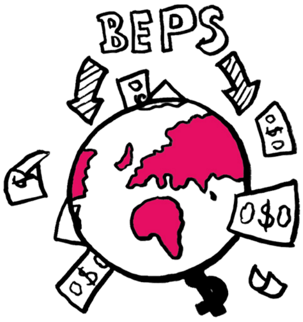
Debevoise & Plimpton



Diverted Profits Tax & BEPS

What is Diverted Profits Tax ("DPT")?

The DPT is a UK tax aimed at preventing tax avoidance by multinationals operating in the UK. The DPT represents a significant change in approach for the UK tax authorities as it seeks to tax the profits of foreign companies even where there is no permanent establishment (previously UK tax was very clearly limited to UK resident companies and UK permanent establishments).

The DPT aims to prevent two circumstances:

1. where a foreign company exploits permanent establishment rules to avoid creating a UK taxable presence; and
2. where a UK company manufactures tax advantages by using entities or transactions that lack economic substance.

The rate of DPT is 25% (in contrast to the current UK corporation tax rate of 20%).

Is DPT just BEPS Beta?

DPT certainly has the look and feel of BEPS about it and the way in which it is assessed encourages transparency but despite initial similarities, the DPT is incompatible with the collaborative ethos of the BEPS Project. BEPS is a multiparty approach to tax evasion with the intention to implement rules in a consistent manner across signatory states. The DPT is also heavily reliant on the UK's definition of permanent establishment, given that this definition is under review as part of the BEPS Project, the DPT may become out of date once the BEPS action plan has been fully implemented.

Why is DPT controversial?

The DPT is controversial for lots of reasons (not just its uncomfortable relationship with BEPS):

- the DPT may be open to challenge under the European Convention on Human Rights (because of the penal tax rate) and under EU law (because of the breadth of its scope);
- the DPT may not be compliant with the UK's network of double tax treaties – the UK government claim that DPT is not a corporation tax and is therefore outside the scope of the treaties (which cover income, corporation and capital gains taxes), although there are some treaties which contain anti-discrimination clauses relating to all taxes; and
- from an administrative perspective, the way that the DPT is assessed and charged is somewhat unusual – it sits outside of the self-assessment process, allows HMRC wide discretion to levy tax on notional profits and gives taxpayers limited rights of appeal.

Is there a future for DPT alongside BEPS?

This remains to be seen. BEPS is not fully implemented. The UK has not indicated what will happen to DPT once BEPS is on the statute books; having the two regimes running in parallel certainly does not fall in line with the government's stated aim of tax simplification. For now the DPT plugs a perceived gap but it is not inconceivable that, for example, as the UK's definition of permanent establishment changes in line with BEPS, the DPT falls away.

Please contact BEPS@Debevoise.com to discuss further.