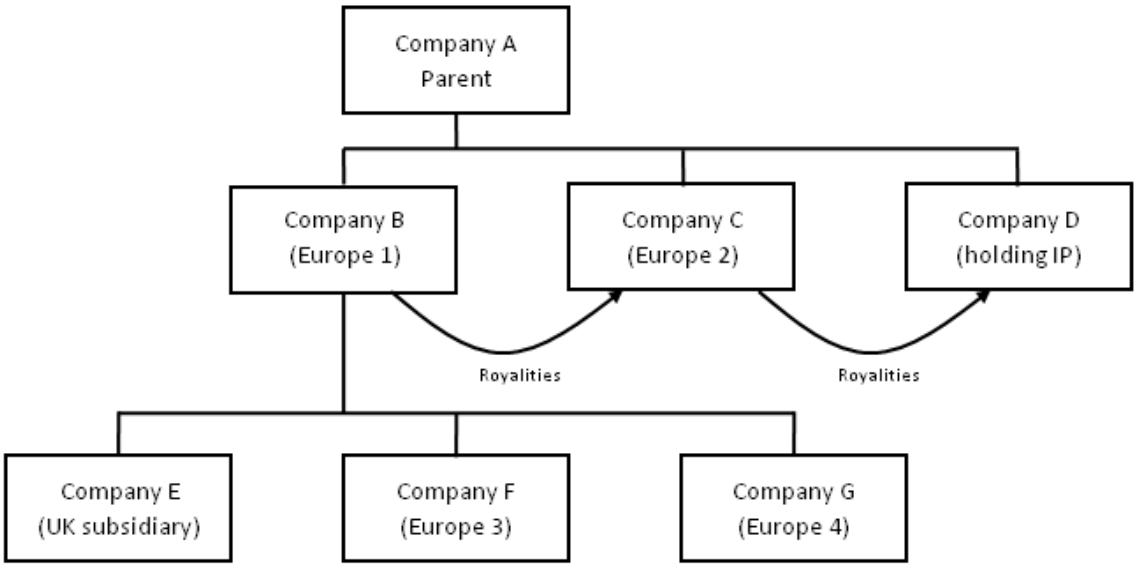
The review also confirmed that it is not reasonable to assume that the activities of the European sales company or the UK support company, in particular the signing of sale contracts by the European sales company, was designed to ensure the European sales company was not trading in the UK though a permanent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

The allocation of profit between the Europeans sales company and the UK support company reflect their contribution to the generation of profits from sales to UK customers.

Analysis and calculation of taxable diverted profits

On the above facts the DPT does not apply.

Example3: Avoiding a UK taxable presence



- 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 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. 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 tax. 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 transaction with Company C – either in terms of its design to secure the tax reduction or in terms of Company C's involvement in it 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 had been carrying on its trade through "the avoided PE" – Company E. In considering the appropriate deduction for the IP expense, the inflated expenses condition would need to be considered.

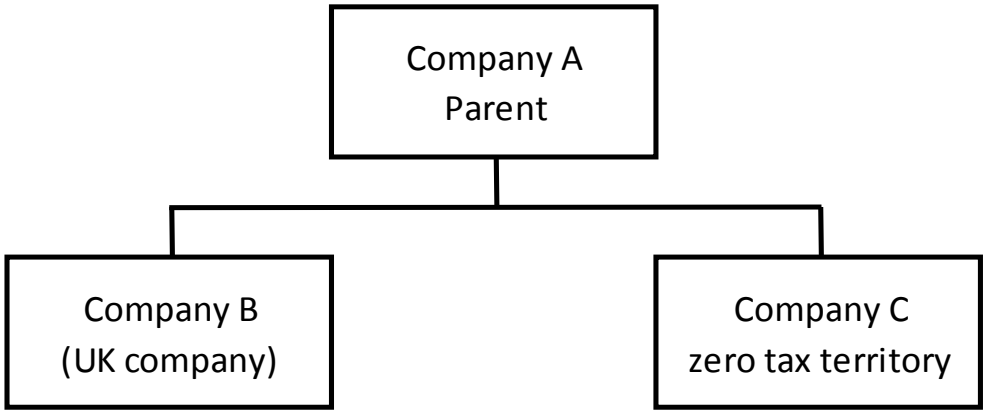
Whatever provision it is reasonable to assume would have been made had tax on income not been a consideration, Company B would have made some payment in respect of its use of the IP. In this case there is no reason to believe that such payments would have given rise to "relevant taxable income" in the UK. On that basis the calculation of taxable diverted profits would be on the basis of the actual provision condition.

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 mentioned above.

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

Example 1:



- 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.

The material provision between B and C is the provision of IP under the license agreement and as a result of the 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 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.

This would lead to considering the two tests that relate to the contribution by the staff of C. 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. 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.

