Hogan Lovells

When is a tax amnesty not an amnesty?

HMRC’s Profit Diversion Compliance Facility

Does your multinational group have a UK business? Does it have dealings with group entities overseas?

If so, then an ongoing HMRC’s campaign could affect you

We recommend groups complete an initial review promptly, to give time to plan any resourcing needed

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What is the Profit Diversion Compliance Facility?

What the PDCF does

The facility is a mechanism that multinational firms can use to settle potential tax liabilities for past years that remain open. It relates to transfer pricing, the diverted profits tax, and other relevant areas of UK tax. This could include permanent establishment, WHT, CFCs, hybrid mismatch rules, and corporate residence.

How does the facility change things?

The facility stands things on its head. Taxpayers accept that they may owe extra tax for open years, take the lead in raising this with HMRC, conduct a detailed internal investigation and analysis, and then submit a proposal. This represents a step-change in HMRC's approach.

What does it target?

"Old-style" or US transfer pricing models, ones not firmly anchored in a very detailed examination of facts, and arrangements not up-to-date with BEPS or business changes are at risk.

A detailed technical report and proposal

Taxpayers using the facility must file a detailed report including a proposal to settle all identified liabilities. HMRC has provided extensive guidance on what the report must contain.

How it works

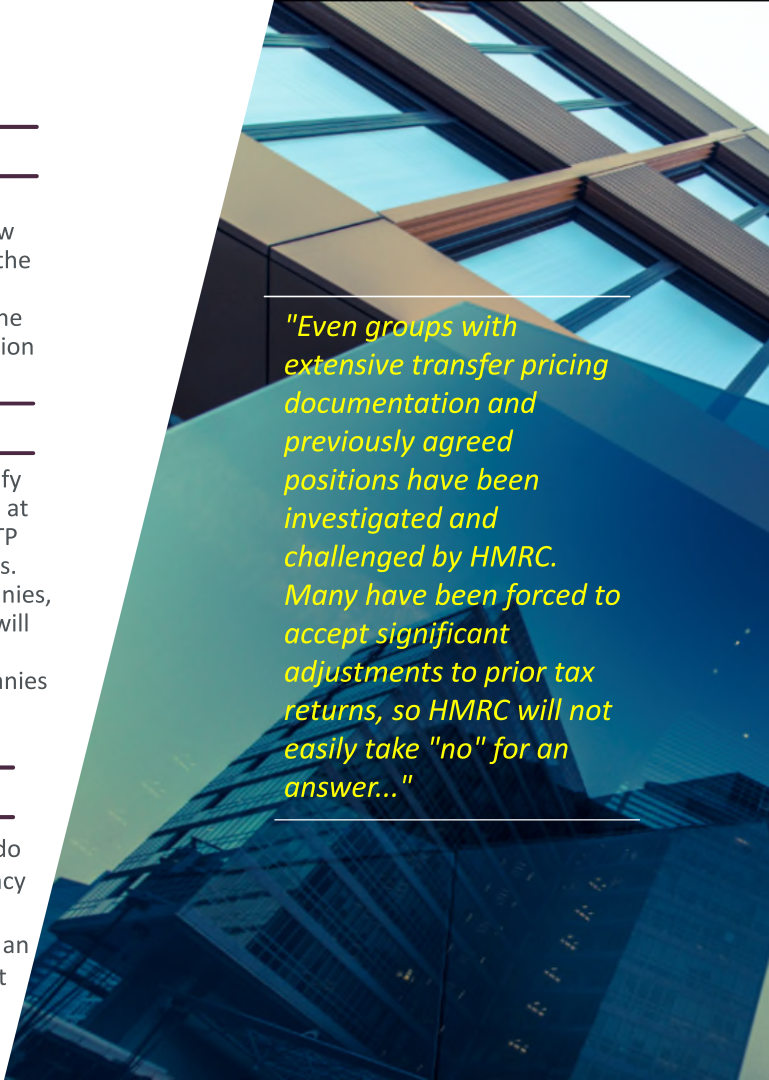
Taxpayers register to use the facility, and then have 6 months to file a report. HMRC will review it within 3 months, and decide whether or not the proposal is accepted. If it is, then the years are closed. If not, HMRC will discuss matters with the taxpayer. HMRC would expect a speedy resolution given the work done by the taxpayer.

Why even consider using the facility?

HMRC has already used data analytics to identify several hundred companies that it believes are at risk. This even includes groups with extensive TP documentation and previously agreed positions. HMRC has sent warning letters to some companies, and will be sending more. In the meantime, it will continue to open investigations, and has a few hundred extra staff to handle the work. Companies that ignore the facility are vulnerable to investigation and penalties.

Incentives to use the PDCF

Taxpayers that register to use the facility, and do so in the manner expected, may avoid inaccuracy penalties. They will also control the process of compiling a report, and avoid the disruption of an HMRC investigation. If a proposal is accepted, it will mean certainty for prior years, and potentially greater assurance for the future.



