NOTE ON COUNTRY-SPECIFIC ANALYSIS: THE UNITED KINGDOM

Through the collaboration of members of the Inclusive Framework on BEPS, Anonymised and Aggregated Country-by-Country Report (CbCR) statistics have been published. Further information about these data can be found in the Corporate Tax Statistics publication. While these CbCR statistics represent an important new source of data on the global tax and economic activities of multinational enterprises (MNEs), they are subject to a number of data limitations. These limitations are detailed in the disclaimer accompanying the dataset.

A number of jurisdictions have carried out analysis on their CbCR data to investigate the potential impact of some of the limitations for their country data. This document contains analysis carried out by the United Kingdom.

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UK 2017 CbCR statistics – data quality issues

Summary
The UK has analysed its 2017 CbCR dataset to correct for the inclusion of intragroup dividends receivable within reported profit by some multinational enterprises (MNEs). This issue has been identified and acknowledged by the Inclusive Framework, as is set out in the disclaimer which accompanies the third edition of the Corporate Tax Statistics Report.
As an exact estimate of the value of intragroup dividends receivable included in reported CbCR profit is not possible, the UK has analysed its 2017 CbCR dataset in line with a methodology which has been approved by the Inclusive Framework. These corrective steps have identified approximately £55 billion in intragroup dividends receivable included in CbCR profits, which represents 49% of domestic CbCR profit reported by UK MNEs.

The effect of the inclusion of intragroup dividends in CbCR reported profit

1. The UK is committed to Action 11 on the effective measuring and monitoring of BEPS. As part of this commitment, we continue to work within and beyond OECD frameworks to improve the quality of CbCR statistics. This includes the UK's active participation in OECD forums on CbCR statistics, and HMRC's proactive analysis of the UK's 2017 CbCR statistics and extraction of intragroup dividends.

2. As set out in the disclaimer accompanying the OECD's aggregated and anonymised Country by Country Reporting (CbCR) statistics, it is acknowledged that there is inconsistency in reported CbCR profit figures in relation to the inclusion of intragroup dividends receivable, with multinational enterprises (MNEs) taking different approaches.

3. Intragroup dividends receivable are dividend payments from one company to another in the same corporate group. These payments are post-tax distributions of profit and are not subject to UK Corporation Tax (CT) in the hands of the recipient. The inclusion of intragroup dividends receivable therefore has the effect of inflating UK reported profit.

4. As this effect has arisen in the absence of OECD guidance on this point, as opposed to erroneous reporting on the part of MNEs, it has not been possible, nor would it be appropriate, to request that companies amend their CbCR returns to remove intragroup dividends.

5. The UK tax authority (HMRC) has therefore investigated UK CbCRs and has found that many groups have taken the approach of including intragroup dividends receivable in their reported profits, in the absence of OECD guidance on this point. This has led to the inflation of UK CbCR reported profits.

6. There is now consensus within the Inclusive Framework, as reflected in the OECD's updated guidance (published November 2019), that intragroup dividends receivable should be excluded from reported CbCR profit to ensure that the true commercial profit a group generates in each jurisdiction is not misrepresented. This guidance will not filter through into the reports HMRC and other tax authorities receive until 2020.

The UK's approach to cleansing 2017 CbCR data of intragroup dividends receivable

7. The UK's tax authority, Her Majesty's Revenue and Customs ("HMRC"), has undertaken corrective analysis to estimate and extract the value of intragroup dividends receivable included by MNEs in UK profits in the UK's aggregated and anonymised CbCR statistics for 2017, with the intention of improving the accuracy of reported profit figures in line with a methodology which has been approved by the Inclusive Framework.

8. The UK received 394 CbCR reports from UK ultimate parent entities (UPEs) in 2017, with a cumulative reported profit of approximately £110 billion, without any adjustments in respect of intragroup dividends receivable.

9. In order to identify the CbC reports which have included intragroup dividends receivable, HMRC first compared CbCR reported profits with profits reported in companies' Corporation Tax computations to identify unexplained discrepancies. Accordingly, cases in which CbCR profits were greater than profits per accounts, or were within 10% of profits per accounts, were assumed to have been highly likely to have included dividends within CbCR reported profit. This approach identified that approximately 25% of UK headquartered groups had included dividends in CbCR reported profit, resulting in a substantial inflation of UK reported profit.

10. Using an algorithm, Corporation Tax computations of constituent entities of UK subgroups were searched for key phrases indicating the presence of intragroup dividends receivable. The list produced by this algorithm was used to manually inspect constituent entities to extract a value for the intragroup dividends received. These intragroup dividends received figures were then aggregated at the subgroup level and extracted from the reported profit of the UK subgroup, with additional checks to correct for improbable dividend amounts. The total value of dividends extracted for groups we believe had included intragroup dividends received was approximately £55 billion.

11. The inclusion of intragroup dividends receivable in CbCR reported profit is particularly impactful for the UK as a prominent headquarter location for MNEs, with almost 400 ultimate parent entities. Many of these MNEs have large overseas operations, generating significant inbound dividend flows.

12. It should also be noted that HMRC's analysis only covers UK subsidiaries of UK groups. Intragroup dividends receivable may still be included in the reported profit of foreign subsidiaries, meaning that CbCR profits could still be inflated.

Supplementary UK analysis of 2017 CbCR statistics

13. As part of the UK's commitment to working with the Inclusive Framework to continuously improve the quality of CbCR statistics, HMRC have further scrutinised the UK's 2017 CbCR data to identify other significant data quality concerns.

14. This analysis found that whilst the inclusion of intragroup dividends receivable has had a significant impact on UK reported profits, a range of additional adjustments would be needed to make CbCR reported profit approximate taxable profits. It is the taxable profit figure, rather than CbCR reported profit, which is ultimately subject to corporation tax. An effective tax rate derived from CbCR data would be inaccurate, as set out by the OECD's disclaimer.

15. Among these additional adjustments, HMRC analysis has found that loss carry forwards, exempt gains on share disposals and pension contributions to defined benefit pension schemes are particularly impactful:

    a. Loss carry forwards: companies are able to offset their taxable profits with losses realised in prior periods. This ensures taxable profit reflects the economic profit of a business over time. CbCR reported profit does not reflect the impact of losses carried forward from prior years, which may reduce taxable profit.
    b. Exempt gains on share disposals: where certain conditions are met, gains on the disposal of shares are exempt for corporation tax purposes under the Substantial Shareholdings Exemption. This ensures that share disposals are not subject to double taxation and allows groups of companies to restructure without triggering a tax charge. CbCR reported profit is inclusive of exempt gains on share disposals.
    c. Pension contributions to defined benefit pensions schemes: companies are able to offset their taxable profits with contributions to defined benefit pension schemes, as these payments are considered allowable costs incurred wholly and exclusively for the purposes of the trade. These expenses are not deducted from CbCR profit.

16. The significance of these effects, and others, is also captured by the OECD disclaimer published alongside the third edition of the Corporate Tax Statistics Report, which notes that there are many differences between the CbCR measure of profit and taxable profit. These differences, as the disclaimer notes, can lead to inaccuracies which limit the utility of CbCR data for the purpose of corporate tax analysis.