HM Revenue
& Customs

Diverted Profits Tax – Guidance

Guidance
10 December 2014

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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 Diverted Profits Tax will be applied using a rate of 25% from 1 April 2015.

This document provides further details and guidance on the measure and should be read alongside the draft Finance Bill legislation, Explanatory Notes and the Tax Information and Impact Note, all of which were published on 10 December 2014.

The legislation will be included in the pre-election Finance Bill in 2015, and will come into force from 1 April 2015.

This note provides guidance on the legislation and explains how it will work by reference to practical examples. It will, in due course, form the basis of guidance to be included in HMRC Manuals.

HMRC invites comments on this guidance, including in particular further practical examples which it would be useful to incorporate.

The Government has made clear its commitment to introduce this legislation and would not expect to make significant changes of substance, although comments on technical details would be welcome. Comments should be sent by email to:

divertedprofits.mailbox@hmrc.gsi.gov.uk.

Additional ways to be involved:	HMRC intend to hold an Open Day on 8 January 2015 to explain and answer questions on technical aspects of the proposals. If you would like to register to attend, you can do so by sending your name, organisation and contact details by email to the mailbox address above by no later than 19 December.

Chapter 1 – Diverted Profits Tax – introduction & overview

DPT1000 – Diverted Profits Tax: Introduction

Who is affected?

1. Businesses that enter into arrangements to divert profits that reduce the UK tax base by either:

    - designing their activities to avoid creating a taxable presence (a permanent establishment) in the UK; or
    - creating a tax advantage by using transactions or entities that lack economic substance.

Overview of the Diverted Profits Tax

2. The Diverted Profits Tax (DPT) is a charge on diverted profits. Its main objective is to counteract arrangements used by large groups (typically multinational enterprises) that would otherwise erode the UK tax base. DPT applies in two situations. The first is where a foreign company exploits the permanent establishment rules. The second situation is where a UK company or a foreign company with a UK-taxable presence creates a tax advantage by using transactions or entities that lack economic substance.

3. DPT applies to diverted profits arising on or after 1 April 2015. There are apportionment rules for accounting periods that straddle that date. Affected companies are required to notify HMRC within 3 months of the end of an accounting period in which it is reasonable to assume that diverted profits might arise. There is a tax-geared penalty for failure to do so.

4. Before a DPT charge is raised, a designated HMRC officer must issue a preliminary notice explaining why the officer considers the DPT applies, how the amount of diverted profits for the accounting period is calculated, who is liable for the tax and when the tax would be payable.

5. Following this the company then has 30 days to make representations to the designated officer. The designated officer may consider the representations in relation to certain specified matters, such as in relation to errors or whether an exemption applies, but is not required to take into account any representations relating to transfer pricing or profit attribution in relation to permanent establishments. Such representations though may be considered during the review period (see paragraph 7).

6. Following the end of the 30-day representation period, HMRC has 30 days to issue a charging notice or confirm that no charge arises. The charging notice will include much of the information included in the preliminary notice, but updated to reflect the representations. The charge itself is at a rate of 25% of the diverted profit plus any "true-up interest (DPT1381).

7. There can be no immediate appeal against the notice but following the charging notice there will then be a further 12 month review period within which the group will have the opportunity, amongst other things, to demonstrate that they were not liable for the charge or provide further information to HMRC in relation to the level of the charge, for example to show that the level of disallowance of intra-group expenditure in computing the charge is wrong on normal transfer pricing principles. The review period can be brought to a conclusion earlier either by agreement or if HMRC issues a "supplementary notice" (DPT1341) and the company then informs HMRC that it wishes to conclude the review. After the review period, if the charge has not been withdrawn, the company will have the right to appeal the charge to a Tax Tribunal.

8. A company cannot postpone the payment of DPT which must be paid in full within 30 days after the issue of a charging notice. There is provision for interest and penalties if payment is late. If a foreign company fails to pay DPT, HMRC may collect the tax from related companies.

9. There are some specific exemptions in the legislation that apply to one or both of the rules mentioned above, including for SMEs, companies with limited UK sales, and where arrangements only give rise to loan relationships. These are described in more detail in the guidance.

Chapter 2 – Application of Diverted Profits Tax

DPT1110 – Application of Diverted Profits Tax: Situation 1 - Avoidance of a UK Taxable Presence – Section 2

10. The aim of section 2 of the draft legislation is to apply DPT to cases where foreign companies make substantial sales 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).

11. The legislation seeks to identify these cases by identifying whether economic activity takes place in the UK in connection with the supply of goods and services to customers in the UK by a foreign company, but structured in a way so as to ensure that the foreign company is not treated as trading through a UK permanent establishment. This includes, for example, arrangements involving significant sales activity in the UK, but designed to stop short of the conclusion of contracts.

12. Section 2 applies where the following conditions are met:

- There is a company (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 or services by the foreign company to customers in the UK. 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 is not carrying on a trade in the UK through a permanent establishment by reason of the avoided PE’s activity. It does not matter whether it is designed to secure any commercial or other objective.
- It is reasonable to assume that either or both of the following conditions are met:
    - the mismatch condition), or
    - the tax avoidance condition.

These two conditions are described at DPT1113.

Exclusions

13. 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

14. 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).

15. Section 2 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 12) where the foreign company's total sales revenues (together with those of connected companies) from all supplies of goods or services made to customers in the UK in a 12-month accounting period are no greater than £10 million. If the accounting period is shorter the UK sales threshold is reduced proportionately (see DPT1220).

Small or Medium-Sized Enterprises

16. Although the definition of SME is based on the EU definition (2003/361/EC) there are some adaptions 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.

17. 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.

DPT1113 – section 2 – the Mismatch and Tax Avoidance Conditions

The mismatch condition

18. The mismatch condition is met if:

- in connection with the supplies of the goods or services, 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 (DPT1140),
- the material provision results in an effective tax mismatch outcome as between the foreign company and A (DPT1150),
- the insufficient economic substance condition is met (DPT1160),
- the foreign company and A are not both small or medium-sized enterprises, and
- that the material provision is not an excluded loan relationship.

