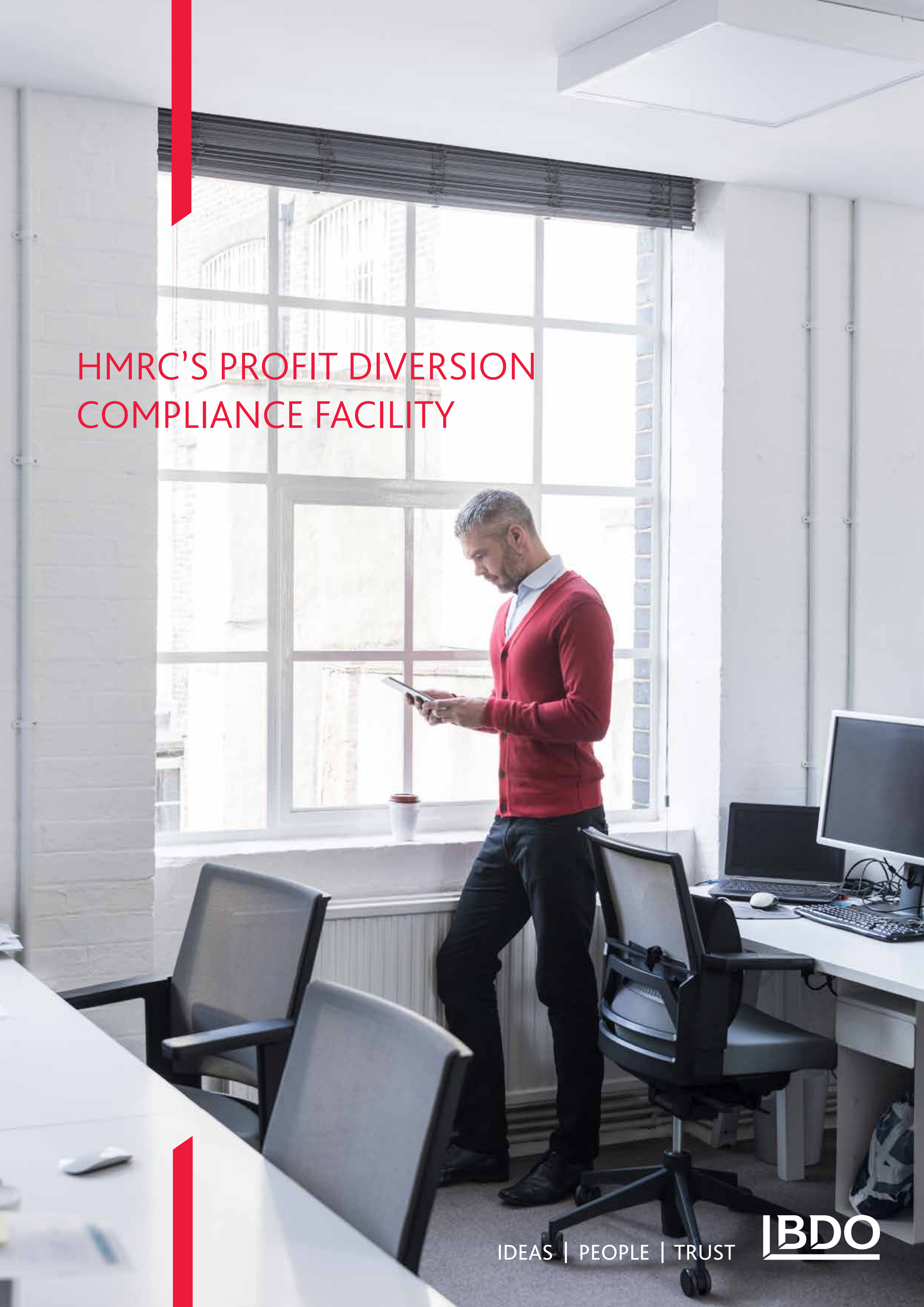
HMRC'S PROFIT DIVERSION COMPLIANCE FACILITY



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HMRC'S PROFIT DIVERSION COMPLIANCE FACILITY

On 10 January 2019 HMRC launched the Profit Diversion Compliance Facility (PDCF). This has been prompted by HMRC research and data analysis which indicates that a number of multinational companies are still involved in the artificial diversion of profits from the UK. It usually relates to inconsistencies in adopted pricing policies with the activities and behaviours of personnel within the organisation.