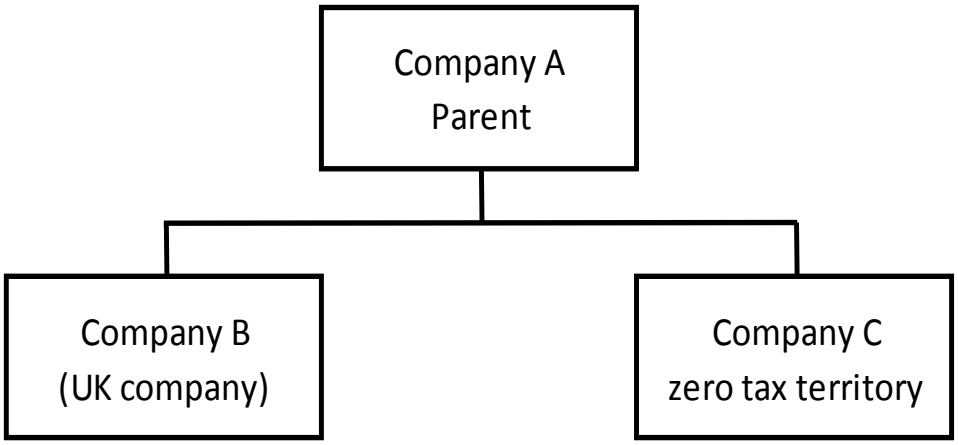
Company B's tax return is submitted based on the material provision. No transfer pricing adjustment to reduce the deduction in respect of the royalty is included in B's return.

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 expense condition is met the charging notice will disallow 30% of the royalty giving rise to a DPT charge of £30m.

As a result of discussions during the review period but before the end of that period Company B submits an amended self-assessment 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.

Example 2:



- Companies B and C are wholly owned by Company A so the participation condition is met.
- B is the UK subsidiary which manufactures and distributes branded widgets in the UK. Company A owns worldwide IP.
- Company C provides technical support services to Company B, and to other group companies, to support its manufacturing activities.
- Company C has a staff of engineers who are qualified to and do provide these support services from the zero tax territory by a combination of telephone and webchat.

The material provision between B and C is the provision of support services to B. The group's transfer pricing policy and the basis on which Company B's returns are submitted, is that the services provided by Company C are invaluable to the smooth operation of the operating companies and to their ability to generate profits and should be remunerated by a 10% share of the operating company's operating profit. In the relevant period this amounts to £20m.

The transaction that gives rise to the effective tax mismatch outcome is the services 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.

On close examination of the facts it is determined that Company C provides a genuine service to Company B which Company B would need to obtain from another party if Company C did not exist. However, Company C owns no unique IP and the services provided by Company C could be obtained more cheaply from a third party supplier. Considering all the facts and circumstances an arm's length return for Company C would be calculated on a cost plus basis. In the relevant period this amounts to £15m.

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 still have paid for the services provided by Company C but would only have paid £10m for them.

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 service payment is included in 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 a profit share methodology is the appropriate basis for resolving the transfer pricing while HMRC maintains the cost plus is the more appropriate method. As there is no realistic prospect of reaching agreement HMRC will issue a preliminary notice, and assuming the impasse remains, a charging notice.

As the inflated expense condition is met the charging notice will include an upfront disallowance of 15% the actual expense of £20m. This will be £6m.

As a result of discussions during the review period but before the end of that period Company B submits an amended self-assessment increasing its profits by £5m 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.

If the 30% disallowance prescribed by the legislation were less than HMRC's true estimate of the appropriate disallowance then HMRC would during the review period be likely to issue a supplementary notice, so that in aggregate the total DPT charge would be represent HMRC's true best estimate of total taxable diverted profits. Only one such notice could be issued.

DPT1260 - 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 lead to a diverted profits charge if:

- The insufficient economic substance condition is met; and
- 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; and / 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 of 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 on the basis of that alternative provision. 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.

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.

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 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).

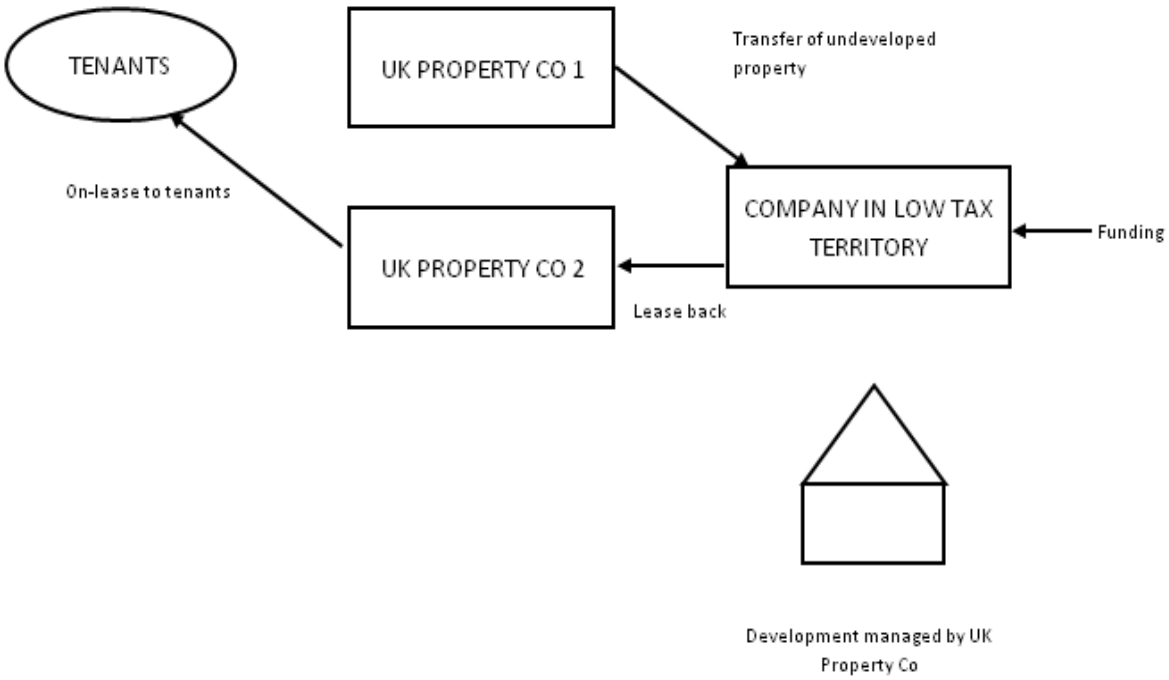
However the amount of the additional profits in relation to those in the relevant corporation tax return would depend on the extent to which the £45m hire cap restriction has been tax effective.