Excluded Loan Relationships

19. For the purpose of the mismatch condition, material provision is an excluded loan relationship if it is made or imposed by means of a transaction or series of transactions (DPT1170) that only give rise to one or more loan relationships. This is either loan relationships within the meaning of section 302 CTA 2009 or what would be treated as such by Part 6 of CTA2009 (CFM 40110).

20. The existence of a loan relationship within a provision does not of course automatically mean that the provision is an excluded loan relationship. The exclusion requires that the one or more loan relationships are the only relationships that the transaction or transactions (by means of which the provision is made or imposed) give rise to.

The tax avoidance condition

21. This condition is met if, in connection with the supply of goods or services, arrangements are in place one of the main purposes of which is to avoid a charge to tax in the UK.

22. 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.

23. 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

24. 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.

Examples at DPT1230

DPT1115 - Consequences of section 2 applying

25. There is an important distinction between the calculation of the provisional charge and its final determination. Section 9 explains how the designated officer is to determine the initial estimated charge for the purpose of securing upfront payment of tax (DPT1190). The final charge to tax is computed in accordance with section 8 (DPT1180).

DPT1120 – Application of Diverted Profits Tax: Situation 2- Involvement of entities or transactions lacking economic substance - Section 3

26. Section 3 in the draft legislation contains the second case addressed by the DPT, which is where a UK company is party to an arrangement meeting a number of requirements similar to those set out in the mismatch condition described at DPT11113. The rules operate in this situation 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.

27. In order for the DPT to apply in this scenario the following conditions must be met:

- 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 (DPT1170);
- C and P are connected in accordance with the participation condition (DPT1140);
- C and P are not both small or medium-sized enterprises within the definition of Section 172 TIOPA 2010 (INTM412080);
- the material provision must result in "an effective tax mismatch outcome" between C and P. This is discussed at DPT1150;
- the "insufficient economic substance condition" must also be met. This is discussed at (DPT1160).

Exclusions

28. The excluded loan relationship and SME exclusions apply for section 3 cases in the same way as for section 2 (DPT1110).

Example at DPT1240

DPT1130 – Application of Diverted Profits Tax: Situation 3 - Involvement of entities or transactions lacking economic substance - Extension to foreign companies with a UK permanent establishment - Section 4

29. The third case where a DPT charge may arise is set out in section 4. The rule is in effect just an extension to the second, applying where a non-UK resident company ("the foreign company") trades through a UK permanent establishment (referred to as "UKPE"). The section 3 rules described at DPT1120 are extended and adapted by section 4 so that they can work in the same way as they do in relation to companies.

30. 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.

31. 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 3 would have applied to the UK PE as a result of it satisfying the mismatch requirements set out in that section.

32. Whether the material provision results in an effective tax mismatch outcome (DPT1150) and the whether the insufficient economic substance condition is met (DPT1160) are considered based on the treatment of the UKPE as a separate UK resident company as described above.

33. The exclusions for small or medium-sized enterprises and excluded loan relationships described at (DPT1120) also apply to this situation.

Example at DPT1250

DPT1140 – Application of Diverted Profits Tax: The participation condition

34. Application of the diverted profits tax (DPT) in the second and third situations (described at DPT1120 and DPT1130) 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").

35. For the purposes of the first situation ("Avoidance of a UK Taxable Presence" (DPT1110) there is no participation condition in section 2 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 DPT1113).

36. So for the purposes of applying the participation condition to the first situation (the section 2 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 3 and therefore through the relevant adaptation, section 4) the "first party" is "C" and the second party "P".

37. 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.

38. 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.

39. The first and second parties are "the relevant parties" for conditions A and B.

The Participation Condition A: Financing Arrangements

40. 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,
    (a) one of the relevant parties was directly or indirectly participating in the management, control or capital of the other, or
    (b) 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

41. The condition is met if at the time of making or imposing the material provision,
    (a) one of the relevant parties was directly or indirectly participating in the management, control or capital of the other, or
    (b) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the relevant persons.

42. 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.

DPT1150 – Application of Diverted Profits Tax: Definition of the effective tax mismatch outcome

43. For section 3 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 2 (“avoidance of a UK taxable presence”) see DPT 1113. The detail of the calculation of taxable diverted profits in a section 2 case (Section 8 – see DPT1180) also depends on whether or not the material provision results in an effective tax mismatch outcome.

44. References to “first party” and “second party” below relate to the following for each of the situations described at DPT 1110 - 1130

	First Party	Second Party
The first case (“avoided PE”)	Foreign company	Another person (A)
The second case (UK resident company)	UK resident company (C)	Another person (P)
The third case (UK PE of non-resident company)	UK permanent establishment (C)	Another person (P)

45. References to “relevant tax” are to corporation tax, income tax or any non-UK tax. Non-UK tax has the meaning at section 187 CTA 2010.

46. There is an effective tax mismatch outcome if the material provision results in the following:

- an increase in 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 second party’s total liability to corporation tax, income tax or any non-UK tax and
- the second party does not meet the 80% payment test.

47. References in the DPT rules to “the tax reduction” are to the amount of that excess and 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.

48. The reduction in the first party’s liability to a relevant tax is measured by:

$$A \times TR$$

Where:

“A” is the amount of the increase in expenses or reduction in income referred to in the first bullet of paragraph 46 above and

"TR" is the rate at which, assuming the first party has profits chargeable to the relevant tax for the accounting period, those profits would be chargeable to that tax.

49. The increase in the second party's total liability to corporation tax, income tax or any non-UK tax is the lower of –

- the total amount of corporation tax, income tax and non-UK tax which falls to be paid by the second party as a result of the material provision (so far as is not refunded), and
- the total amount of corporation tax, income tax or any non-UK tax that would be payable by the second party in consequence of A, based on two assumptions.

50. The first assumption is that the second party's tax liability includes withholding tax on payments made to the second party (to the extent it is not refunded).

51. The second is that 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. Such steps include claiming or otherwise securing the benefit of, reliefs, deductions, reductions or allowances and making elections for tax purposes.

52. However, in determining the level of tax paid by the second party, no regard is had to any loss relief that it would be able to use to cover the profit. This means in effect that the second party is treated as paying tax where the only reason for its not doing so is that it has losses to cover the profit. Those losses may either be its own or ones surrendered to it by another company.

