KPMG
cutting through complexity

DIVERTED PROFITS TAX | Navigating your way

Diverted Profits Tax

5 key points you need to know

01 **Diverted Profits Tax ("DPT")** is a new tax aimed at companies that enter into arrangements that divert profits from the UK. The rules are complex. DPT applies from **1 April 2015** and is charged on both UK tax resident companies and non-UK tax resident companies.

02 **The rate of tax charged on diverted profits is 25%** (55% for oil and gas activities in the UK operating in the ring fence) i.e. higher than the UK corporation tax which could have been payable on those profits.

03 Profits are considered to be diverted by the avoidance of a UK taxable presence of a foreign company, or by moving profits out of the UK through deductible expenses or forgoing the opportunity to earn profits. **The rules are drafted very widely and can apply in a broad range of scenarios.**

04 The rules generally **do not apply to small and medium sized enterprises ("SME").**

05 **It is the company's responsibility to notify HMRC that they are potentially within the scope of the rules by the statutory deadline.** Failure to notify could result in significant tax geared penalties being applied.

When is DPT applicable?

DPT applies differently to non-UK companies in comparison to UK companies.

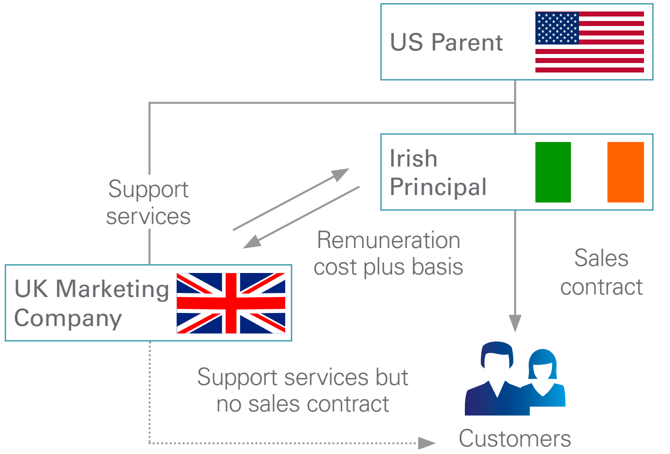
For a non-UK tax resident company, DPT broadly applies where arrangements have been put in place to avoid a UK taxable presence being created.

For a UK tax resident company, DPT generally applies in certain circumstances where profits are regarded as diverted to foreign companies that are not subject to an effective tax rate of at least 80% of the UK tax rate.

The following examples are intended as an illustration of the circumstances in which a DPT liability may arise, but in all cases, the analysis needs to be performed on the specific facts.

Example 1

PRINCIPAL COMPANY

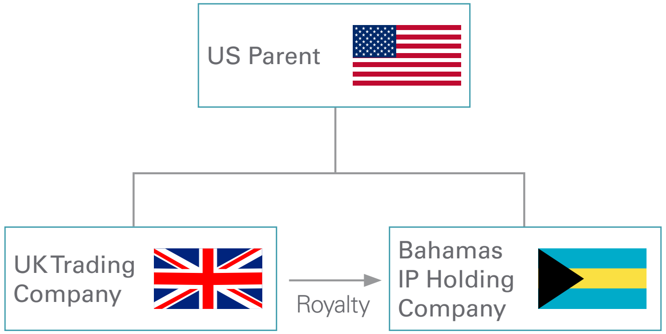


An Irish Principal company provides services to third party European customers and its activities are supported by the UK Marketing Company. While the UK Marketing Company assists in negotiating contracts, the Irish Principal agrees and signs the final contract with customers. As a consequence, the Irish Principal does not have a presence in the UK for corporation tax purposes under current tax rules.

In this example, subject to a detailed analysis of the facts, the Irish Principal may be regarded as diverting profits from the UK by avoiding a UK taxable presence, and so may be liable to DPT.

