



## **FINANCE BILL 2015 DRAFT CLAUSES – DIVERTED PROFITS TAX**

ICAEW welcomes the opportunity to comment on the draft clauses on Diverted Profits Tax published for consultation by the government on 10 December 2014.

This response of 4 February 2015 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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For more information, please contact ICAEW Tax Faculty: [taxfac@icaew.com](mailto:taxfac@icaew.com)

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## **Introduction**

1. We welcome the opportunity to comment on the consultation on the draft clauses on the proposed Diverted Profits Tax (DPT) to be included in Finance Bill 2015. These draft clauses were published on 10 December 2014.
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on these proposals.
3. On 8 January 2015 we attended an HMRC presentation, along with other interested parties, in which HMRC speakers outlined the main features, and objectives, of this new legislation.

## **The statutory timetable**

4. The draft statutory clauses, with suitable amendments, will be included in the Finance Bill 2015, to be published shortly after the Budget on 18 March, and will receive Royal Assent in the short 12 day period before Parliament is dissolved, on 30 March, in the run up to the Parliamentary Elections on 7 May 2015.

## **Our public policy concerns**

5. We have a number of public policy issues with the current proposals which we elaborate on below.
6. There are also concerns as to whether the detailed proposals will achieve the intended policy objective and we are aware that the major professional firms, which are members of ICAEW, have made detailed representations on these more technical points.
7. In the current representation we have, in addition to our overarching policy concerns, provided a, brief, general overview in relation to some of the more detailed concerns.

## **What is the focus of the proposed Diverted Profits Tax (DPT)?**

8. Our understanding is that the DPT will apply:
  - a) where a foreign company with UK sales of £10m or more structures its affairs to avoid a UK taxable presence (a Permanent Establishment); or
  - b) where a company which is taxable in the UK creates a tax advantage by involving entities or transactions with “a lack of economic substance”.

## **The Public policy issues**

### **The uncertainty created by the proposals**

9. We understand from the UK government that the companies targeted by these proposals are limited to no more than a dozen or so and yet the provisions would appear likely to catch a very considerable number of companies and there is, at the moment, no adequate “gateway” to ensure that only a limited number of business need to concern themselves with the proposals.

### **Notification by businesses which are caught by the proposals**

10. The UK government has already agreed, in the course of the public meeting held on 8 January 2015, that the current notification provisions are unduly onerous and need to be more appropriately targeted.
11. We appreciate that there will not be time before the Budget/Finance Bill publication in the second half of March to consult on the full DPT proposals but it is imperative that the notification arrangements are recast and re-presented to commentators well before 18 March to make sure the proposals are proportionate and workable.

### **The mismatch with the UK's involvement in the OECD BEPS project**

12. The UK has played a pre-eminent role in the work of the OECD on the BEPS project which is "sponsored" by the G20.
13. A major target of the DPT is the same as Action 7 of the OECD BEPS project, namely to ensure that business cannot carry on significant commercial activities in a country without becoming liable to tax on the related profits from that activity.
14. All the participants in the G20/OECD process have agreed that international efforts need to be coordinated in order to ensure that any recalibration of the international tax system works coherently, and works well, and deals with the dysfunctional elements of the current system.
15. Unilateral action along the lines of the current UK DPT proposals will undermine that coordinated approach.
16. We have heard representatives of HM Treasury state that participation in the OECD BEPS project does not mean that there should be no domestic law changes while the OECD proposals are under consideration.
17. Clearly the UK Government is free to change its domestic tax system as it sees fit but if it is in effect going to change an element of that system, i.e. what does or does not constitute a Permanent Establishment, which is a key element of the international tax system then that is not a purely domestic matter.

### **The UK's Tax Treaty network and European Union Treaty law**

18. We understand that the UK Government has taken advice from leading Tax Counsel to the effect that DPT is not a tax covered by the more than 120 existing Double Tax Conventions which the UK has entered in to with other countries and that DPT does not breach the UK legal obligations under the EU Treaty.
19. Our understanding is that the position is not as clear cut as the British government is suggesting.

### **The EU Treaty considerations**

20. We think it is very important for the UK Government to set out, in clear terms, why it is of the opinion that the EU Treaty and, in particular, the EU Treaty Freedoms do not apply and cause the proposed law to be in breach of EU law.
21. In our view the position is not clear cut and we are concerned that the UK will be introducing legislation that could be the subject of cases being referred to the Court of Justice of the European Union (CJEU) for a definitive judgment on the matter.
22. It is not clear that the insufficient substance condition in section 7 is consistent with the "wholly artificial arrangement" test laid down in the Cadbury Schweppes judgments of the CJEU (C-196/04).
23. We also have concerns that applying the provisions as to what it is "just and reasonable" to assume would have happened may infringe the EU principle of legal certainty for which guidance is provided by the case of Société d'investissement pour l'agriculture tropicale SA (SIAT) v État Belge C-318/10).

### **The UK Treaty network**

24. The DPT stands on its own and the UK government has received advice that it is not a tax that can be "blocked" under the terms of relevant Double Tax Agreements.

- 25.** We understand that the UK Government has also got an indication, from US lawyers, that if the tax were to be paid by US resident corporations it would be accepted by the US IRS that such tax is creditable against the US liabilities of those US resident corporations.
- 26.** It would be helpful to have more detailed analysis and confirmation of this position.

#### **Some more detailed technical concerns**

#### **Sections 2 and 8 – profit attributable to the UK taxable presence**

- 27.** There is in our view legitimate concern that the current provisions could result in more profit being attributable to the deemed UK PE than represents the profits attributable to, for instance, Significant People Functions (SPF) within the UK. How the rules are going to operate in practice needs to be clarified: ideally in the legislation but certainly in the Guidance.

#### **Section 3 – Entities or transactions lacking economic substance**

- 28.** The current exclusion for loan relationships only applies when what is involved is “only a loan relationship”. We support other representations which recommend a broader exclusion from the DPT charge.
- 29.** We also support other representations that there should be a gateway test to ensure that non contentious situations do not potentially get caught by these provisions and then the companies involved face the burden of having to justify why they should not be and, indeed, why they are not caught.

## APPENDIX 1

### ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).