The 80% payment test

53. This test is to ensure that the legislation applies only if the tax reduction resulting from the material provision is substantial.

54. The test is met if:

- As a result of the material provision, there is an increase in the second party's liability to tax, or would have been apart from loss relief;
- The whole or part of that increase is paid by the second party (and not refunded) and
- The amount paid (and not refunded) by the second party is at least 80% of the corresponding reduction in the first party's liability to a relevant tax.

55. In considering the second bullet of paragraph 54, an amount of a tax reduction resulting from loss relief obtained by the second party is treated as if the amount had been paid.

56. So if the second party makes a profit in the accounting period of the test but a loss in the next accounting period which it carries back to the year of the test, this would effectively be ignored in calculating the second party's liability to tax for the accounting period of the test. In the same way losses carried forward from an earlier accounting period would effectively be ignored.

Quantifying the tax reduction

57. The quantum of "the tax reduction" is also relevant to the insufficient economic substance condition (DPT 1160). It is the amount of the excess of the reduction in the first party's liability to a relevant tax resulting from the material provision over the increase in the second party's liability to the taxes specified. 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.

Example

Company X is resident in country X and pays corporation tax on its profits at 15%. It makes royalty payments to another group company, Y in country Y, that holds intellectual property 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 x the rate that Company X's profits would be chargeable, based on the required assumptions).

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.

DPT1160 – Application of Diverted Profits Tax: The Insufficient Economic Substance Condition

58. Section 3, and the mismatch condition in section 2, also require the insufficient economic substance condition to be met. This requires a comparison to be made between the value of the tax reduction resulting from the effective tax mismatch outcome and any other financial benefit flowing from the transaction, series of transactions, or involvement of any entity that is party to those transactions. This effectively provides three separate means by which the condition may be met. If under any of these the value of the tax reduction exceeds other financial benefits or economic contribution, then the condition is met.

59. Where the effective tax mismatch outcome is referable to a single transaction the condition is met if, for the first party and the second party taken together, the financial benefit of the tax reduction is greater than any other financial benefit and it is reasonable to assume the transaction was designed to secure the tax reduction.

60. The same test is adapted 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 transactions.

61. The final test is applied in relation to an entity that is party to the transaction or one of the transactions in the series, and considers the contribution of economic value to the transaction(s) in terms of the functions and activities of the entity's staff. It compares this to the financial benefit of the tax reduction. The test is met if the person's contribution of economic value is less than the value of the tax reduction and it is reasonable to assume that the entity's involvement in the transaction(s) was or were designed to secure the tax reduction.

62. "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.

63. 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. For example, if in applying the transaction based test the tax benefit was only marginally greater than the other financial benefit, it could be less clear that the transaction was designed to secure the tax reduction than if there was a large difference. Similarly with the entity based test, if the contribution of economic value is close to the level of the tax reduction this could potentially point away from a design to secure the tax reduction.

64. The consideration in relation to the design of the transaction should 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.

65. For the entity test the functions and activities of the entity's staff to be considered included those performed in engaging and directing workers, subject to connection

conditions based on section 1122 CTA 2010. The draft legislation uses terms in relation to staff functions that refer to Chapter 9 of Part 13 of CTA 2009 (Additional Relief for Expenditure on R&D)".

66. "Economic value" for the purpose of the entity based test excludes any value from the reduction or elimination of a liability to tax, with "tax" including non-UK tax.

Example 1

The example at DPT 1150 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 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

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.

DPT1170 – Application of the Diverted Profits Tax: Transaction or series of transactions

67. As for the transfer pricing rules at Part 4 TIOPA 2010, “transaction” has a very wide definition, including arrangement, understandings and mutual practices (whether or not they are legally enforceable).

68. Similarly the meaning of a series of transactions is consistent with section 150 TIOPA and a series is not prevented by such matter as 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.

69. “Arrangement” means any scheme or arrangement of any kind (whether or not they are legally enforceable or intended to be so).

DPT1180 – Calculation of taxable diverted profits – section 2 case

70. The method of calculating the initial charge imposed by the charging notice differs in some respects from the ultimate basis that is used for determining the charge. The initial estimated charge is calculated in accordance with section 9 of the draft legislation as explained in DPT1190. This estimated charge gives rise to a requirement to pay the DPT within 30 days. The ultimate determination of the DPT charge is to be in accordance with section 8. This part of the guidance sets out how that ultimate charge is determined.

71. The taxable diverted profits of the foreign company in the situation described at DPT 1110 are the amount that it is just and reasonable to assume would be the chargeable profits, computed in accordance with sections 20 to 32 CTA 2009, had the avoided PE been a UK permanent establishment through which the foreign company carried on the relevant trade (INTM267000 et seq). The relevant trade is that in connection with which the avoided PE carries on the activity in the UK. The foreign company's accounting period is determined on the assumption that it is within the charge to corporation tax (see DPT1310).

72. However, if,

- the mismatch condition is met (DPT1110); and
- 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 (DPT1150)

then for the purpose of calculating what would have been the chargeable profits of the avoided PE it is assumed that some different provision ("the alternative provision") would have been made.

73. Alternative provision means any provision that differs in any detail from the actual material provision. So the alternative provision is substituted in all cases unless it is reasonable to assume that exactly the same provision, including the precise terms, pricing and parties to it, would have been made in the absence of the tax mismatch outcome.

74. The alternative provision is that which it is just and reasonable to assume would have been made or imposed if the avoided PE had been a UK PE through which the foreign company carried on the trade and which would not itself have resulted in an effective tax mismatch outcome. For this purpose, making or imposing no provision is to be treated as an alternative provision.

75. This is most likely to apply where the foreign company pays an expense such as a royalty for use by the avoided PE of an asset where that asset is located in a low tax territory so as to result in a tax mismatch outcome. If it is reasonable to suppose that in the absence of the tax mismatch outcome the foreign company would have held the asset itself, then the just and reasonable alternative provision would be one that ignored the royalty in computing the avoided PE's profit.