Example 2

OVERSEAS IP HOLDING STRUCTURE



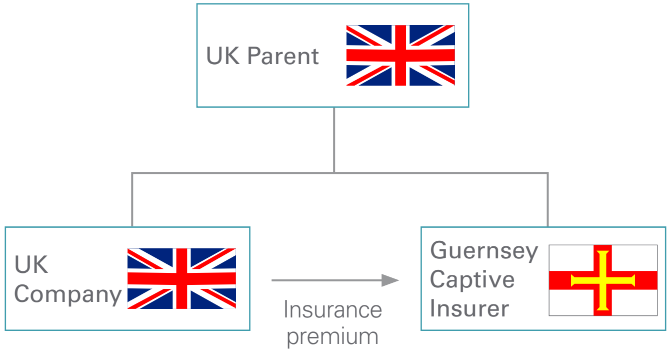
A Bahamas IP Holding Company has co-funded the development of IP with its US Parent and holds worldwide rights for exploiting that IP outside the US. It licenses this IP to a UK company and charges a royalty in respect of this arrangement. The Bahamas IP Holding Company pays no tax in the Bahamas.

The individuals responsible for the development, maintenance, exploitation and protection of the IP are employed by the US parent and not by the Bahamas IP Holding Company.

Given the tax profile of the overseas company and the fact that the employees responsible for the IP are not employed by the Bahamas IP Holding Company, there is a risk that some (or conceivably even all) of the royalty may be regarded as diverted and subject to DPT.

Example 3

CAPTIVE INSURER



A Guernsey Captive Insurance Company insures business risk of a UK group company. The Guernsey company has a low effective tax rate as it is located in a lower tax jurisdiction.

For reasons specifically relevant to captive insurance, there is a high risk that the premiums paid by the UK company would be regarded as profits diverted from the UK and subject to DPT.

Examples of arrangements that may be at risk

HIGH RISK

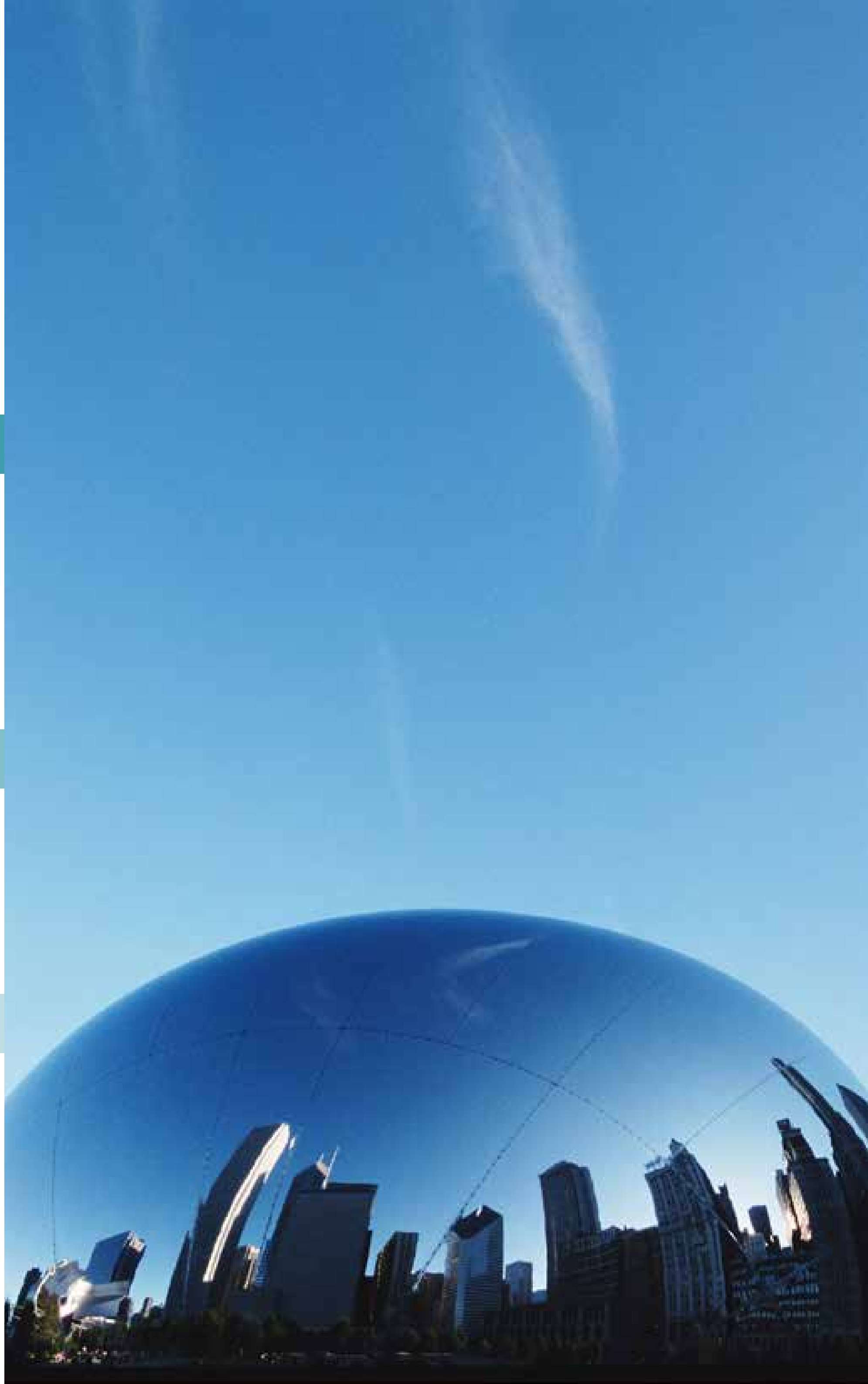
- Commissionaire and sales agent structures.
- Principal structures or operating models lacking adequate substance.
- IP migrations from the UK where key personnel do not move.
- Captive insurance companies.
- Companies operating in the UK without a taxable presence.

