25 April 2019

HMRC's Profit Diversion Compliance Facility Aims For Collaborative Relationships

By **Amanda Pletz, Dr. Emmanuel Llinares, Diana Kabir,** and **Bernardo Danesi**

Following the 2018 Budget, revisions were made to the Diverted Profits Tax (DPT) legislation with effect from 29 October 2018. Amendments included an extension of the review period, relief from Corporation Tax (CT) if taxed under DPT, and to the calculation of diverted profits amongst others.[1]

To further prompt disclosures, HMRC created a new facility dedicated to profit diversion compliance in January 2019. It aims to foster more transparent and collaborative relationships by encouraging taxpayers to be proactive in discussing their tax arrangements that may be subject to DPT.[2]

NERA's global transfer pricing experts have substantial practical experience evaluating transfer pricing (TP) arrangements to provide guidance to clients who are considering participating in the Compliance Facility. In the following guide, we summarise HMRC's key message for taxpayers, we delve into the details of the new Profit Diversion Compliance Facility (PDCF), and we review the benefits of using the facility to avoid investigations into profit diversion.

Are You Comfortable with Your TP Policies and Documentation?

HMRC's key message in relation to the new facility is for taxpayers to review their transfer pricing arrangements and supporting documentation alongside their tax affairs, in light of the new guidance released relating to the facility. The information included in the PDCF guidance provides an important opportunity for taxpayers to re-evaluate whether they are fully comfortable with their TP policies and documentation. In case they fall within scope of DPT, most DPT risks can be eliminated through updates to TP policy design and implementation.

The Compliance Facility is available to multinational enterprises (MNEs) not currently under investigation by HMRC for profit diversion. Some of HMRC's indicators of profit diversion risk include 1) legal arrangements being inconsistent with risk allocation, 2) important regional functions being undertaken in the UK but the functions' profits are transferred overseas, 3) inclusion of entities in low tax jurisdictions receiving high rewards with low functionality, and 4) UK entities undertaking key DEMPE functions being classified as low value.[3] NERA's transfer pricing experts are well-versed on HMRC's approach to TP and can help assess potential TP risk areas for your business.

HMRC will continue to issue 'nudge letters' to taxpayers identified based on their internal risk filters, encouraging them to revisit their tax affairs and consider registering with the Compliance Facility (the first letters were sent at the end of January 2019).

How to Use the Compliance Facility to Potentially Avoid Investigation

If on reviewing the guidance the MNE considers that they may have additional tax to pay, they should email a completed registration form to HMRC, who will acknowledge its receipt before arranging a registration meeting to discuss plans for completing the Disclosure Report. The Report should contain six sections, including (i) an introduction, (ii) relevant facts and circumstances, (iii) application of the tax law to the facts, (iv) analysis of behaviours and application of penalties, (v) proposal to settle liabilities, and (vi) a signed declaration. Additionally, an annex including supporting evidence is also to be included.[4] Pre-submission meetings can also be arranged to provide a draft Report and allow both sides to raise any concerns before the MNE submits proposals to pay additional tax, interest, and where applicable, penalties due.

Given the requirement for a penalty analysis, HMRC has indicated the Compliance Facility is not designed for MNEs that are confident in their TP policies. However, if HMRC believes that an MNE's tax arrangements divert profit, an investigation is likely to commence without any of the benefits available through the Compliance Facility.

If you are already paying the right amount of UK CT, you will need documentation with robust economic analyses to support your TP procedures. The potential benefits of using the Compliance Facility, outlined by HMRC, include avoiding such investigations into profit diversion. If an MNE is considering registration and notifies HMRC, a delay in opening an investigation may be granted until a decision has been made.

Taxpayers have access to an accelerated process to gain faster certainty around their tax affairs due to HMRC's commitment to accept or decline a proposal within three months of receipt. MNEs also have complete authority of their internal processes (e.g., fact gathering, interviewing staff, use of comparables, and presentation of the Disclosure Report). If the proposal is accepted by HMRC, DPT notices will not be issued for the relevant accounting periods. While this doesn't provide immunity against future tax, the taxpayer receives greater assurance that their TP arrangements and treatment are not considered high risk and an investigation is unlikely to be opened. A less favourable penalty treatment will potentially apply for MNEs that register after 31 December 2019, so registering before this deadline can be advantageous for some MNEs.

NERA Can Work Collaboratively with You, and Your Legal and Tax Advisors

NERA's Global Transfer Pricing Practice helps clients minimise tax risks resulting from transfer prices. This is achieved by our transfer pricing experts utilising market-based pricing techniques including value-chain and industry structure analyses, benchmarking studies, and rigorous valuation methodologies to design intercompany pricing policies grounded in sound business strategy and well-established economic principles. The results are transfer pricing solutions that meet both business objectives and the arm's length requirements imposed by national tax administrations.

NERA experts can perform detailed reviews of your current TP arrangements to help you determine if it could be beneficial to register with the Compliance Facility. The standard of our independent advice has strengthened our reputation with tax authorities and we have substantial practical experience in assisting clients in negotiating successfully with HMRC. We can also ensure that your TP policies and documentation complies with UK tax legislation and the OECD's updated 2017 Transfer Pricing Guidelines.

For further information on or questions about the issues examined in our response, please contact NERA Associate Director Amanda Pletz or Managing Director Emmanuel Llinares.

Notes

1 HMRC, "Diverted Profits Tax Amendments," October 2018, available at https://www.gov.uk/government/publications/diverted-profits-tax-changes/diverted-profits-tax-amendments.

2 HMRC, "Profit Diversion Compliance Facility," January 2019, available at https://www.gov.uk/government/publications/hmrc-profit-diversion-compliance-facility/profit-diversion-compliance-facility.

3 Ibid.

4 Ibid.

NERA
ECONOMIC CONSULTING

About NERA

NERA Economic Consulting (**www.nera.com**) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. We bring academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

Contact

For further information and questions, please contact the authors:

Amanda Pletz
Associate Director
+44 20 7659 8528
amanda.pletz@nera.com

Diana Kabir
Economic Analyst
+44 20 7659 8500
diana.kabir@nera.com

Dr. Emmanuel Llinares
Managing Director
+33 1 70 75 01 93
emmanuel.llinares@nera.com

Bernardo Danesi
Economic Analyst
+44 20 7659 8764
bernardo.danesi@nera.com

To receive publications, news, and insights from NERA, please visit **www.nera.com/subscribe**.