76. However, if the alternative provision would have resulted in the foreign company paying a royalty for the use of the same asset, but in a different amount or to a different party, then the charge under section 8 is to be based on the actual material provision rather than the alternative provision. For example, if the just and reasonable alternative provision would have resulted in the foreign company paying a royalty to a company in a jurisdiction with an equivalent or higher tax rate than UK CT rather than to a company resident in a territory where no tax is paid, then the profits of the avoided PE are to be determined based on the actual transaction that the foreign company has entered into. If the amount of that royalty has been inflated then this will be counteracted as part of the normal attribution process under sections 20 to 32 CTA 2009.

77. In some cases the alternative provision would have resulted in a UK resident company being in receipt of income. For example, a company may use an asset that is located in a territory where no tax is paid and, absent the contrived arrangement, the asset would have been held by a UK company. If, under the alternative provision, the overseas company would have paid a royalty to the UK company for the use of that asset by the avoided PE then that income is to be added to the taxable diverted profits of the avoided PE for the purposes of calculating the DPT.

Example at DPT1230

DPT1190 – Estimating profits for notices – section 2 case

78. Section 9 applies for the purpose of estimating the taxable diverted profits to be included in a notice in a section 2 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 8.

79. However, specific rules for determining the estimated charge apply if the "inflated expenses condition" is met. This condition is particularly aimed at arrangements such as "double Irish" or "Dutch sandwich" 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.

80. Under the specific rules there is an upfront 30% disallowance of payments that have been routed through the contrived arrangements. This applies to the actual material provision, if it is reasonable to assume that it would still have been made absent the tax mismatch outcome, or to the alternative provision (see paragraph 82).

81. The inflated expense condition is met if:

- the mismatch condition is met (DPT1113)
- the material provision results in expenses of the foreign company that would be taken into account as a deduction 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, are responsible for the effective tax mismatch outcome (DPT1150); and
- as a result it is reasonable for the designated officer to assume that those expenses, or part of them, exceed an arm's length amount.

82. If the inflated expense condition is met, and it is reasonable to assume that

- the material provision would not have been made in the absence of the effective tax mismatch outcome; but
- the alternative provision (within the meaning of section 8) would still have resulted in expenses of the foreign company of the same type and for the same purposes as the expenses responsible for the tax mismatch outcome,

then the expenses allowed as a deduction in calculating the chargeable profits of the foreign company to be included in the charging notice (DPT 1340) should be reduced by 30%.

83. So (for example) the designated officer may consider that expenses of the foreign company for use of an asset in its business are greater than they would otherwise be, because the asset is located in a territory where no tax is paid on the income stream, particularly if the royalty leaves the foreign company with only a modest amount of

profit. However, that asset may be one that is essential to the business of the foreign company. If so then the alternative provision that it is just and reasonable to assume would have been made would still have resulted in the foreign company paying a royalty for the use of that asset (though possibly to a different party). If so then in calculating the estimated profits of the avoided PE 30% of the expense under the actual material provision is disallowed.

84. The computation of taxable diverted profits outlined at DPT1180 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%.

85. 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.

86. 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 (DPT1341). 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.

DPT1200 – Calculation of taxable diverted profits – section 3 case

87. There are parallel provisions to those described in DPT1180 and DPT1190 for calculating and estimating the diverted profits charge in section 3 cases (including those where section 3 is applied by virtue of section 4 in the case of a UK PE). The initial estimated charge is calculated in accordance with section 11 as explained in DPT1210. This estimated charge gives rise to a requirement to pay the DPT within 30 days. The ultimate determination of the DPT charge is to be in accordance with section 10. This part of the guidance sets out how that ultimate charge is determined.

88. The basic charging rule is that C's taxable diverted profit is the amount that would be due if the pricing of the material provision were determined in accordance with the arm's length principles set out in Part 4 of TIOPA 2010 (transfer pricing). However, this amount is reduced by any amount which is reflected in C's in self-assessment return, before the end of the review period, as a result of the application of the transfer pricing rules to the material provision.

89. So if, for example, C were to adjust its CT return to reflect the arm's length price of the material provision, the DPT charge would be nil. This amendment would have to be made by the company before the conclusion of the review period.

90. However, this basic rule does not apply (unless the conditions discussed in paragraph 94 arise) if 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 (DPT1150). In such a case then for the purpose of calculating the company's taxable diverted profits, it is assumed that different provision ("the alternative provision") would have been made.

91. Alternative provision means any provision that differs in any detail from the actual material provision. So the alternative provision is substituted in all cases unless it is reasonable to assume that exactly the same provision, including the precise terms, pricing and parties to it, would have been made in the absence of the tax mismatch outcome.

92. The alternative provision on which C's liability to DPT is based is that which it is just and reasonable to assume would have been made or imposed in the absence of the effective tax mismatch outcome and which does not itself result in an effective tax mismatch outcome. For this purpose, making or imposing no provision is to be treated as an alternative provision.

93. It may be the case that as a result of the actual material provision the 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 alternative provision would have resulted in the UK company holding that asset itself (on the basis that the main reason for the affiliate holding the asset is to secure the tax reduction). If so then no deduction will be allowed for the royalty.

94. However, if the alternative provision would also have resulted in the UK company paying a royalty for the use of the same asset, but in a different amount or to a different party, then the charge under section 10 is to be based on the actual material provision rather than the alternative provision. For example, if the just and reasonable alternative provision would have resulted in the UK company paying a royalty in respect of the same asset to a company in a jurisdiction with an equivalent or higher tax rate than UK CT, then the profits of the UK company are to be determined based on the actual transaction that it has entered into. If the amount of that royalty has been inflated above an arm's length rate then this will be counteracted as part of the normal transfer pricing analysis under Part 4 of TIOPA 2010.

95. In some cases the alternative provision would have resulted in a UK resident company being in receipt of income. For example, a company (the first UK 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 a UK company (the second UK company). If, under the alternative provision, the first UK company would have paid a royalty to the second UK company for the use of that asset by the avoided PE then that income is to be added to the taxable diverted profits of the first UK company for the purposes of calculating the DPT.

96. Adaptations are made in the legislation to apply the same principles where the section 3 rules apply, through section 4, to a UK permanent establishment rather than a UK resident company.

DPT1210 – Estimating profits for notices – section 3 case

97. Section 11 applies for the purpose of estimating the taxable diverted profits to be included in a notice in a section 3 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 10.