HIGH TO MEDIUM RISK

- Royalties paid to lower tax jurisdictions.
- High value services provided on a cost plus basis.
- Groups with internationally mobile workforces.
- Bareboat charters in the oil and gas industry.

MEDIUM RISK

- Centralised IP structures with UK royalties.
- Regional hub structures.
- Leasing arrangements.
- Companies with long-running transfer pricing disputes.



Frequently asked questions

My company is an SME, do I need to consider DPT?

No. The DPT legislation generally excludes SMEs from the scope of DPT. An SME for DPT purposes is defined as an enterprise with less than 250 employees and has an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. All tests are applied on a worldwide group basis.

I have arm's length transfer pricing policies in place, do I still need to consider DPT?

Yes. There are a number of situations where DPT can apply even if an arm's length transfer pricing policy is in place. For example, there may still be a DPT charge where a non-UK company has avoided a UK taxable presence. Alternatively, in certain cases, DPT may be due on payments by a UK company even where arguably they meet the arm's length test.

Our group only operates in jurisdictions with a high tax rate. Do I still need to consider DPT?

Yes. For example, the DPT charge for avoidance of a UK taxable presence applies even if the foreign company is taxed at a high rate. Alternatively it may be the case that a non-UK company is paying a low rate of tax despite being in a 'high tax' jurisdiction due to rules relating to how tax is imposed in that jurisdiction, for example, tax grouping rules, utilisation of losses, and entity classification.

Do double tax treaties provide protection from a DPT charge?

No. DPT is not a tax that is covered by the UK's double tax treaty network.

Are there any exemptions?

Yes. The DPT legislation includes a variety of available exemptions and exclusions. Not all arrangements which fall into the examples above will give rise to a DPT charge. In most cases the analysis is complex.

When must I notify HMRC?

For periods ending on or before 31 March 2016, companies must notify within six months following the end of the accounting period. For all other accounting periods, the notification period reverts to three months following the end of the accounting period.

What should I do now?

01 Determine whether the DPT rules apply to you.

Review your group's activities to determine whether they fall within the scope of DPT.

02 Consider approaching HMRC before your notification deadline to discuss your specific circumstances.

This could help provide greater certainty as to whether you are required to notify.

03 Notify HMRC where appropriate and quantify any potential liability.

It is the company's responsibility to notify HMRC of a potential liability with significant penalties for non-notification.

04 Discuss the approach taken with your auditors and agree whether a provision needs to be made for a DPT liability in your group or company financial statements.

A DPT liability could be material for reporting purposes.

How can KPMG help?

We can provide support through the following:

- Evaluating your DPT position.
- Assisting you in discussing your DPT position with HMRC on points of doubt.
- Providing advice on documentary evidence required to support your DPT analysis.
- Advising you on options to restructure your business model as required.
- Helping you prepare for DPT discussions with your auditors.

This is a highly simplified description of an extremely complex set of rules. It is intended to provide an impression of how the DPT rules work and should not be used as a substitute to obtaining professional advice covering your specific circumstances.

Contact us

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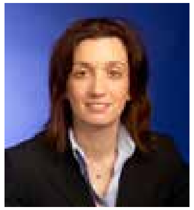

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