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).

Example 1



- A UK company which has traditionally held and managed all its property assets onshore sets up a company in a very low tax territory and transfers ownership of 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.

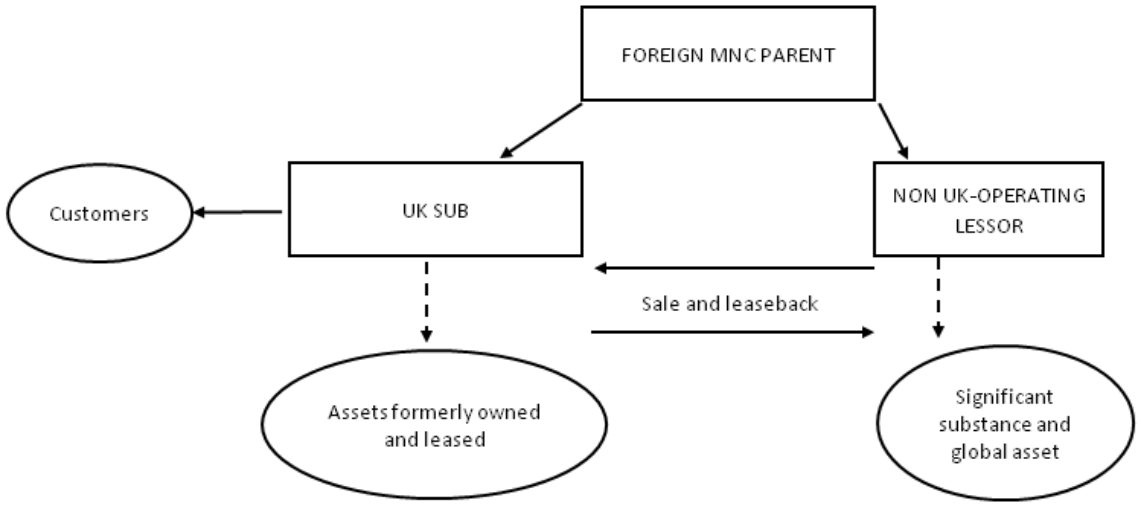
Analysis

While the rental payments might be argued to be on arm's length terms, the conclusion that it is reasonable to draw from these arrangements is that what has caused them to be established is the attraction of having tax-free profits offshore. 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 transaction

can, therefore, be considered for DPT purposes as amounting to an arrangement where all the offshore company is doing is holding the property on behalf of a member of the UK group.

As a result the transaction would not have occurred absent tax, DPT is to be applied by reference to the relevant alternative provision. This means no deduction for the rental payments would be due.

Example 2



- 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.

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.

DPT1340 - Intangible assets

Where IP has been transferred from a UK group company to one subject to a lower rate of tax the effective tax outcome 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 use of the IP in or from the UK, in comparison with use in or from other parts of the world.
- 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 synergies as a result of using a centralisation model (but not those based on the original centralisation having been tax-driven).
- extra costs associated with the transfer, including taxes paid on exit.
- 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 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.

DPT1350 – 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.

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 rest of 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 (bench-marked as arm's – length) 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.

The IPCo continues to develop the IP by undertaking its own R&D activities. It shares that R&D with another UK company in the group with the resulting IP being owned by IPCo and Parent 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 equally significant.

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, 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 IPCo.

Analysis

The participation condition is met.

There is a 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, on the facts given, the cost saving of moving the RoW IP to IPCo and the projected increased income from new IP exceeds the tax reduction and more than half of IPCo's income in relation to the IP can be attributed to the ongoing functions of its staff. Therefore there is no DPT charge.

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

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 IP with a third party company in the UK. UKCo has the opportunity to buy out the third party once the development was 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 IP which is subsequently licensed to UKCo.

IPCo provides IP protection and management activities in relation to the IP and takes the associated risk of ownership. IPCo charges a royalty to UKCo for access to the third party patents.

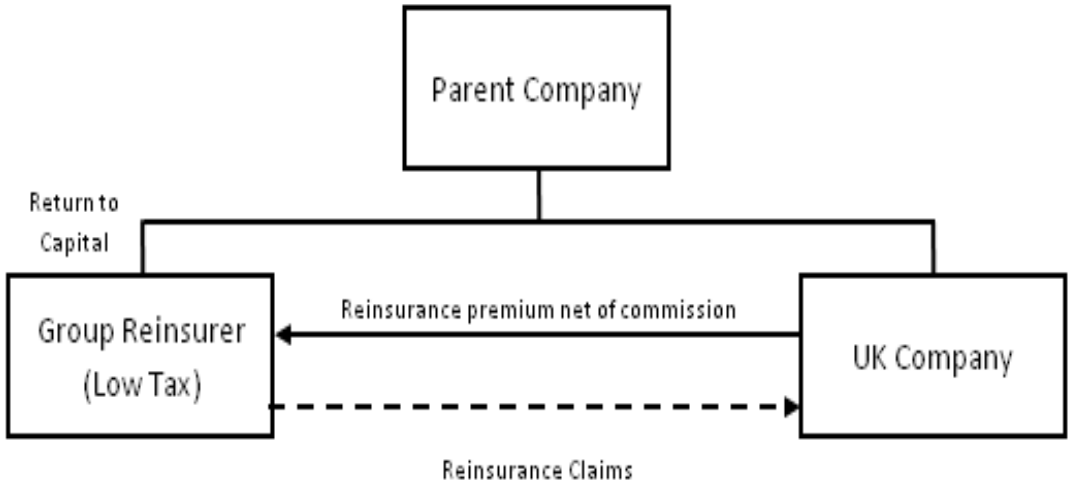
Analysis

In the absence of 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, DPT would charge profits to UKCo as if it had acquired the third party patents.