98. However, specific rules apply for determining the estimated charge applies if the "inflated expenses condition" is met.

99. Under the specific rules there is an upfront 30% disallowance of payments that have been routed through the contrived arrangements. This applies to the actual material provision, if it is reasonable to assume that it would still have been made absent the tax mismatch outcome, or to the alternative provision (see paragraph 101).

100. 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 (DPT1150); and
- as a result it is reasonable for the designated officer to assume that those expenses, or part of them, exceed an arm's length amount.

101. If the above condition is met, and it is reasonable to assume that:

- alternative provision would have been made in the absence of the tax mismatch outcome; but
- the alternative provision would still have resulted in expenses of the foreign company of the same type and for the same purposes as the expenses responsible for the tax mismatch outcome.

then the expenses allowed as a deduction in calculating the chargeable profits of the foreign company to be included in the charging notice (DPT 1340) should be reduced by 30%, without regard to the transfer pricing rules in Part 4 of TIOPA.

102. As Company C is within the charge to CT, it 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. .

103. Adaptations are made in the legislation to apply the same principles where the section 3 rules apply, through section 4, to a UK permanent establishment rather than a UK resident company.

104. 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 (DPT1341).

DPT1220 – The sales threshold condition

105. In order to help focus the operation of section 2 (“avoidance of a UK taxable presence”) on situations where there is a substantial level of economic activity in the UK there is an exemption based on the level of a company’s UK sales. Where a the sales revenues of the company and connected companies from all supplies of goods and services to customers in the UK are no more than £10 million in a 12-month accounting period, no charge to diverted profits tax will be made on the basis that section 2 applies.

106. This threshold is reduced proportionally if the accounting period is less than 12-months. In considering “connected” companies’ sales, the definition follows section 1122 CTA 2010.

107. For the purposes of the UK sales threshold condition HMRC would consider sales revenues to be sales net of sales returns, allowances and discounts, as would be reported in the company’s accounts. The condition is intended as an indication of the level of economic activity in the UK.

DPT1230 - Section 2 Examples

Example 1: Avoiding a UK taxable presence

1. A foreign company (FCo) acquires widgets from a third party and sells them to customers in the UK as well as in other markets across Europe.

2. A UK company (UKCo), which is a subsidiary of FCo, provides sales support services to FCo.

3. UKCo identifies new customers in the UK, and undertakes all selling activities to the point of concluding the contract with the customer which is done by FCo. There is no commercial reason why the contracts are not concluded in the UK except for FCo imposing a restriction on UKCo.

4. Except for acquiring products and concluding sales contracts, no activity is performed by FCo in relation to the UK market.

5. FCo is resident in a low tax jurisdiction, and its country of residence has a tax treaty with the UK.

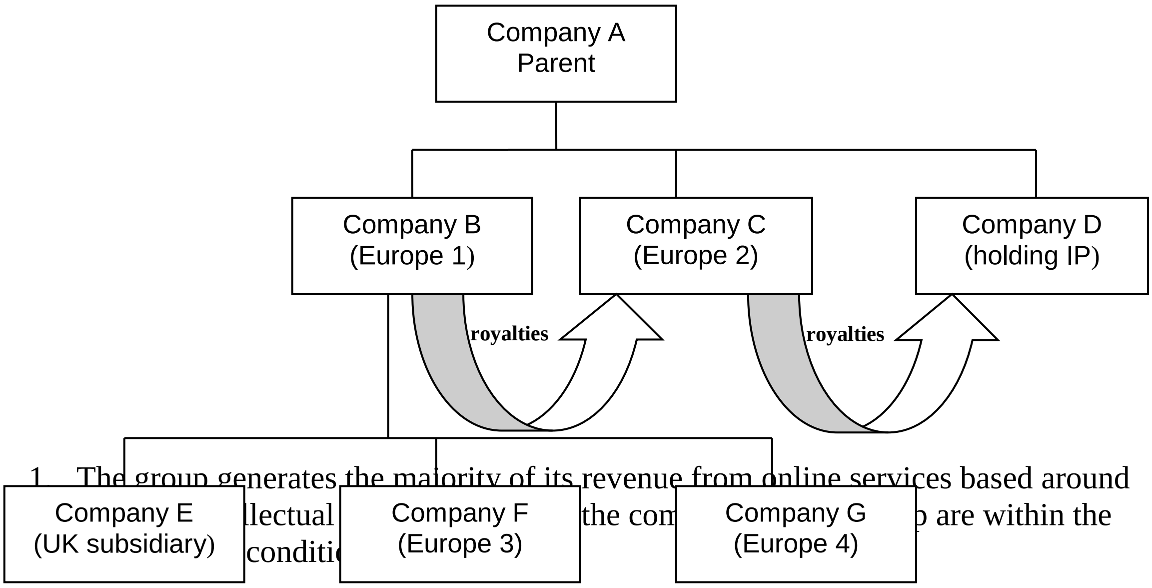
6. From an examination of the facts and circumstances around the arrangements in relation to customer contracts it is found that there is a contrived separation of the conclusion of contracts from the selling activity and process of agreeing terms and conditions. The requirement for FCo to conclude the contracts is deliberately intended to limit the activity which takes place in the UK.

7. It is reasonable to assume that:
    - the activities of both companies are designed so as to ensure that FCo is not carrying on a trade in the UK through a PE, and
    - that the arrangements have a main purpose to avoid a charge to corporation tax, so that the tax avoidance condition has been met

8. In this case the widgets are purchased from a 3rd party and sold direct to the customer in the UK. As those widgets are acquired at arm’s length, there is 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 FCo’s chargeable profits for corporation tax if it had been trading through a PE in the UK for the preliminary notice.

9. This will be a best estimate that can be amended through the review period (either by reducing the amount chargeable through an amending notice or increasing the amount chargeable through a supplementary notice).

Example 2: Avoiding a UK taxable presence



1. The group generates the majority of its revenue from online services based around [illegible]llectual [illegible] the com[illegible]p are within the [illegible]conditi[illegible]

2. 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.

3. 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.

4. 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.

5. 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.

6. 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).

7. 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.

8. 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.