Key features and requirements

Taxpayers need to think carefully about whether to use the facility, and then plan how to do it

HMRC expects "old-style" transfer pricing models to be reconsidered and updated in line with its expectations, and the facts

The PDCF will be particularly relevant to groups with commonplace transfer pricing models which HMRC now believes need updating in line with its view on application of the OECD's 2017 Transfer Pricing Guidelines. HMRC has had what it sees as considerable success in challenging certain TP models and structures that it previously accepted, even recently in APAs or after audit. Even having comprehensive documentation often has not been enough, especially where it or the TP policies are not fully aligned with the facts.

Delaying registration, or ignoring the facility and/or warning letters altogether, could expose a group to investigation and penalties

HMRC is not suspending its program of investigations, and is identifying hundreds of targets using data analytics, and CbCR reports. It has substantially expanded its resources for working cases. Delaying registration may expose a company to investigation. Ignoring warning letters sent by HMRC will do the same. If HMRC opens an investigation before a group registers, or registration is not made (i) within 90 days of a warning letter, or (ii) within 3 years of filing a tax return that is adjusted through the PDCF, then HMRC may still apply penalties for inaccuracy.

All open years and potential relevant tax issues must be considered -- not just the diverted profits tax and transfer pricing

The facility requires a review of all years that HMRC is within time to review. Although the PDCF is focused largely on transfer pricing and diverted profits tax (DPT), HMRC expects taxpayers to consider all potentially relevant issues including corporate residence, permanent establishment, withholding tax, controlled foreign companies, and hybrid mismatch rules.

The potential application of penalties need to be addressed, along with reasons for mitigation or suspension

Action may be needed by certain deadlines to reduce DPT notification penalties, and potentially to eliminate inaccuracy penalties (failing this, suspension may be possible).

PDCF reports will require a level of factual detail, technical analysis and evidential support proportionate to the case

HMRC guidance indicates that taxpayers must prepare reports in the detail necessary to support proposals. Taxpayers are directed to consider the nature and level of tax risk involved, and conduct investigations proportionate to the scale and complexity of the business, extent of tax risk, and quantum of proposals.

But extensive factual information will still be needed in reports, reflecting HMRC 's new forensic approach

A log of the evidence used to establish the facts must be attached to the report. This evidence must be kept available for HMRC to review if requested. Certain foundation facts must be presented in every report:

- group facts, structure and profitability;
- description of the disclosed arrangements;
- staff profiles for UK and overseas employees;
- segmented financial data for UK and non-UK cos.;
- asset ownership and relevant background;
- group and UK R&D activity and costs.

Detailed guidance is provided by HMRC on these and extensive other additional information requirements.

The taxpayer must arrive at a proposal for the additional amount of tax, interest and penalties to be paid, and upfront

Based on the facts and technical analysis presented, the report must contain a proposal for the additional tax due, plus interest and penalties payable. There should be an explanation of why the share of system profit now taxable in the UK is appropriate given the profitability of the group, plus a statement of what changes are being made to the group's transfer pricing policies and arrangements going forward, and what the tax implications will be. Any payment must be made before or at the time the report is submitted.

What should you do?

The PDCF will not be for all groups.

But taking a fresh look at your group's transfer pricing arrangements, and carefully assessing its relevance, to confirm this is well-advised.

That's the starting point. It may be as far as you need to go. If not, there's a staged process to deal with past, present and future years.

The internal investigation would usually take 6-12 months, so timing is important.

Step 1 – assess risk

Taxpayers should conduct a risk assessment based on HMRC's likely application of risk indicators published in its guidance, and then take an informed decision. Stakeholders need to be engaged.

If decide to use the PDCF

Step 2 – use the facility

If a group decides to use the facility, then it should plan when to register, and how to conduct the internal investigation.

Step 3 – follow-up

Consideration should be given to whether MAP is relevant, and how to apply. Timing could be important. Taxpayers would also need to adjust unfiled years.

Final stage of process

Step 4 – address future

If more than fine-tuning of parameters is necessary, then more fundamental change might need to be considered and implemented. Bilateral APAs may come into play.

How can we help?

We can:

Help you conduct a risk and cost-benefit analysis to inform the decision on using the PDCF.

Advise you on using the facility – from registration to submission, and potentially beyond.

Assist you in gathering evidence, interviewing personnel, and drafting a robust report.

Help you formulate, test and present a proposal using TP methods and "triangulation".

Explain in a way HMRC will understand why the UK share of system profit is reasonable.

Support you in registration and pre-submission meetings with HMRC, negotiations, and MAP if required.

Help you develop and implement a plan for future years, including supporting APA applications.

Why work with us?

Independence

We are free of audit conflict, and provide objective and impartial advice. Good or bad, we'll tell you how it is.

Experience

Our team includes specialists that have successfully settled some of the most significant DPT and TP investigations in recent years. It includes HMRC's former lead transfer pricing economist and inaugural member of its DPT team.

Expertise

Our team offers insight from leading transfer pricing specialists, economists, and lawyers. It has a unique blend of advisory, in-house, litigation, expert witness, and tax authority experience.

Commercial approach

Our unique blend of expertise and experience means we can provide solutions that are insightful, robust, and pragmatic.

Key contacts

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