DPT1360 – 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. It reinsures 50% of its written business to the group reinsurer under a standard whole account quota share (WAQS) contract.

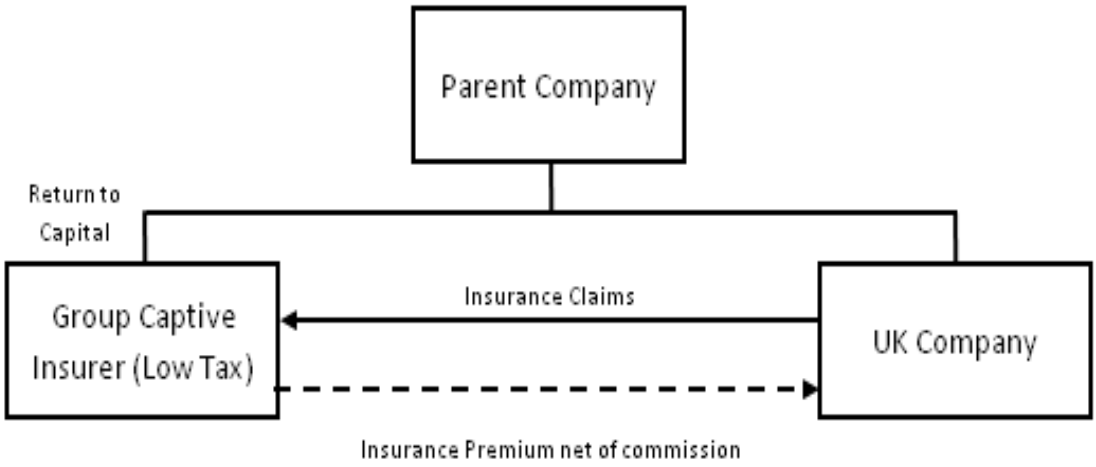
The group reinsurer writes 25 WAQS reinsurance contracts with its major subsidiaries including the UK and has a staff of 20 including senior underwriters and actuaries capable of assessing the risks it reinsures from the rest of the group. In calculating its capital requirement the reinsurer gets credit for the geographic diversity of its risks. By reinsuring the group's capital requirement has been reduced by 30%

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.

The question that needs to be addressed for the purposes of determining whether there is a DPT charge is whether or not, 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. In this case the more efficient capital structure is a quantifiable non-tax financial benefit and, where the facts show that this is greater than the tax saving, there will be no DPT charge.

Example 2: Captive Insurance



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 cover should be extended to €550m and the €50m excess is placed with the group captive, 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 captive insurer employs three people part time including a senior underwriter. Most of the underwriting and actuarial risk pricing is outsourced to 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 reinsurer ("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.

The question that needs to be addressed for the purposes of determining whether there is a DPT charge is whether or not, 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 outweigh the financial benefit of the tax reduction.

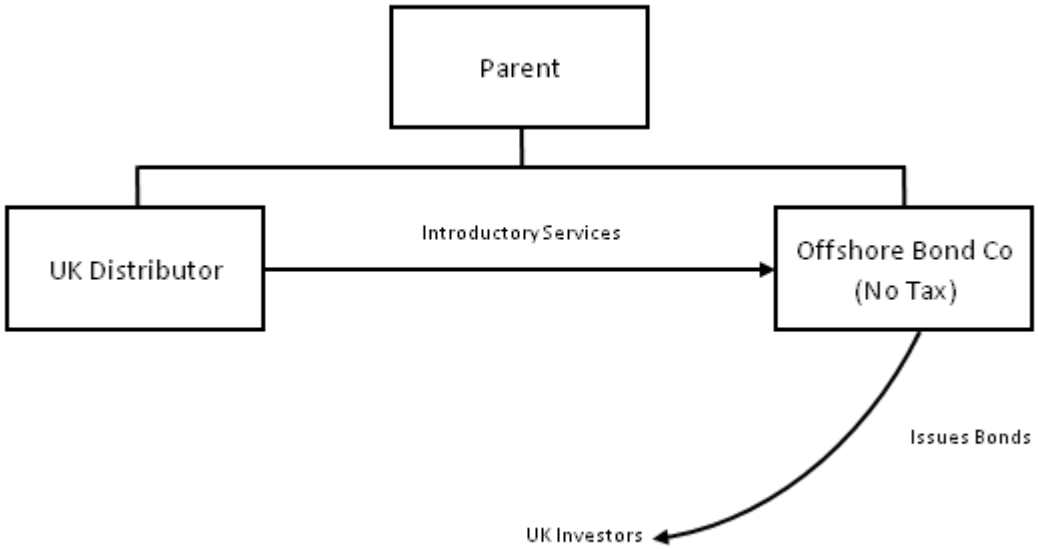
This is not a regulated insurance group and the captive is not being used to create capital efficiencies. Indeed the group has sufficient liquid assets to meet any claim over the excess amount. There is no economic benefit directly related to the movement of the insurance risk.