9. 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. Apart from other considerations, the insufficient economic substance condition is most obviously met in respect of the transaction with Company C. It is reasonable to assume that Company C's involvement in the transaction was designed to secure the tax reduction.

10. 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.

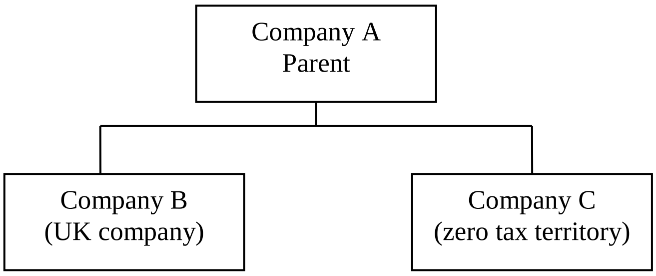
11. In estimating the taxable diverted profits for the preliminary and charging notices the designated officer would need to consider what the chargeable profits of Company B would have been if had been carrying on its trade through "the avoided PE" – Company E. In considering the appropriate deduction for the IP expense, the inflated expenses condition would need to be considered.

12. Whatever provision it is reasonable to assume would have been made absent the effective tax rate mismatch outcome, Company B would have made some payment in respect of its use of the IP. 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%.

13. 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 at 11 above.

DPT1240 – Section 3 Examples

Example 1: Section 3 Applying



Companies B and C are wholly owned by company A, so the participation condition is met.

1. Company B needs to invest in new expensive fixed plant and machinery (P&M) to carry on its trade in the UK.

2. 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. This is then leased to Company B leaving the UK company with relatively small profits over a number of years.

3. 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.

4. The material provision between B and C is the provision of P&M under lease and as a result of that material provision, there is an effective tax mismatch outcome. The payments are allowable in Company B's tax computation but are not taxed in the hands of Company C.

5. The contribution by the staff of C provides little economic value, and that value is much less than the financial benefit of the associated tax reduction.

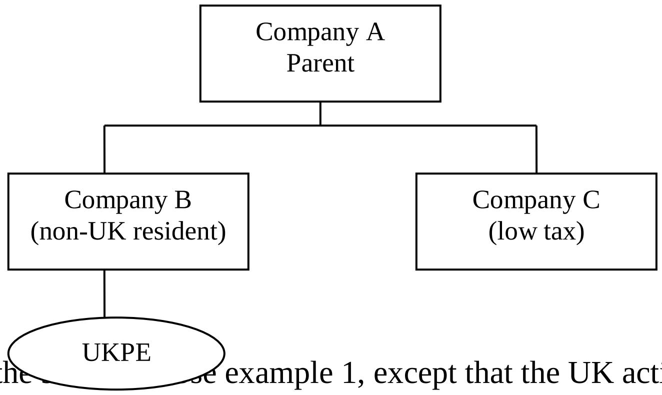
6. It is reasonable to assume that C's involvement in the transaction was designed to secure the tax reduction.

Calculation of taxable diverted profits

7. It is reasonable to assume that, in the absence of the effective tax mismatch outcome, B would have purchased the P&M itself. In this situation the alternative provision would assume that B acquired and owned the P&M. Capital allowances would have been available to it in that situation.

8. In this case there would be no need to consider the inflated expense condition, as it is reasonable to assume that the lease of P&M would not have happened in the absence of the effective tax mismatch outcome.

Example 2 – Involvement of entities or transactions lacking economic substance - Section 3, extended to a UK PE by Section 4



Assume the facts are the [illegible] 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 4 ensure the same result follows as in example 1, with similar analysis to arrive at the taxable diverted profits.

Example 3: Section 3 applying

1. 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.

2. 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.

3. 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.

4. 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.

5. On the assumption that the other conditions are met, DPT would charge profits to UKCo as if it had acquired the third party patents.

Example 4: Section 3 not applying

1. In this structure the UK company, (UKCo) manufactures widgets under licence with the related IP being held in a low tax jurisdiction (IPCo).

2. The group has manufacturing entities in four other locations in Europe. IPCo develops new IP with some small amounts of contract R&D being performed by UKCo.

3. IPCo charges a royalty to UKCo, as it does for the other group manufacturers. IPCo also contracts with a 3rd party for manufacturing outside of Europe on comparable terms, charging an equivalent royalty rate.

4. IPCo holds all IP for the group and has a large team that coordinates all R&D activity across the group, including decisions on new areas of development. The team includes specialists in the industry who have knowledge and experience to generate new ideas for development and a separate financing team that review the final proposal. All decisions are reviewed and concluded by the Board who are all employed by IPCo.

5. Very little input into development of the IP is made outside of IPCo.

6. In this situation, the economic value generated by the staff in IPCo far outweighs the financial benefit of the associated tax reduction.

7. The insufficient economic substance condition is not met, despite there being an effective tax mismatch outcome.

Chapter 3 – Diverted Profits Tax – processes: content

DPT1301 – Diverted Profits Tax Processes: Summary

Company must notify it is potentially within the scope of DPT within 3 months after the end of the accounting period

If the company does not make the notification it may be liable to a penalty.

HMRC may issue a preliminary notice of chargeability within 2 years after the end of the accounting period (4 years if no notification)

The company has 30 days from receipt of the notice to make representations

HMRC may consider representations on certain factual matters and the threshold conditions, but not at this stage on other matters (including transfer pricing)

Having considered the representations, HMRC must either issue a charging notice, or confirm that no charging notice will be issued, within 30 days from the end of the representation period

Charge to tax includes an interest element on the DPT from 6 months after the end of the accounting period to the date the 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 a12 month period from the relevant payment date for HMRC to review the charging notice and may issue a supplementary notice or amending notice 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

DPT1310 – Diverted Profits Tax Processes: Duty to notify potential liability to DPT

108. If for any accounting period a company meets the conditions set out in Section 2 (DPT1110), Section 3 (DPT1120) or Section 4 (DPT1130), with some modifications, it must notify HMRC accordingly.

109. The modifications to the conditions that apply for this purpose are:

Section 2

110. The requirements set out at condition 4 in DPT1110 are removed and replaced with a simpler factual requirement that the foreign company is not carrying on a trade in the UK through a permanent establishment.