WHAT IS THE FACILITY'S AIM?

The Profit Diversion Compliance Facility (PDCF) is aimed at groups using, or which have used, arrangements which divert taxable profits from the UK to lower tax jurisdictions.

HMRC have said the PDCF's aim is to provide a process through which UK companies and groups can *"review both the design and implementation of their Transfer Pricing policies, change them if appropriate, and use the facility to put forward a report with proposals to pay any additional tax, interest and where applicable, penalties due."*

HOW WILL HMRC IDENTIFY COMPANIES WHO MAY WISH TO DISCLOSE?

HMRC will use a variety of data sources, including publicly available data and accounts to identify groups which it considers may have a transfer pricing or DPT liability. HMRC may write to companies which it considers may need to make a disclosure. These letters are called 'nudge' letters.

WHAT SHOULD WE DO IF WE RECEIVE A 'NUDGE' LETTER?

The first step is to review your transfer pricing arrangements and seek advice to establish whether the group needs to make a disclosure. If no disclosure is needed, then a reply should be drafted to HMRC explaining broadly why this is the case. For large groups, a meeting with their CCM at HMRC may be appropriate. If a disclosure is needed then advice should be sought on whether this facility is the most appropriate way to make the disclosure in the circumstances. Other options are available.

It is important not to ignore the 'nudge' letter. If HMRC does not receive a response then its Fraud Investigation Service is likely to open a Code of Practice 8 (COP8) investigation into the group's tax affairs.

WHAT IF WE DO NOT RECEIVE A 'NUDGE' LETTER BUT ARE CONCERNED?

Again, you should review your transfer pricing arrangements and seek advice to establish whether companies in the group need to make a disclosure.

HMRC may not send a 'nudge' letter to every affected company; so companies cannot necessarily take comfort if they do not receive one of the first rounds of letters sent. Alternatively, HMRC may open an investigation instead.

If companies need to make a disclosure then we can advise on the best process to use in the circumstances and help you through the process from start to finish. Making a voluntary disclosure before HMRC opens an investigation usually results in reduced penalties, if penalties are due.

WHAT IS THE DISCLOSURE PROCESS?

The process starts with the taxpayer registering with HMRC to make a disclosure. Next an initial meeting between HMRC and advisers will broadly agree the work to be undertaken in preparing a disclosure report and the deadline for that report's submission.

The disclosure report must contain a detailed review of evidence setting out the group's operations as well as an analysis of the facts related to legislation e.g. for transfer pricing or DPT purposes. Any computations of tax, interest and penalties arising must be included in the report and voluntary disclosures must include an offer for settlement. The report must be adopted as a full factual disclosure before submission.

For disclosures through the PDCF, HMRC specifies that the disclosure must be submitted within six months of registration unless HMRC agrees a longer deadline. It also aims to reply to PDCF disclosures within three months of submission.

In all cases HMRC will review the reports in detail and may review underlying documents of evidence relied on in the report's preparation. This work involves HMRC's transfer pricing and diverted profits specialists and a consistent approach is taken across different taxpayers' cases. HMRC hopes to accept most disclosures submitted through the facility without change. However, if HMRC considers that any disclosure offers insufficient tax, interest or penalties then it will challenge the report.

Any other tax issues which are identified during the report's preparation must also be disclosed to HMRC. If HMRC considers the disclosure to be incomplete then it will investigate. Such investigations will usually be conducted using its civil powers but if HMRC considers deliberate behaviour to have occurred then it may transfer the case for criminal investigation with a view to prosecution.

HOW MANY YEARS' TAX COULD HMRC COLLECT?

