

## United Kingdom Expected to Introduce Punitive “Diverted Profits Tax”

*By Jared Walls*

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**News:** In his parliamentary budget speech on March 18, the UK Chancellor of the Exchequer confirmed the introduction of a new 25 percent Diverted Profits Tax (“DPT”) into the country’s 2015 finance bill. The DPT is intended to apply to profits of multinational enterprises that are deemed to have been artificially shifted out of the United Kingdom to foreign tax jurisdictions.

A DPT Consultation Draft was released on December 10, 2014 and a parliamentary debate was held on January 7. A revised draft will be published and debated on March 24 and submitted for parliamentary approval on March 25. Once approved, the new tax is scheduled to take effect on April 1.

**Views:** Although the DPT has been dubbed the “Google Tax” by members of the media, taxpayers should be aware that its scope extends well beyond the digital economy.

Specifically, the DPT may apply when (i) a non-resident company avoids UK corporate tax by structuring itself so as not to have a permanent establishment in the United Kingdom; or (ii) a UK resident company or permanent establishment reduces or eliminates its UK corporate tax liability by using transactions or entities that lack substance.

In light of the Organization for Economic Co-operation and Development’s (“OECD”) Base Erosion and Profit Shifting (“BEPS”) initiative—which also addresses the avoidance of permanent establishments and transactions that lack substance—at first glance the DPT may be confused for a mere adaptation of BEPS concepts into local legislation. However, there are notable differences that warrant careful consideration.

1. The punitive DPT rate of 25 percent exceeds the nominal UK corporate tax rate of 20 percent, so profits that are deemed to have been artificially diverted will be taxed at a higher marginal rate than reported profits.
2. The DPT is not intended to be considered a corporate income tax; a move that could render the country’s network of double tax treaties inapplicable and leave taxpayers without any recourse in the event of double taxation.
3. Taxpayers may be required to report possible instances of diverted profits to Her Majesty’s Revenue and Customs (“HMRC”) within six months of the end of the accounting period. Payment of the tax will be due upfront even if the taxpayer disputes the applicability of the DPT under the facts and circumstances.

Critics argue that the DPT is complex, out of step with the OECD’s work on BEPS, and that such a unilateral action could undermine the effectiveness of the BEPS initiative. While some members of the business community have also been critical of certain aspects of the BEPS initiative, to its credit the OECD has made an effort to engage stakeholders throughout the world—among them G-20 and OECD member countries, as well as more than 80 developing nations and other unaffiliated

economies—in an attempt to develop a global consensus.<sup>1</sup> There is concern that the DPT could serve to disrupt the OECD’s momentum and, ironically, promote the sort of jurisdictional tax competition that the BEPS initiative seeks to discourage.

While any mid-size or large multinational enterprise with significant commercial activity in the United Kingdom could be subject to the provisions of the DPT, certain structures, including UK commissionaire arrangements, may be considered particularly problematic. Taxpayers should review their intercompany value chains and transfer pricing policies within the context of the final version of the DPT legislation and consider whether any changes might be necessary in order to ensure compliance.

Multinational enterprises with significant operations in the United Kingdom that do not expect their transactions to give rise to the DPT may also consider engaging HMRC on an informal basis to request assurance that this is indeed the case.

### **Contact Us**

Jared Walls

*Partner*

[jared.walls@petersadvisors.com](mailto:jared.walls@petersadvisors.com)

+1 530 301-1818

*The views expressed herein are those of the author and do not necessarily reflect the opinions of the Firm.*

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<sup>1</sup> About BEPS. (2015, March 19). Retrieved from <http://www.oecd.org/tax/beps-about.htm>.