111. The exclusions set out at DPT1110 including the de-minimis UK sales threshold exclusion (DPT1220) continue to apply for the purposes of the duty to notify.

Section 3 and 4

112. The requirement set out at condition 3 in DPT1150 (the 80% payment test), and the requirements set out at condition 3 in DPT1160 (reasonable to assume that the transaction, transactions or person's involvement were designed to create a tax advantage), are removed and replaced by the requirement that the financial benefit of the tax reduction must be significant relative to any other benefit obtained by the provision.

113. The notification must be made:

- in writing; and
- within 3 months from the end of the relevant accounting period.

114. The company is not required to quantify the profits potentially chargeable to DPT when making the notification.

115. Failure to notify within the time limit may give rise to a penalty (DPT1390).

Accounting Period

116. For companies within the charge to corporation tax accounting period has the meaning it has for corporation tax. For a non UK resident to which section 2 applies the accounting period is the accounting period that would apply for corporation tax purposes if the foreign company had carried on trade in the UK through a PE. Such a period cannot commence before 1/4/2015.

DPT1320 – Diverted Profits Tax Processes: Preliminary notice

117. Before issuing a notice to a company, HMRC must complete a template [model to be developed for internal use] which details the basis by which they believe a preliminary notice should be issued.

118. This template along with the preparation of the notice [model to be developed for internal use] should be finalised by the Designated Officer. The Designated Officer is authorised to sign and issue the preliminary notice and will be an officer with an appropriate level of seniority.

Issuing the notice

119. The notice should be issued to the company for which Section 2 (DPT1110), Section 3 (DPT1120) or Section 4 (DPT1130) applies and in addition a copy to be provided in the case of;

- Section 2 to the Avoided PE
- Section 4 to the UK permanent establishment

120. A preliminary notice can be issued to a company, regardless of whether that company has filed a notification (DPT1310)

Content of the notice

121. The notice should include the following;

- The basis on which the officer has reason to believe that Section 2, 3 or 4 applies
- The accounting period to which the notice applies
- The basis on which the proposed charge is calculated to separately identify
    - The taxable diverted profits
    - Any interest included in the charge (DPT1381)
- An explanation of the determination of the taxable diverted profits
- Confirmation of who would be liable to pay the tax
- The date by which the tax must be paid
- An explanation of how interest is charged for late payment (section 101 FA 2009) to include the period for which interest is paid and the rate at which it is paid.

Timing of issuing the preliminary notice

122. A preliminary notice must be issued no later than two years after the end of the accounting period to which the notice relates.

Provisions relating to preliminary notices more than two years after the end of the accounting period

123. Where a company has not made a notification (DPT1310) and it is discovered that an amount of diverted profits tax that ought to have been charged has not been charged, the Designated Officer may issue a preliminary notice to the company to make good the loss of tax.

124. The preliminary notice must be issued no later than four years after the end of the accounting period that the charge relates to.

DPT1330 – Diverted Profits Tax Processes: Representations

125. Following the date of receipt of the preliminary notice (DPT1320), the company has 30 days to send written representations to HMRC.).

126. The grounds on which such representations can be made are unrestricted, but HMRC may only consider (at this stage – see DPT1341) representations on the following:

- There is an arithmetical error in the calculation of the amount of diverted profits tax.
- An error in a figure on which an assumption in the preliminary notice is based.
- That the small or medium sized requirement is not met as detailed in DPT1110, DPT1120 or DPT1130.
- That one of the exclusions apply in Section 2 (DPT1110) related to:
    - Section 1142 CTA 2010 – Agent of independent status;
    - Section 1144 CTA 2010 – Alternative finance arrangements.
- With regard to Section 3 (DPT1120) and 4 (DPT1130) either:
    - The participation condition (DPT1140), or
    - The 80% payment test (DPT1150);
    - is not met, or
    - The material provision is an excluded loan relationship (DPT1113).

127. All the above representations should be considered before issuing the charging notice (DPT1340) but there is no requirement for HMRC to consider 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 2 cases – DPT1110).

DPT1340 – Diverted Profits Tax Processes: Charging notice

128. Following the issue of a preliminary notice (DPT1320) and consideration of any written representations (DPT1330) HMRC must decide whether to:

- Issue a charging notice to the company for the accounting period that the preliminary notice refers, or
- Notify the company that no charging notice will be issued for the period that the preliminary notice refers.

Timing

129. Such a notification to the company must be made within 30 days immediately following the end of the 30 day period that the company who received the preliminary notice had to make written representations.

130. The charging notice creates a formal liability to pay the Diverted Profits Tax (DPT) within 30 days of the date the notice is issued and there is no provision for postponement. The notice is not at this stage appealable, but a review period is built into the legislation during which the responsible officer must review the computation of taxable diverted profits and may amend the amount of DPT due (DPT1341)

Who issues the notice?

131. The notice will be issued by the Designated Officer.

Who should be issued with the charging notice?

132. The notice should be issued to the company for which Section 2 (DPT1110), Section 3 (DPT1120) or Section 4 (DPT1130) applies and in addition a copy to be provided in the case of;

- Section 2 to the Avoided PE
- Section 4 to the UK permanent establishment

What should be included in the charging notice

133. The charging notice must include the following:

- The amount of the charge to diverted profits tax imposed by the notice;
- The basis on which the officer considers that either Section 2 (DPT1110), Section 3 (DPT1120) or Section 4 (DPT1130) 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 (DPT1381);

- 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.

DPT1341 – Diverted Profits Tax Processes: HMRC review of charging notice

134. Following the issue of the charging notice HMRC has a further period in which they must review the charging notice and make amendments as necessary. 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 (DPT1110 and DPT1120) 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.

Designating the end of the review period

135. 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 responsible officer agree in writing to terminate the review.

136. Before notifying the company of the designated end of the review period, the officer responsible for the case must seek approval and sign off by the Designated Officer.

Supplementary charging notice

137. During this period HMRC can issue a supplementary charging notice if it is considered that the amount of profits included in the charging notice for an accounting period is insufficient.

138. The supplementary charging notice has the effect of bringing additional amounts of profits into charge that were not included in the original charging notice and bringing into charge additional amounts of diverted profits tax (DPT). The supplementary charging notice does not replace the original charging notice.

