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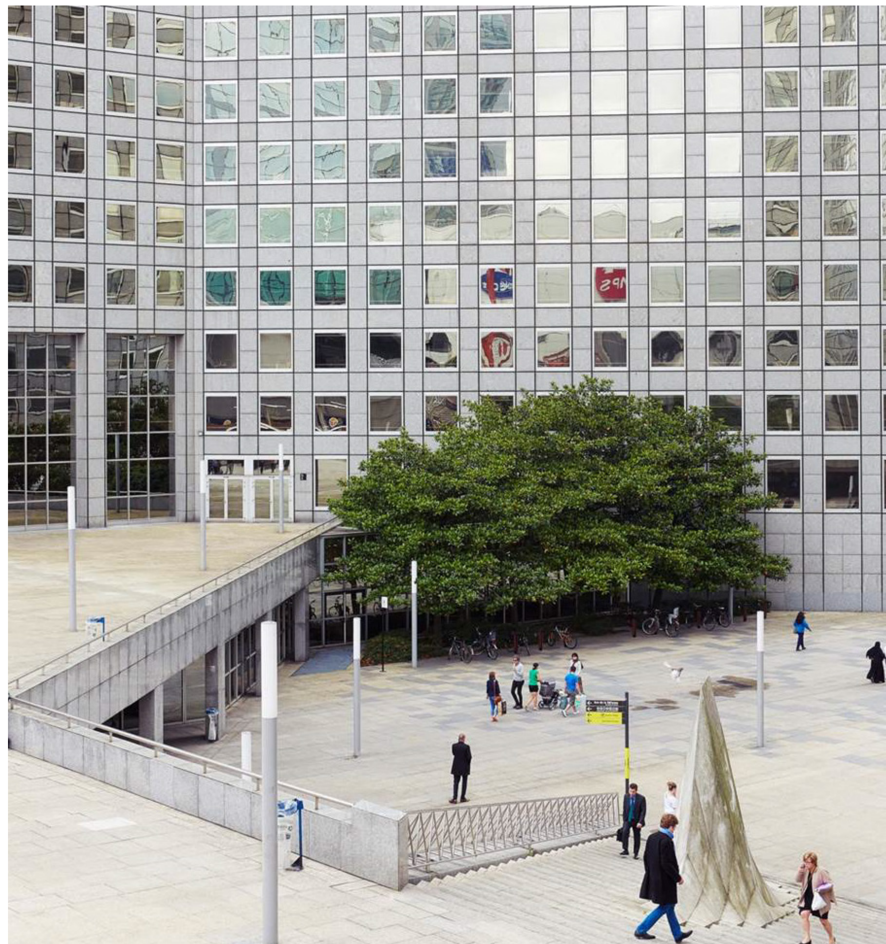
PwC Alert

United Kingdom Diverted Profits Tax ("DPT"): Could it apply to you?



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George Osborne,
UK Chancellor of the Exchequer,
The March 2015 United Kingdom budget speech

In a borderless international marketplace, there are many transactions that are executed seamlessly for the convenience of the end consumer. Therefore, regulations, legislations and taxes have begun to evolve, in order to ensure that such transactions are appropriate and are appropriately taxed. Cross border trade and investment is a key requirement for businesses that intend to expand their regional and global footprint, and Malaysian companies play a larger part in global trade than ever before. However, it can be difficult to monitor the changing global environment and ensure that you are compliant with the relevant rules and regulations and a recent example of this is a change in the UK.

Do you trade with or own property in the UK? Have you recently acquired companies that have UK business activities? If so, then the Diverted Profits Tax (“DPT”), a brand new tax introduced in the UK last year, could have implications for your business.

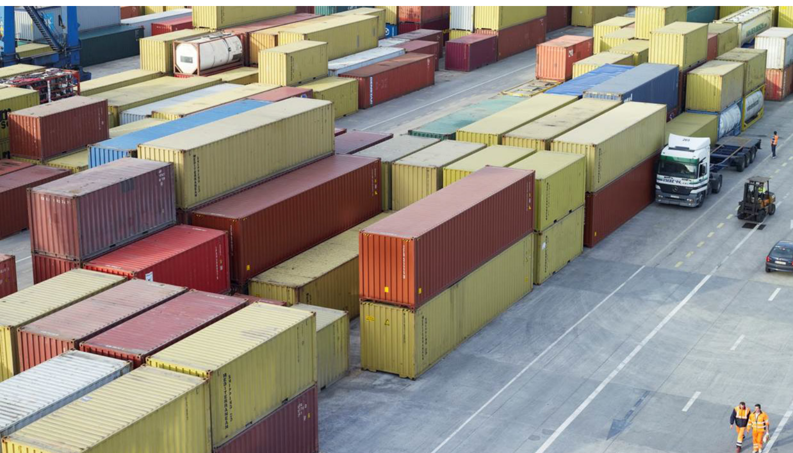
What is DPT?

