Written evidence submitted by the Chartered Institute of Taxation (FB12)

Finance Bill 2020 Public Bill Committee

Digital Services Tax
Part 2 - Clauses 38 to 71 and Schedules 7, 8 and 9

Executive Summary

The Digital Services Tax (DST) is a unilateral tax measure intended to force the pace of multinational negotiations on reallocating taxing rights over large digital platform-based multinationals.

With effect from 1 April 2020 it taxes 2% of revenues deemed to be derived from such companies' search engines, social media services and online marketplaces. It is expected to raise of the order of £400 million in a full year.

It does not challenge the basic principle that taxing rights belong where value is created rather than where sales are made: its premise is that some value is created in the UK and elsewhere by users of the digital platforms. However, by using revenue attributable to the UK as a proxy for the profits generated in the UK, it is likely to under-tax companies with high profit margins, and could over-tax those with low profit margins.

The attribution of revenues to the UK is potentially complex as users typically access platforms for free.

We understand why the government has introduced the tax and the policy it reflects. We have concerns, including over some uncertainties in its application, but mostly that it risks contributing to a tide of unilateral measures, which bring compliance cost, complexity and double taxation, and ultimately also a less effective basis for combatting avoidance than full multinational agreement.

The government has said they will review the tax in 2025, with a view to repealing it if suitable international agreement is reached.

1. Outline of the proposed Digital Services Tax rules

1.1 The DST will apply to a group's businesses that provide a social media service, search engine or an online marketplace to UK users. These businesses will be liable to the DST when the group's worldwide revenues from these digital activities are more than £500m and more than £25m of these revenues are derived from UK users.

1.2 If the group's revenues exceed these thresholds, its revenues derived from UK users will be taxed at a rate of 2%. There is an allowance of £25m, which means a group's first £25m of revenues derived from UK users will not be subject to the DST.

1.3 The legislation seeks to set out the scope of the businesses and revenue streams that fall within the tax and how revenues should be apportioned between different activities in order to arrive at the amounts liable to the DST. It also sets rules as to when revenues are to be considered as derived from UK users. For example, if advertising (which is a major source of revenue for the companies affected) is directed at UK users, that may be taken as evidence that the UK users have contributed to the value of the platform, and therefore for subjecting that revenue to the tax. The users themselves of course typically access the platforms for free, but for many platforms the ability to attract paying advertisers adds value to the platforms, accepting that this is still largely attributable to the original software development (which for most of the affected companies, mostly took place in the United States).

1.4 The legislation seeks to reduce the instances of double taxation in a rough and ready way, by reducing the revenue chargeable by 50% if it arises from a transaction when a user in respect of a marketplace transaction is normally located in a country that operates a similar tax to the DST.

1.5 Groups will be able to elect to calculate their DST under an alternative calculation. This is intended to ensure that the DST does not have a disproportionate effect on business sustainability in cases where a business has a low operating margin from providing in-scope activities to UK users. This may mitigate the effect of using revenue as a proxy for profit in some cases.

1.6 The total DST liability will be calculated at the group level, but the DST will be charged on the individual entities in the group that realise the revenues that contribute to the total. The group consists of all entities which are included in the group consolidated accounts, provided these are prepared under an acceptable accounting standard. Revenues will consequently be counted towards the DST thresholds even if they are recognised in entities which do not have a UK taxable presence for corporation tax purposes. This is a key reason for the tax being able to access the arguably UK-created value in a way that corporation tax could not easily do.

1.7 A single entity in the group will be responsible for reporting the DST to HMRC. Groups can nominate an entity to fulfil these responsibilities. Otherwise, the ultimate parent of the group will be responsible. The DST will be payable and reportable on an annual basis.

2. Comments on the DST

2.1 The DST was a response to public concern about digital companies in the context of an apparent lack of progress of multilateral negotiations on this specific issue (see Appendix). It was originally announced by then Chancellor Philip Hammond in 2018. Following this there was a consultation which closed in February 2019. Draft legislation was published in July 2019 followed by a further consultation which closed in September 2019. At Budget 2020 the Chancellor confirmed that the DST will be introduced with effect from 1 April 2020.