The functions performed by the captive are minimal and the facts show that the insufficient economic substance condition is met. Assessment and management of the group's insurance risk is directed and performed by the parent.

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 would not have happened. 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 the net of commission premium payable to the captive.

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

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 and the investment managers who manage the funds invested.
- 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 of (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, 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 gross roll up business. 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.

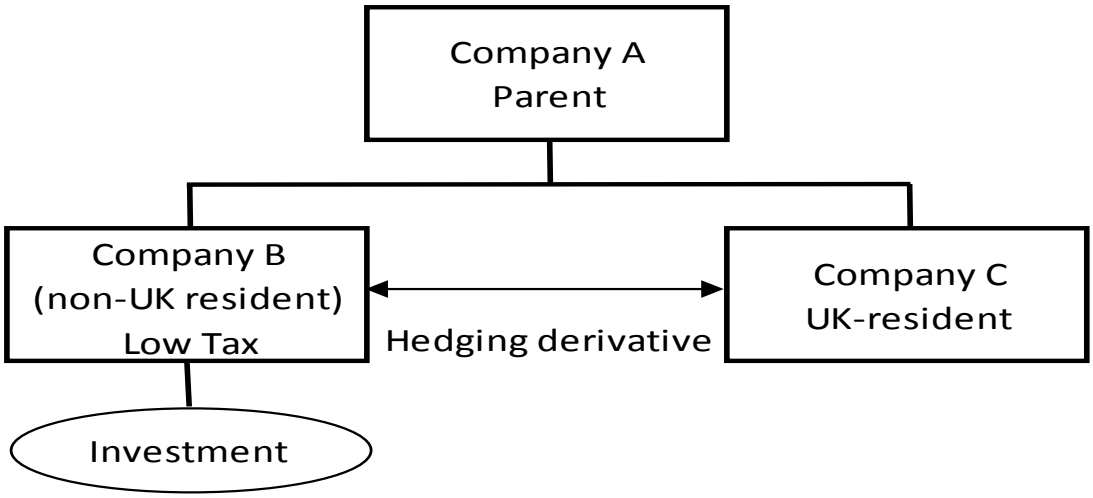
A tax reduction will arise if any of the profits of the overseas company would have been attributed to the UK if the avoided DAPE were a UK PE of the non-resident company. To determine whether any profits of the overseas company would be attributed to the UK PE the authorised OECD approach to attributing 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 the KERT. In this arrangement the KERT 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.

DPT1290 – Banking / Financial

Example 1: Involvement of entities or transactions lacking economic substance

Hedging strategy



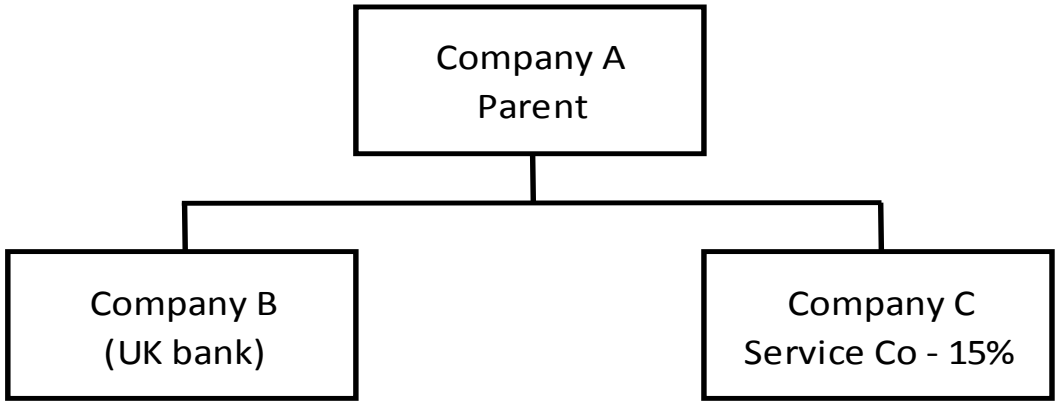
- Companies B and C are wholly owned by company A, so the participation condition is met
- Companies B and C are members of a financial services group and each carries on a financial trade. Company B holds an investment as part of its trading stock and enters into a derivative contract with company C, which fully hedges company B's investment.
- Company B is resident in a low tax jurisdiction. 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 investment 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 investment of £5m and a compensating receivable under the terms of the derivative contract of £15m. The loss on the investment 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 will give rise to either a profit or a loss that is dependent on factors entirely outside of the control of either party, and assuming that the pricing of the contract is at arm's length, it would not be reasonable to assume that the provision 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



- As part of "recovery and resolution" planning, a banking group places crucial back-office shared services into a separate service company
- The services performed are high value and are performed by staff in the territory of Company C.
- Because more than half of Company C's income is attributable to the ongoing functions of its staff DPT will not apply.