The introduction of the DPT was announced by the UK Government in its Autumn Statement of 2014. The legislation was included in the Finance Act 2015 and became effective from **1 April 2015**. Guidelines providing detailed explanation were published by HM Revenue & Customs ("HMRC") in March and November 2015.

DPT is intended to cast the UK tax net over Multinational Companies ("MNCs"), which have entered into aggressive tax planning schemes to divert profits from the UK to other countries with a lower tax rate. It was introduced prior to the final recommendations released by the Organization for Economic Co-operation and Development ("OECD") of the proposed changes to existing international taxing principles under its Base Erosion and Profits Shifting ("BEPS") project.

The DPT may apply to companies/groups (apart from small or medium-sized enterprises) that:

1. Create a tax benefit by using transactions or entities that lack economic substance. Or;
2. Arrange activities in such a manner so as to avoid creating a taxable presence in the UK.



The DPT rate is 25% on the diverted profits of a company, which is much higher than the current corporation tax rate of 20% (reducing to 19% in 2017). The purpose of the higher rate is widely considered to be to encourage MNCs with arrangements within the ambit of the DPT to pay corporation tax in line with the level of economic activity in the UK.

It should be noted that following tax reform over the last several years, the UK remains a competitive place and one of the preferred destinations for Malaysian companies to do business and establish regional headquarters. DPT should not have a significant impact on this as it is designed to catch profits that are artificially diverted rather than genuine trading activities. However, some companies are finding that they are falling within the rules due to reasons such as incorrect transfer pricing or ineffective reporting systems and, therefore, it remains important for all companies to consider whether the rules may apply to them.

Is there any impact on Malaysian companies?

The DPT legislation is onerous as it requires a company to notify HMRC if it is potentially subject to the tax. A tax-geared penalty will be imposed based on the potential lost DPT revenue if notification is not done within the stipulated timeframe.

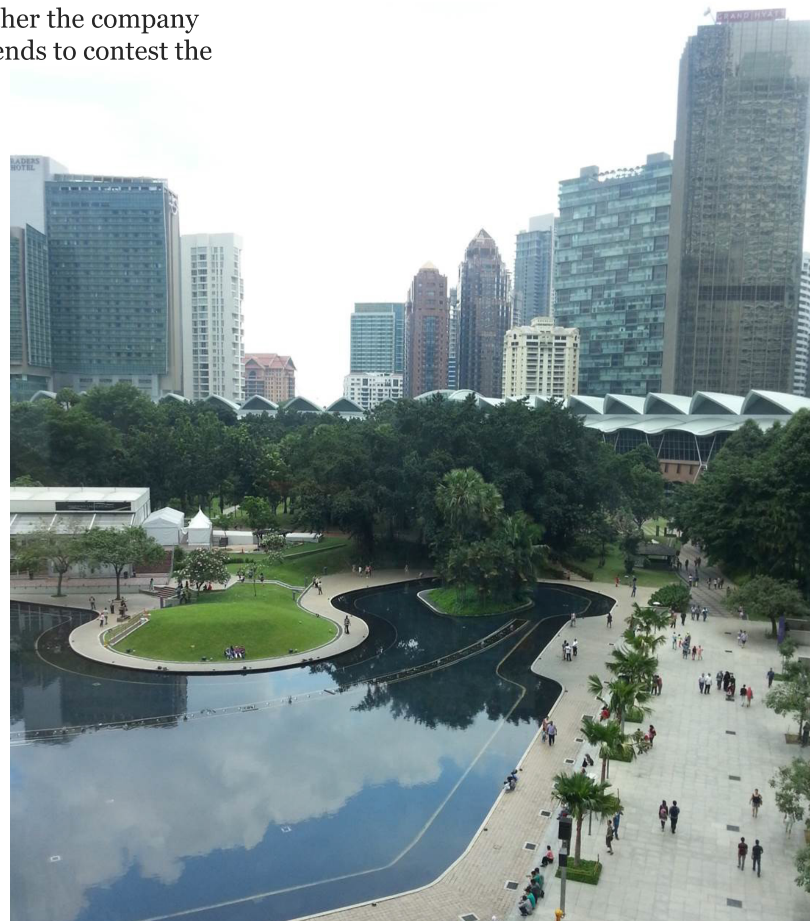
MNCs established and based in Malaysia which are doing business in or with the UK should undertake a thorough review of their business arrangements to determine whether they are caught under the DPT net. Some common business arrangements which may trigger a DPT include the following (not exhaustive):

- A Malaysian company that sells goods or services to UK customers, with the key sales and marketing activities in relation to those sales being undertaken by a related party in the UK;
- A Malaysian company that sells goods or services to UK customers, via a UK commissionaire agent/company, who contractually has obligations to remit revenue received to Malaysia;
- A Malaysian company that owns real property in the UK (directly or indirectly) and carries out some activity in the UK e.g. marketing/sales activities in relation to units in a residential building;
- A UK company that transfers the ownership of intellectual property to its Malaysian subsidiary, which may be enjoying a tax incentive. However, key personnel and research and development activities in relation to this IP remain in the UK; or
- A Malaysian company that acquires a group of companies that have UK activities, which possibly may be subject to DPT that was not identified prior to the acquisition.

