Transfer pricing and profit diversion: reform for the future

Large Corporate



23 June 2025

We consider the importance of the UK's profit diversion rules and the main points in the current consultations for reform.

Key Points

What is the issue?

Transfer pricing and profit diversion remain a key area of focus for the UK government to ensure that profits generated in the UK are taxed appropriately.

What does it mean to me?

The government is consulting on a package of changes to the UK's legislation concerning transfer pricing, permanent establishments and diverted profits tax aimed at simplifying the tax framework and aligning the UK rules more closely with

international tax standards.

What can I take away?

The proposed changes are intended to address concerns of businesses and tax professionals, but some may bring businesses that previously benefited from exemptions within scope of the transfer pricing rules.

Multinational enterprises with global operations present a challenge for national tax authorities in ensuring fair taxation. Transfer pricing and the diverted profits tax (DPT) are two key mechanisms designed to prevent tax avoidance and ensure that profits generated in the UK are taxed appropriately.

Transfer pricing refers to the rules and methods for pricing transactions within and between enterprises under common ownership or control. Because of the potential for cross-border controlled transactions to distort taxable income, tax authorities in many countries can adjust intra-group transfer prices that differ from what would have been charged by unrelated enterprises dealing at arm’s length (the arm’s length principle).

The UK adopted formal transfer pricing regulations in 1998, aligning with the OECD Transfer Pricing Guidelines to ensure that intra-group transactions reflect market conditions.

The DPT was introduced in 2015 to tackle aggressive tax planning by large multinational corporations. It specifically targets:

- companies that artificially avoid permanent establishment in the UK; and
- transactions that lack economic substance and are designed to shift profits offshore.

DPT is set at a higher rate than corporation tax to encourage those businesses with arrangements within the scope of DPT to change those arrangements (usually by changing transfer pricing models) and pay corporation tax on profits in line with economic activity. Initially set at 25%, the DPT rate increased to 31% in April 2023, reinforcing the UK’s commitment to tackling tax avoidance.

Why transfer pricing and DPT matter

UK transfer pricing and DPT rules aim to:

- prevent profit shifting: ensuring that profits generated in the UK are taxed fairly, rather than being moved to low-tax jurisdictions;
- maintain fair competition: preventing large corporations from gaining an unfair advantage over domestic businesses;
- boost tax revenue: helping the UK government to collect rightful tax revenues to fund public services; and
- align with international standards: ensuring compliance with OECD guidelines and global tax frameworks.

Transfer pricing is sometimes inaccurately presented by commentators as a tax avoidance practice or technique, although the term itself refers to the set of substantive and administrative regulatory requirements imposed by governments on certain taxpayers. However, aggressive intra-group pricing (transfer mispricing) – especially for debt and intangibles – has played a major role in corporate tax avoidance. This was one of the issues identified when the G20/OECD released its base erosion and profit shifting (BEPS) action plan in 2013.

The OECD's 2015 final BEPS reports called for country-by-country reporting and stricter rules for transfers of risk and intangibles but recommended continued adherence to the arm's length principle. The UK has adopted these recommendations.

In January 2019, HMRC launched a Profit Diversion Compliance Facility (PDCF) to encourage businesses to voluntarily review and adjust their transfer pricing positions. It allows businesses to disclose structures or arrangements that may be subject to DPT. The facility provides an opportunity for multinational enterprises to bring their UK tax affairs up to date and avoid potential penalties.

Consultations on reform

During 2023, the previous government undertook a consultation on a package of changes to the UK's legislation concerning transfer pricing, permanent establishments and DPT. Progress on those changes was delayed by the intervening general election. However, in April 2025 the government announced its next steps in this area, and launched a consultation on reforming transfer pricing, permanent establishment rules and DPT, also publishing draft legislation for stakeholder

comments (tinyurl.com/4w4ukxcn).

The proposals aim to:

- simplify the tax framework to reduce administrative burdens;
- align UK rules more closely with international tax standards; and
- address concerns raised by businesses and tax professionals.

This marks a significant step in modernising the UK's approach to international taxation.

The proposed legislation makes a multitude of changes to the UK's international tax rules, most notably reforming DPT by bringing it within the corporation tax charge. Most of the changes were trailed in a consultation response document published in January 2024, and do not come as a surprise. However, there is new clarity about the government's intentions regarding reforming the permanent establishment definition, which was the main aspect of the 2023 consultation on which the previous government did not reach a decision.

The draft legislation and consultation published in April confirm that the government will proceed with aligning the UK's permanent establishment definition with that in the OECD Model Tax Convention, while simultaneously broadening the investment management exemption to address key concerns that UK-based investment managers might be regarded as constituting permanent establishments of the funds for which they make investment decisions (notwithstanding that the funds have third-party investors). The changes to the investment management exemption make clear that commercial investment structures should not be caught.

Overall, we welcome the proposed reforms which will result in some simplification, particularly the repeal of DPT and its integration into corporation tax. This will reduce complexity and align UK tax rules with international standards.

In a separate consultation (see tinyurl.com/mvx5jh5j), the government also invites views on two further changes to the UK's transfer pricing rules:

- Changing the definitions and thresholds around which businesses are within scope of the transfer pricing rules, and removing the current exemption for medium-sized businesses. Although this change would be made alongside taking UK to UK transactions out of the transfer pricing regime (with some

exceptions), this would bring more medium-sized enterprises within scope.
- The introduction of a requirement for in-scope businesses to annually report information about certain cross-border related party transactions to HMRC. The proposed scope includes dealings between a UK-resident company and its overseas permanent establishments, and dealings of UK permanent establishments of foreign-resident companies.

We understand that there is some concern around compliance costs as the new framework may increase administrative burdens, especially for businesses that previously benefited from exemptions.

The closing date for these consultations is 7 July 2025.

The future

For the reasons set out above, transfer pricing and profit diversion continues to be an important area of focus for the government.

The most recent statistics were published in January 2025 for the year 2023 to 2024 (see tinyurl.com/428x5dnk). CIOT discussed these with HMRC as part of our engagement on transfer pricing and profit diversion. It was interesting to put some context around the figures. We were reassured that HMRC has sufficient capacity to deal with advance pricing agreements (APAs) and that all suitable requests for these are accepted into the APA programme.

The time taken for APAs to be agreed and cases brought within the mutual agreement procedure to be resolved may look lengthy but are good by international comparisons. It is important to remember that APAs are usually bilateral or multilateral and so the delivery of them is not solely in HMRC's gift; they involve negotiations with other fiscal authorities, and sometimes more than one. Also, the time periods are less surprising if you consider that it is generally the most complicated cases that go into mutual agreement procedure.

The importance of providing certainty was underlined by the consultation published alongside the Spring Statement on the proposals for advance tax certainty for major projects that was trailed in the Corporate Tax Roadmap (see tinyurl.com/2fu2zp5s). The new process will attempt to avoid duplication, and the consultation document suggests that questions about certainty around transfer pricing will be introduced to

the APA programme.

We suggested in our response that, given the time lag in achieving an APA, while this may be appropriate for agreeing the pricing detail of an arrangement, it would be helpful if the advance clearance process could rule on the basic transfer pricing model design. This would provide an overall understanding at the investment decision point about how HMRC would look at something from a transfer pricing perspective.

This consultation document also confirmed the outcome of the government’s review of the transfer pricing treatment of cost contribution arrangements (contractual agreements between group companies to share the costs and benefits of developing assets such as intellectual property). We welcome that clearance on the validity of a UK entity’s participation in cost contribution arrangements will available under the APA programme.

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