Chapter 3 - Customer engagement with HMRC

Chapter Summary

- DPT1600 - Initial contact between customers and HMRC
- DPT1610 - DPT - internal advice & support network for case workers and CRMs
- DPT1620 - Informal discussions between HMRC & customers
- DPT1630 - Diverted Profits Risk Team must be consulted
- DPT1640 - No formal statutory or non-statutory clearance procedure for DPT
- DPT1650 - Circumstances where HMRC will not be able to provide a view
- DPT1660 - What an initial informal discussion should cover
- DPT1670 - Seeking information from other sources
- DPT1680 - Informing a customer that they do not have to notify
- DPT1690 - APAs do not extend to DPT
- DPT1700 - How APAs in force at 1 April 2015 interact with DPT
- DPT1710 - APAs entered into after the introduction of DPT
- DPT1720 - APAs concluded for periods ending before 1 April 2015
- DPT1730 - DPT and ATCAs

DPT1600 - Initial contact between customers and HMRC

DPT, where it applies, affects large multi-national groups that operate in the UK. The majority of such groups will be Large Business (LB) customers and have a Customer Relationship Manager (CRM), 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 CRM.

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 CRM 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.

A new Large Business Task Force has been created to support HMRC's customer engagement on DPT, co-ordinate its implementation and investigate 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). 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 Unit.
- Diverted Profits technical co-ordinators. They are located in both LB and MSB directorates. They provide case workers and CRMs with 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 CTIS. Within MSB, the Diverted Profits technical co-ordinators also engage directly with customers.
- Diverted Profits tax specialists. They provide a flexible resource to support risk assessment and the working of the case, and expertise in tax risks from profit diversion.
- 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 Issues Managers (IIMs) and transfer pricing specialists. They also provide case workers and CRMs with advice and support.
- Designated HMRC officer. The designated HMRC officer has statutory responsibility for issuing preliminary, charging and supplementary charging notices under the DPT legislation.

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.

In the initial period from 1 April 2015 when DPT first comes into force, unfamiliarity with the legislation is likely to mean that customers and their advisers will seek to engage with HMRC to obtain greater clarity about its application to their circumstances.

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, including the circumstances in which HMRC can provide a view on the application of DPT outside the formal DPT process.

DPT1630 - 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 DPRT, case workers or transfer pricing specialists), or
- a customer contacts HMRC to seek greater certainty on the application of the DPT to their particular circumstance.

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 CRMs 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 co-ordinators.

However, HMRC officers should not comment on the potential application of the DPT rules in any particular case until they have consulted the Diverted Profits Risk 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.

While HMRC will not provide formal statutory or non-statutory clearances in respect of DPT, it may be possible, where the customer has been open and transparent (including providing a full value chain analysis where relevant), for HMRC to provide a written opinion on the likelihood of whether a DPT notice for a particular period will be issued.

But HMRC officers must consult the Diverted Profits Risk Team before providing an opinion.

The opinion will not reflect the customer's overall Business Risk Rating (low or non-low).

DPT1650 - Circumstances where HMRC will not be able to provide an opinion

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. 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.

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. 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 must not give any opinions on the application of the DPT without first consulting the Diverted Profits Risk Team.

DPT1670 - Seeking information from other sources

In addition to information provided by the customer, HMRC staff should actively seek, in conjunction with the Diverted Profits Risk Team, relevant material from public sources to inform the designated HMRC officer's decision on whether or not to issue a Preliminary Notice and to aid understanding of the DPT liability during any subsequent review period.

For example, published accounts and other public documents (for example US filings such as the SEC 10-K) can contain useful information about the group's structure and the level of its sales and profits in particular markets. Typically these will not go down to the level of individual countries outside the USA but information about, for example, the Europe, Middle East and Africa (EMEA) region might help HMRC to make informed estimates of UK sales. Also the accounts of non-UK group companies in 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.

DPT1680 - Informing a customer that they do not have to notify

A company does not have to notify its potential liability to DPT if it has provided sufficient information to enable the designated HMRC officer to determine whether or not to issue a Preliminary Notice and HMRC has examined that information and confirmed that no notification is required.

If a company provides such information, it 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.

DPT1690 - APAs do not extend to DPT

DPT is a separate, standalone 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 PE issues. In these cases it may be possible to provide a view as to the likelihood of a DPT notice being issued in respect of those transactions.

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 attributable to the 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 a DPT review has been concluded in relation to these transactions. 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 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 SP 02/10 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.