Is there any impact on Malaysian companies?

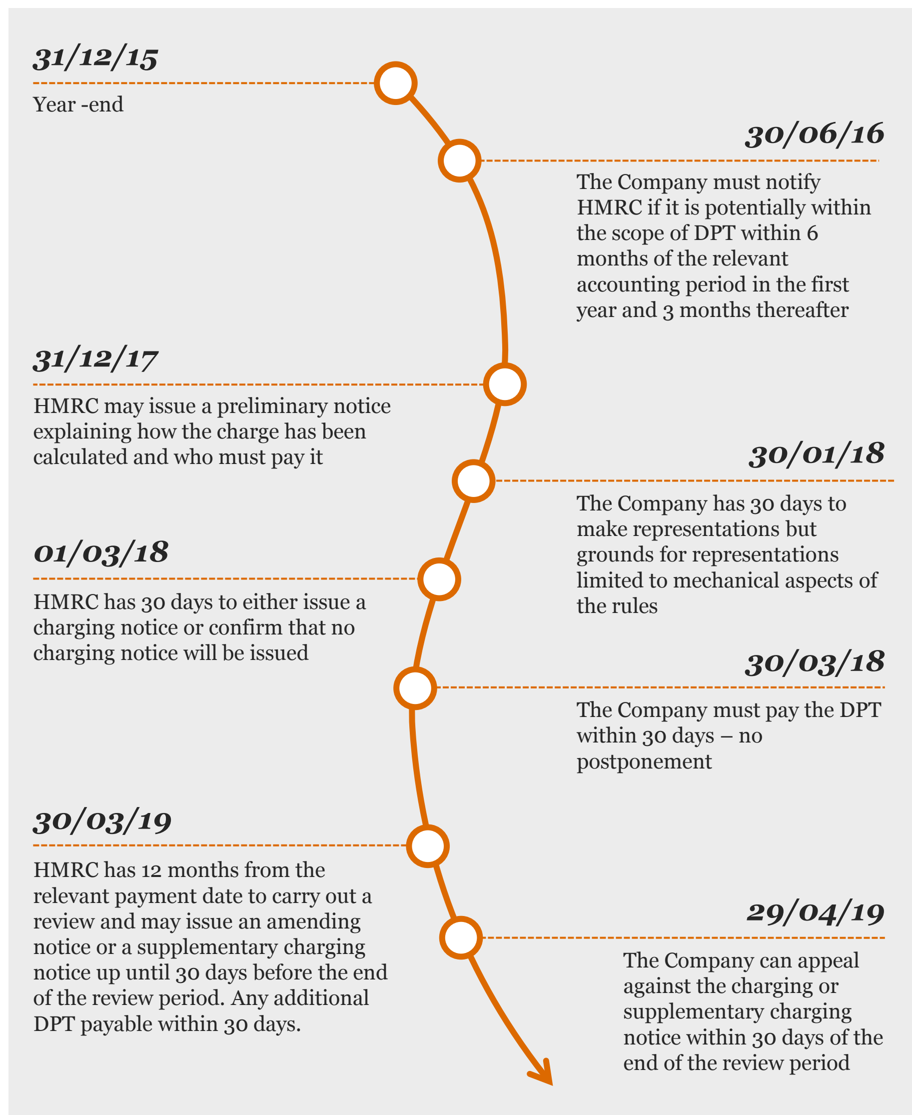
The review of whether a transaction has sufficient economic substance can be onerous, as the tests (focusing on activities, functions and design) applied are complex and the elements subjective. Therefore, given this complexity, it is particularly important that companies have sufficient documentation on file to support their DPT position as HMRC may not have adequate insight to the intricacies of the taxpayer's industry and consumer requirements. HMRC appears to be aware of this given the use of words such as "*reasonable to assume*" and "*the main purpose or one of the main purposes*" in determining whether the tax applies. However, the legislation does not define these terms and therefore there is some degree of interpretation that may only become apparent over time through experience or the introduction of case law.