2.2 In the course of these consultations many problems have been addressed and uncertain points have been clarified.

2.3 Some issues remain, including:
- some businesses are still likely to be over- and others under-taxed by reference to profit margins;

- the bases for attributing revenues to UK platform users will involve judgment and subjectivity, and may be challenged by HMRC, leading to increased disputes;
- the scope of the DST is unclear (especially as regards whether gambling platforms are caught);
- the interaction with other national tax regimes (including broadly similar but subtly different unilateral taxes in other countries) will still mean some double taxation. We remain of the view that this unilateral tax is very much a second-best solution given the downside risks of provoking retaliation which could affect British-based businesses, and / or 'copycat' measures which may be less narrowly targeted.

2.4 The CIOT strongly supports the UK government's aim of a long term reform of the international tax system to address the challenges of the digitalised economy. We welcome therefore, confirmation in Budget 2020 that the government remains committed to a multilateral solution to taxing digital multinational companies, and the commitment to repeal the DST once an appropriate global solution is in place (enshrined in clause 70 of the Finance Bill). Given the importance of maintaining a multilateral framework, we would have preferred to see a sunset clause (which time limited the tax, meaning that active decisions were required to extend the tax beyond the specified timeframe).

2.5 We expect that the general public is broadly behind the DST; particularly at the current time when many online companies are perceived to be doing well as more business is directed online due to COVID-19 restrictions on movement. We suggest that the government and others involved in the public debate could do more to manage expectations as to its likely and possible impact. It should be made clear that the DST is not aimed at protecting the high street from competition from on-line retailers. Nor is it aimed at stopping profits arising in the UK being shifted by multinationals out of the UK to tax havens, as some recent reports have said. By the government's own estimates it is unlikely to raise amounts that materially affect the country's finances particularly in the context of the amounts being spent on COVID-19 measures. Nor will the projected revenues come close to amounts that are often cited as being at stake in media coverage of these issues, based on the revenues that the companies earn in the UK and on apportioning global profit margins accordingly.

2.6 The DST should not be viewed as a long term solution; and questions remain on its scope and impact. We regard it as "rough and ready" and it should be repealed as soon as a better solution is available.

3. The Chartered Institute of Taxation

The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
June 2020

Appendix: Multinational negotiations on international profit allocation ('BEPS' – Base Erosion and Profit Shifting).

1. Very broadly, international agreements allocate taxing rights according to where the value contributing to profit is created (including, for example, where software is developed and intellectual property generated) and not, for example, according to where sales are made. At a high level, this will not change, but it is argued by the UK and many others that the value of widely used software platforms is enhanced by use and, therefore, some taxing right should accrue where the users are situated. Given the actual users typically access platforms for free, the potential complexity of attributing such value is obvious.

2. The much broader G20/OECD Base Erosion and Profit Shifting (BEPS) project began in 2013 as a response to public criticism in the UK and other countries about perceived tax avoidance by multinational groups. It was understood that addressing this issue effectively would benefit from international agreement. The project identified 15 actions in 2015 which are being implemented in various countries, with the UK in the forefront. However, although the digital economy had been identified as a focus of the BEPS project, there were no specific actions as the digital economy could not be separated from the economy as a whole ('*The digital economy is increasingly becoming the economy itself and it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes.*').

3. The challenge of identifying a discrete 'digital economy' is compounded because different business models, types and sizes of businesses and sectors are impacted by digitalisation in very varied ways. However public concern remains and latterly debate has resumed in earnest within the OECD machinery on the 'digitalised economy'.

4. The OECD is continuing work towards a consensus-based, long term global solution which addresses the tax challenges raised. This work is based on the *Programme of Work for Addressing the Tax Challenges of the Digitalisation of the Economy* which was adopted by the Inclusive Framework on BEPS in May 2019 and is due to reach a conclusion by the end of 2020.

5. The shift in taxable revenues between jurisdictions that now seems possible and even likely as a result of the OECD negotiations will not be of the same order of magnitude as would be entailed by a fundamental shift, such as to a sales based allocation. (This would shift billions of pounds of annual revenue from 'home countries' of multinationals such as the US to 'user' countries although it is unlikely that such a shift would be a feasible negotiating objective - or necessarily a desirable one for the UK, as it is not clear that, looking at all sectors, including those such as pharma where the UK is a major 'home country', the UK would ultimately end up a net winner from such a change.)

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