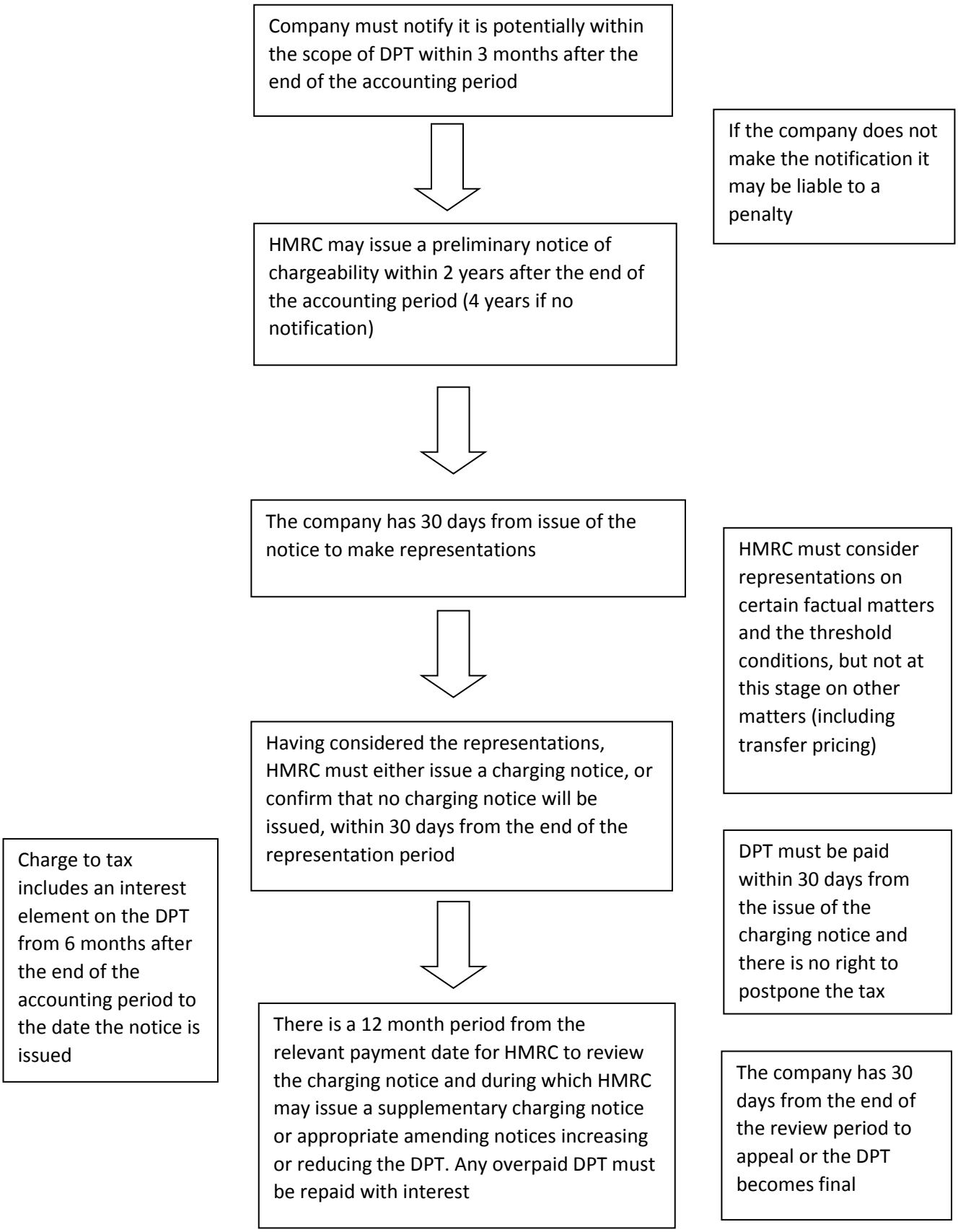
Chapter 4 - Notification, charging & payment

Chapter Summary

- DPT2000 - Outline of the Diverted Profits Tax process
- DPT2010 - Duty to notify if potentially within the scope of DPT - who must notify
- DPT2020 - Situations where notification is not required
- DPT2030 - Time limits and penalties
- 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
- DPT2300 - Taxes that can be credited against DPT
- DPT2310 - CFC charges
- DPT2320 - Process for collecting tax
- DPT2330 - Collection of tax from a non-UK resident
- DPT2340 - Collection of tax from a related company
- DPT2350 - Serving a notice on the related company
- DPT2360 - Appeals by a related company
- DPT2370 - Amount of DPT paid by a related company in a consortium case
- DPT2380 - Related company's right to reimbursement
- DPT2390 - No tax deduction for DPT paid by a related company
- DPT2400 - Interest
- DPT2410 - True Up interest
- DPT2420 - Late payment interest
- DPT2430 - Penalties

DPT2000 - Summary of the Diverted Profits Tax process



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 uses transactions or entities lacking economic substance which result in a tax mismatch, or
- it is a non-UK company which has a UK-taxable presence (a permanent establishment) and uses transactions or entities lacking economic substance which result 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 modified so that companies must notify that they are potentially within the scope of DPT regardless of whether it is reasonable to assume that the transaction or transactions were designed to secure the tax reduction, or that the person's involvement in the transaction or transactions was designed to secure the tax reduction;
- in the case of a non-UK company avoiding a UK taxable presence, instead of the condition which requires 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 through a PE, the test is that the foreign company is not carrying on a trade in the UK through a PE in the UK by reason of the avoided PE's activity;
- in the case of a non-UK company avoiding a UK taxable presence where the tax avoidance condition applies, instead of the requirement that there are arrangements in place which have a main purpose of avoiding or reducing a charge to corporation tax, there is a requirement 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 one of the following exemptions applies:

- it falls within the scope of DPT because it uses transactions or entities lacking economic substance which result in a tax mismatch, or because it is a non-UK company avoiding a UK taxable presence which meets the mismatch condition, and the tax reduction arising from the mismatch is not significant relevant to the financial benefits arising from the arrangements that give rise to the mismatch. (This exemption does not apply to non-UK companies that have avoided creating a taxable presence in the UK and meet the tax avoidance condition.)
- it falls within one of the specifically exempt situations listed at below:

i. 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. 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.

ii. 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 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).

iii. 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 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).

iv. the company has already notified that it is potentially within the scope of DPT for the immediately preceding accounting period and there has been no change in the relevant circumstances.

v. 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 iii. above and there has been no material change in the relevant circumstances.

vi. 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.

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 to 4 years after the end of the accounting period.

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 uses transactions or entities lacking economic substance which result in a tax mismatch, or it is a non-UK company which has a UK-taxable presence (a permanent establishment) and uses transactions or entities lacking economic substance which result in a tax mismatch –
    - the nature of the material provision; and
    - the identity of the other person that is party to the material provision ("P").
- 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").
- 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 identity of the person carrying on activity in the UK in connection with the non-UK company's trade ("the avoided PE"); and
    - the nature of 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) should also send a copy to their CRM.