Malaysian companies should critically evaluate their business model in relation to their operations in the UK to ascertain whether there is a need to make a DPT notification or payment, particularly as the rate is much higher than the current corporate tax rate. In addition, there would be an impact to the cash flow of the company, as DPT must be paid within 30 days after receiving the charging notice from the HMRC regardless of whether the company agrees with or intends to contest the charge.



DPT compliance

Malaysian-based MNCs subject to DPT should implement processes to ensure that notification and payment of the tax are done on a timely basis if appropriate. Please note the reporting timeline illustrated below for a company with a 31 December 2015 financial year-end.

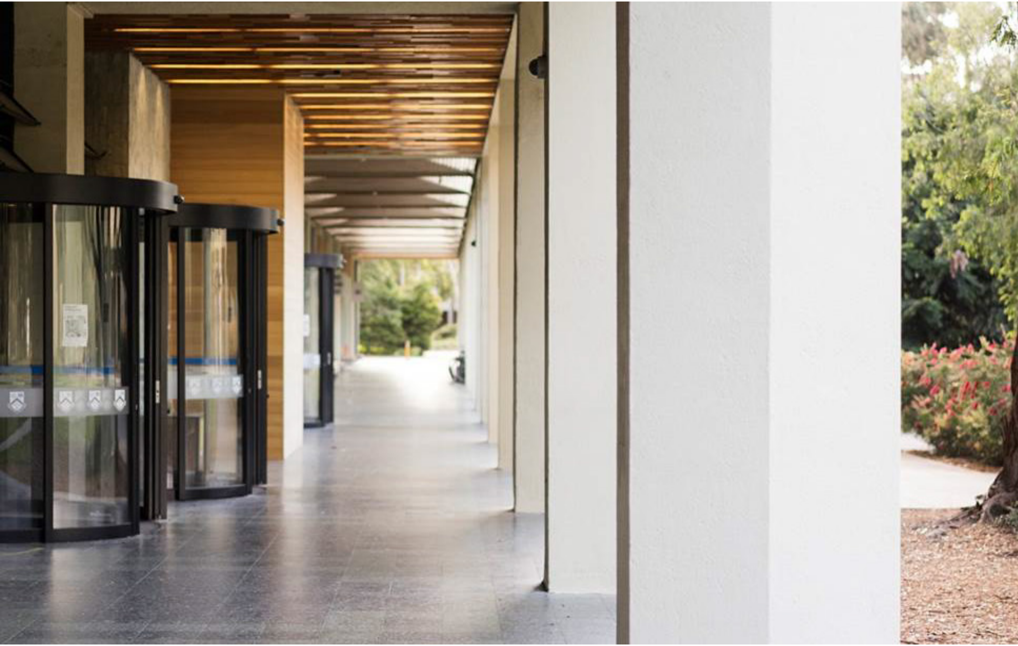


Penalties could arise from non-compliance. We understand that HMRC has identified various groups that they expect to receive DPT notifications in relation to and are expected to follow up with those that do not voluntarily notify.

The tax liability may be reduced by the amount of Malaysian tax paid on the diverted profits, if paid within certain time limits. However, at present, DPT is not covered by the double taxation treaty between Malaysia and the UK because it is regarded as a stand-alone charge on diverted profits, separate from income tax, corporation tax and capital gains tax. Hence, it appears that any DPT paid may not be used to reduce the Malaysian corporate tax on the diverted profits through a bilateral credit.

It remains to be seen whether the Malaysian Inland Revenue Board ("MIRB") will adopt a different view given that it does not seem to be in line with the spirit of the double taxation treaty between Malaysia and the UK. Formal clarification from MIRB on this matter is especially important for those Malaysian-based MNCs currently having interests in the UK.

Conclusion



DPT is a new consideration to Malaysian-based MNCs currently doing business or planning to do business in the UK. A detailed review of existing and future/proposed arrangements is necessary to ensure that DPT is complied with and does not result in unnecessary and unexpected business cost. Companies should:

1. Assess their DPT position and notification requirements;
2. Review accounting and reporting considerations;
3. Consider engagement with HMRC on proposed arrangements; and
4. Review interaction/implication of DPT with transfer pricing, advanced pricing arrangements and operating models.

DPT is a new type of tax that may become increasingly common worldwide, particularly as we move into advanced stages of the OECD's BEPS action plans to combat the shifting of profits to lower tax jurisdictions. Companies need to be cognisant of the requirements, as they quickly evolve to meet the needs of today's volatile business environment. This will ensure that informed decisions can be made to execute sustainable, compliant and cost-effective business arrangements and operations.

Let's talk

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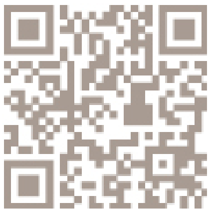

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