139. Only one supplementary charging notice can be issued in the period and a supplementary charging notice cannot be issued during the last 30 days of the review period.

140. Any additional tax due as a result of the supplementary charging notice must be paid within 30 days from the date the notice is issued (DPT1350). A supplementary charging notice may later be amended (downwards) in the same 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.

141. The content of the supplementary charging notice is the same as the charging notice (DPT1340).

142. The notice should be issued to the company for which Section 2(DPT1110), Section 3 (DPT1120) or Section 4 (DPT1130) applies and in addition a copy to be provided in the case of;

- Section 2 to the Avoided PE
- Section 4 to the UK permanent establishment.

Amending notice

143. During the review period HMRC can issue an amending notice if based upon the evidence the Designated Officer considers that the profits included in the original charging notice for an accounting period were excessive.

144. The amending notice has the effect of reducing the amount of profits included in the charging notice and reducing the DPT included in that notice accordingly.

145. There is no restriction on the number of amending notices that can be issued within the review period.

146. An amending notice can reduce the amount of DPT to zero.

147. 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, must be repaid with interest.

Who issues the notices?

148. Both the supplementary notice and the amending notice will be issued by the Designated Officer.

Appeals against charging and supplementary charging notices

149. A company may appeal a charging notice or supplementary charging notice after the end of the review period and the appeal must be made within 30 days from the end of the review period.

150. The appeal must be made in writing and state the grounds on which it is made.

151. Following receipt of an appeal, the special rules disallowing 30% of expenditure under the inflated expenses condition (DPT1110 and DPT1120) must be disregarded when determining whether the level of taxable diverted profits has been properly computed.

152. Appeals may be settled by agreement or by the Tribunal. The Tribunal has power to:

- Confirm the charging notice or supplementary charging notice,
- Amend the charging notice or supplementary charging notice, or
- Cancel the charging notice or supplementary charging notice.

DPT1350 – Diverted Profits Tax Processes: Payment of tax

153. The full amount of the tax included in the charging notice (DPT1340) or the additional tax included in a supplementary charging notice (DPT1341) is payable within 30 days following the date on which the notice is issued.

154. Liability to pay the tax lies with the company to which the notice is issued, and provisions exist to collect this from a non-UK resident company (DPT1360) or alternatively to collect from a related company to the non-UK resident company (DPT1370).

Postponement of tax

155. The tax cannot be postponed on any grounds.

Interaction with other taxes and double taxation

156. 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 or corporation tax. Therefore:

- No deduction or relief is allowed in respect of the DPT paid by the company.
- No amount paid by the company can be treated as a distribution.

157. However, the company is allowed a credit against the payment of DPT for taxes paid, that are calculated by reference to the profits being charged to DPT. For this purpose taxes can include:

- Corporation tax; or
- A non-UK tax which corresponds to corporation tax.

158. For this purpose, withholding tax paid on payments made to a person is (unless it is refunded) to be treated as tax paid by the person

Process for collecting tax

159. All DPT will be collected by raising a charge on the Strategic Accounting Framework Environment (SAFE). See HMRC internal manuals for instructions on raising a charge within SAFE.

DPT1360 – Diverted Profits Tax Processes: Collection of tax from a non-UK resident

160. By extension, Chapter 6 of Part 22 CTA 2010, applies to collection of Diverted Profits Tax (DPT) from a non-UK resident company.

DPT1370 – Diverted Profits Tax Processes: Collection of tax from a related company

161. DPT can be collected from a company related to the "taxpayer company" (the non-UK resident company for which the charging notice or the supplementary charging notice was issued) only if:

- an amount of DPT has been charged for an accounting period;
- the whole or part of the DPT remains unpaid 30 days after the date the charging notice (DPT 1340) is issued;
- the company to which the charging notice was issued was a non-UK resident.

162. A company is a "related company" 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;
- of the same group as a company which at the time was a member of a consortium owning the taxpayer company.

163. The **relevant period** means the period beginning 12 months before the start of the accounting period which the charging notice relates to an ending on the date that the tax becomes payable under that same charging notice.

164. 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.

165. The definition of **consortium** takes its meaning from Part 5.

Serving a notice on the related company

166. A notice to pay the tax related to the taxpayer company must be served on the related company. Such a notice must be issued by the Designated Officer

167. The related company has 30 days from the date the notice is served to pay:

- In a non-consortium case, the full amount of unpaid tax; and
- In a consortium case, the amount detailed below.

168. The related company is entitled to recover any amounts of DPT paid under the notice from the taxpayer company but no amount paid under this notice is allowed as a deduction in calculating income, profits or losses for any tax purpose of the related company.

169. 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.

170. The notice must be served on the related company before the end of the three year period commencing on the date the charging notice was issued to the taxpayer company.

171. If the charging notice is amended (DPT1340), any additional DPT brought into charge by that amendment can be included in a notice served on the related company before the end of the three year period commencing on the date the amendment was issued to the taxpayer company.

Amount of DPT paid by a related company in a consortium case

172. 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.

173. 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 be equal to the share which the related company has had in the consortium for the relevant period.

174. 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 be equal to the share that the group companies have in the consortium.

175. 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.

176. 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.

177. If the above percentages vary over the relevant period an average is taken of the percentages over the relevant period.

DPT1381 – Diverted Profits Tax Processes: Interest

178. There are two stages of interest to take account related to the diverted profits tax.

True Up Interest

179. Although computed in the same way as late payment interest, by reference to the amount of DPT (i.e. 25% of the taxable diverted profits for the relevant accounting period for which a notice is issued), "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.

180. 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 (DPT1320), 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 could arise could be significant. The "true up interest" component of the tax charge is designed to offset this.

181. 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.

182. 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.

183. "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.

Late payment interest

184. 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).

DPT1390 – Diverted Profits Tax Processes: Penalties

185. Schedule 56 FA2009 (penalty for failure to make payments on time) is extended to include diverted profits tax (DPT) (CH150000).

DPT1391 – Diverted Profits Tax Processes: Information and Inspection Powers

186. Schedule 36 FA 2009 and Schedule 23 FA 2011 are extended to include diverted profits tax (CH20100).