A recommended template for notification is contained in the annex 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 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.

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 may 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 month period from the relevant payment date 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 with interest.

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.

A preliminary notice may be issued to a company, even if that company has not notified HMRC of its potential liability to DPT.

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 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:

i) there is an arithmetical error in the calculation of the amount of DPT,

ii) there is an error in a figure on which an assumption in the preliminary notice is based,

iii) the small or medium-sized enterprise requirement is not met,

iv) that in a case where either a UK company is involved with transactions or entities that lack economic substance, or a non-UK company 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.

v) 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
- 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
- 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.

All representations on the above must be considered before issuing the charging notice but there is no requirement for HMRC to consider any other representations, especially those 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).

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 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 issued by the designated HMRC officer.

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 comprised in the charge has been calculated
- who is liable to pay the tax
- when the tax is due and payable, and
- an explanation of how interest is applied 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 must be disregarded. This means that through the review period, the amount of the expenditure disregarded can be either increased or decreased based on due consideration of the evidence.

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 months later. But the review period may end within the 12 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 who will liaise with the designated HMRC officer.

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 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. A supplementary charging notice may later be amended (downwards) by a designated HMRC officer in the same way as an original charging notice, but (as with an original charging notice) this can only be done if the company has paid in full the DPT charged by the supplementary charging notice.

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 taxable diverted profits included in the 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 short 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 and Schedule 23 FA 2011 apply to the diverted profits tax.

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.

For these purposes, where payments are made subject to withholding tax, the tax withheld is treated as corporation tax paid by the person receiving the payment (provides 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 AP.

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, it's unlikely that that the provision would have been designed to secure a tax reduction. 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 should be raised on the Strategic Accounting Framework Environment (SAFE) when a charging or supplementary charging notice is issued. Guidance is available which explains how to raise a charge within SAFE, including how to set up a customer account. (See Chapter 5 for more information.)

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.

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 to 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.

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.

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

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- DPT2610 - Identifying potential DPT cases
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- DPT2710 - Appeals against charging notices and supplementary charging notices
- DPT2720 - Information and inspection powers
- DPT2730 - Interaction with other legislation
- DPT2740 - Governance

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 during the risk assessment process. If a case worker or CRM believes that a company they deal with is potentially liable to the DPT and they have not been contacted by the customer 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 written 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.

Case workers must adhere strictly to the time limits and other statutory requirements.

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 the initial discussions during this period and HMRC officers may wish to gather relevant information from other sources to inform a decision on whether to issue a preliminary notice.

Once a decision has been made in principle to issue a preliminary notice the next question is when to issue it. 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 AP (in which the diverted profits arise) if the company notifies liability, otherwise four years.
Representations from company.	30 days from receipt 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 months beginning immediately after the latest day for payment of the DPT (can be shorter if there is agreement by both sides).
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 mistake 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.

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 complete a template which details the basis on which a preliminary notice should or should not be issued. This template 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 receipt of a preliminary notice to send written representations to HMRC. If a case worker or CRM receives written representations they should 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 the accounting period to which the preliminary notice refers.

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).

As well as receiving a charging notice or supplementary notice customers will receive a separate 'Notification of Charge and Notice to Pay' issued by SAFE, setting out the amount of DPT to be paid for the accounting period and the due date.

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. In carrying out this review, there are no limitations to the representations HMRC may consider and the special rules disallowing 30% of expenditure under the inflated expenses condition described in Chapter 2 must be disregarded. This means that through the review period, the amount of the expenditure disregarded can be either increased or decreased based on due consideration of the evidence presented.

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 months later. But the review period may end within the 12 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 agreeing 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. 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. 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 tax overpaid in relation to the original charging notice, or as the case may be supplementary charging notice, is repaid with interest.

Supplementary notices and the amending notices are issued by the designated HMRC officer. The case worker should send a short 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 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 Chapter 4 for more information about the appeals process.

DPT2720 - Information & inspection powers

The information and inspection powers in Schedule 36 FA 2009 and Schedule 23 FA 2011 apply to diverted profits tax.

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.

DPT2740 - Governance

The DPT legislation requires that a designated HMRC officer issues the preliminary and charging notices and considers representations from the company. The case worker assisted by the DPRT should consult relevant stakeholders and send a report to the DPT Unit to provide details of a potential DPT case. The DPT Unit will liaise with the designated HMRC officer who will authorise the issue of preliminary and charging notices and consider any representations.

As the case progresses through the process set out in the DPT legislation the case worker will need to make several submissions to the DPT Unit regarding preliminary and charging notices, written representations, amending and supplementary charging notices and the outcome of the review period. Technical support will be provided in the first instance by Diverted Profits Technical Co-ordinators in Large Business and Mid-size Business. The co-ordinators can approach the DPT Unit and CTIS for advice on difficult issues.

The DPT is also subject to HMRC's internal governance processes for Large Businesses and Mid-size Businesses.

Case workers and CRMs should be aware of other challenges to structures that divert profits from the UK, particularly for periods before the DPT comes into force. This could involve PE and transfer pricing challenges based on existing legislation. Case workers 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 DPRT.

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	Local Compliance
Large Business	Diverted Profits Tax Team
S0791	Mid-Size Business
Newcastle	SO793
NE98 1ZZ	Newcastle
	NE98 1ZZ

HMRC expects to issue an i-Form for DPT notification in due course for use by customers to notify HMRC.

Appendix B - DPT 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 ☐

[continues on next page]

- 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 _____