HMRC can assess extra tax for any years in which there are open self assessment enquiries. HMRC will use its standard legislative powers so it is restricted by time limits within which it can issue discovery assessments for other accounting periods.

For corporation tax, HMRC must assess the liabilities within the following time limits from the end of the relevant accounting period:

- 4 years – for returns submitted containing errors despite the company taking reasonable care
- 6 years – for returns submitted continuing careless errors
- 20 years – for deliberate submission of incorrect returns or failure to notify liabilities to tax without a reasonable excuse.

HMRC have set out examples of carelessness in a transfer pricing context and will focus on the behaviours of a taxpayer in giving rise to the error.

HOW WILL HMRC CALCULATE AND ASSESS THE TAX?

The calculation will take into account the facts established during the investigation, the legislation and transfer pricing practices.

Liabilities due under a PDCF disclosure will be collected via HMRC's formal assessment and collection processes. HMRC will consider all cases in accordance with its Code of Governance for Resolving Tax Disputes. This may involve various Boards such as the Transfer Pricing Board and the Tax Dispute Resolution Board depending on the amounts involved and other factors.

If no agreement is reached with the taxpayer then HMRC could proceed formally by issuing assessments, closure notices and/or determinations. The company may then appeal in the normal way.

WILL HMRC SEEK TAX GEARED PENALTIES IF TAX IS DUE?

HMRC will consider whether penalties such as those for failures to notify and/or errors are due, depending on the specific facts of the case. The key consideration is why any errors or omissions occurred. Penalties are likely if tax arises despite advice being taken (e.g. if there are implementation issues) or if no advice was taken.

Penalties may be up to 100% of the tax being assessed as a consequence of the disclosure or investigation. Penalties may be lower if a voluntary disclosure is made before HMRC starts an investigation. They may well be nil if a correct, full voluntary disclosure is made and there was no deliberate wrongdoing.

HOW DOES THIS LINK TO OTHER REGULATORY AND COMPLIANCE INITIATIVES?

Making voluntary disclosures about tax process errors and failures is nothing new and the Senior Accounting Officer (SAO) legislation has, for almost ten years, required organisations to disclose where there are not appropriate tax accounting arrangements. These disclosures have often included commentary relating to transfer pricing and other cross-border corporation tax issues.

In fact, section 4.4.4 of the HMRC guidance on the Profit Diversion Compliance Facility specifically refers to the SAO provisions and it is good to note that HMRC states that where a business "makes a full and accurate disclosure through the facility … this will not, of itself, be used by HMRC as a reason to consider a possible related past SAO main duty failure or inaccurate submission of a SAO certificate." However, the overlap is clear.

It is also important to remember that identifying a potential matter for disclosure and 'turning a blind' eye, or seeking to brush it under the carpet could be viewed by taxation authorities as an act of deliberate non-compliance. There may well also be wider implications under the Criminal Finances Act, and specifically the Corporate Offence of Failure to Prevent Facilitation of Tax Evasion.

HOW CAN BDO HELP YOU?

Our award winning Transfer Pricing team was involved in the consultation process of the facility. Our advisers specialise in advising on transfer pricing and other international tax issues as well as dealing with tax authority enquiries. Our Tax Dispute Resolution team also works with clients on all types and is experienced in handling complex disclosures and Code of Practice 8 investigations.

Together we can:

- Evaluate the transfer pricing policies adopted by companies as well as the position taken in relation to other international tax issues
- Help clients decide how to respond to a nudge letter, or whether to approach HMRC before HMRC sends a nudge letter or opens an investigation
- Help clients through the process of making a voluntary disclosure to HMRC including using the PDCF
- Resolve Code of Practice 8 investigations, including preparing detailed disclosure reports covering factual and technical matters as well as negotiating settlements with HMRC covering tax, interest and penalties
- Help clients consider whether to progress the case via settlement or appeals.

HMRC's published guidance is available at:
www.gov.uk/government/publications/hmrc-profit-diversion-compliance-facility

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