

UK's Tax Authority issues next batch of letters regarding Profit Diversion Compliance Facility

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Recently, the United Kingdoms (UK)'s Tax Authority, HM Revenue & Customs (HMRC), provided an update on its activity in relation to the Profit Diversion Compliance Facility (PDCF). Much of this activity is relevant to "Mid-Sized" multinational businesses that may have considered themselves to be at lower risk in respect of international tax issues until now. Mid-Sized for these purposes broadly covers companies with a global turnover, measured in Euros, of more than €50m but an aggregate UK turnover of less than £200m. Businesses with a UK turnover above this upper limit are dealt with by the Large Business directorate of HMRC.

The PDCF is a disclosure facility aimed at multinational enterprises which HMRC believes have used cross-border arrangements that HMRC considers result in an artificial reduction in UK profits. While focused on transfer pricing and diverted profits tax (DPT), the PDCF has a wide scope and encompasses a range of international tax issues such as withholding tax, company residence, and controlled foreign companies (CFCs). The PDCF is available to multinational businesses should they wish to bring their tax affairs up to date.

The first batch of letters issued by HMRC

In January 2019, HMRC issued its first batch of "nudge" letters to certain businesses which it considered had some indicators of profit diversion risk. The letters invited businesses to register for the PDCF and to make a full disclosure of any outstanding UK tax liabilities relating to any artificial reduction in UK profits.

As expected, nudge letters were issued to those businesses which had notified HMRC of a potential liability to DPT as well as those that had not, reiterating that the scope of the PDCF is much wider than DPT.

Based on EY observations and confirmation from HMRC, no particular industry sectors were targeted when these initial nudge letters were issued. HMRC has confirmed that nudge letters have been, and will be, issued based on the risk profile of a business rather than the industry in which it operates. HMRC has also indicated that businesses should not assume that the absence of a letter from HMRC means they are regarded as low risk, as it will not necessarily issue nudge letters to all businesses that it considers may have diverted profits. Furthermore, the nudge letters will be issued in batches which are not determined solely by starting with the highest risk first; indeed, the first batch of letters was issued to taxpayers perceived by HMRC to have a medium risk of profit diversion as well as those considered to be high risk.

Focus on Mid-Sized Business

HMRC has confirmed that it is not focusing the PDCF on the companies dealt with by the Large Business directorate only. The majority of the nudge letters sent to date were issued to businesses in the Mid-Sized population. This may not be what many businesses in this community have been anticipating. Historically, these businesses may have seen themselves as a relatively low priority for HMRC in terms of international investigations and may have had little direct interaction with HMRC prior to this. The issuance of nudge letters to Mid-Sized Business taxpayers appears to be indicative of HMRC increasing its focus on taxpayers in this population.

Where there has previously been limited interaction with HMRC, the PDCF provides an opportunity for these organizations to bring their international tax affairs up to date and, where appropriate, to gain some certainty on their UK tax profile going forward.

PDCF registration and HMRC investigations

Businesses that are sent nudge letters have 90 days to decide whether to register or risk HMRC opening an investigation into profit diversion. HMRC tells us that most businesses which were sent a letter, irrespective of size, in fact decided to register.

HMRC says it has now started the process of opening investigations into those businesses that received letters in the first batch but did not register under the PDCF.

The second batch of letters issued by HMRC

HMRC started to issue the second batch of nudge letters in June 2019. These businesses also have 90 days to decide whether to register for the facility.

We have been informed by HMRC that should the recipients of these letters not register for the PDCF, HMRC expects to follow up in opening investigations more quickly than for the first batch of letters.

Businesses should not wait until they receive a nudge letter to assess the benefits of the PDCF. In particular, Mid-Sized businesses that thought they may not be included as part of this program may wish to consider their risk profiles to decide whether registration may be beneficial.

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