Digital Services Tax: Consultation

Consultation document issued for comment by HM Treasury and HMRC in November 2018

Comments from ACCA
28 February 2019

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GENERAL COMMENTS

ACCA welcomes the opportunity to provide views in response to HM Treasury on digital services tax (DST).

ACCA has consistently maintained that international coordination on such a global challenge as the digitalisation of businesses is paramount. As such, we believe that it would be preferable, both to ensure stability and to provide much-needed certainty to businesses, to implement tax reforms once a multilateral solution has been agreed at the OECD level.

However, we note the political urgency to address the issue. We recognise HM Treasury's intention to avoid disruption to businesses, by restricting the scope of DST to very large, highly digital businesses.

Introducing DST on a unilateral basis, albeit on a limited scope, leads to greater risks of double taxation and disputes. The risks are all the higher, given that the proposed DST is not a listed tax in the OECD Model Tax Convention (as noted in paragraphs 10.16 – 10.19 of the consultation document), and therefore is unlikely to be governed by the terms of existing bilateral double taxation treaties.

In our view, these risks are not sufficiently addressed in the consultation document. We would urge HM Treasury to carefully consider steps to mitigate the risks of double taxation as a matter of priority. We have set out our specific concerns at the end of this document, in the 'ACCA Comments on Chapter 10' section.

With the rapid pace of technological development, the boundary between digital and traditional business models is becoming increasingly blurred. We would urge HM Treasury to consult widely with businesses – not only those viewed as 'digital' businesses – to fully assess the impact of the DST. Further modelling across the large business community may be needed, to minimise the risk that more groups fall within the scope than the policy intended.

AREAS FOR SPECIFIC COMMENT

1. **Do you agree the proposed approach of defining scope by reference to business activities is preferable to alternative approaches?**

It is very difficult to ring-fence the digital economy, and the boundary between digital and traditional business models will become increasingly blurred.

The extent of technological changes means that business profits will be increasingly influenced by intangible drivers of value, which include user participation but covers a much wider range of factors. As such, scoping the DST by reference to business activities is unlikely to remain a sustainable long-term model.

We note that the DST is intended as an interim solution. While ring-fencing business activities may seem a sensible way of ensuring the interim measure does not cause wider disruption and burden, there is a risk that more businesses fall into the scope than intended over time, as businesses increase their digital activities.

As always, care needs to be taken when creating arbitrary regulatory boundaries that do not properly reflect the underlying economic drivers to ensure that the resulting distortions do not outweigh the fiscal impacts.

2. **Do you have any observations on the proposed features used to describe the business activities in scope of the DST?**

The definitions of each of the three in-scope business activities (paragraphs 3.14 to 3.22) are very broad. While on a conceptual level, the presence of an active user base can be expected to generate revenue, the link between user activities and revenue generation can often be indirect.

The wording in paragraph 3.19, which brings in both 'direct and indirect monetisation of users' engagement' with online marketplaces, is particularly concerning. It would be preferable for the scope of DST to be limited to business activities that directly monetise users' engagement only: specifying for example the generation of revenues through online advertising fees, subscription fees, commissions, and sales of data (as mentioned in paragraphs 4.2 and 4.3).

3. **Do you think the approach to scope negates the need for a list of exemptions from the DST?**

In order to ensure certainty, a list of exemptions should be written into legislation.

4. **Do you have any observations on the boundary issues the government has identified or others it has not identified?**

In relation to the boundary between an online marketplace and the selling of own goods, we believe that it will be important to look through legal ownership and consider the substance of transactions, as discussed in paragraphs 3.40 – 3.42.

In relation to the boundary between online content and a social media platform:

- 'professionally-made content' is increasingly hard to define, given the growing professionalisation of influencers

- in cases where a business engages both in the provision of a social media platform and online content, the determination of whether one of the activities is 'of an auxiliary or incidental nature' is very difficult.

5. **Do you have any observations on the proposed approach for attributing revenues to business activities?**

There are likely to be significant challenges for businesses to attribute revenues to in-scope business activities.

This is particularly the case for businesses which do not structure the in-scope activities as separate business lines. For some businesses, an in-scope activity may fulfil an auxiliary function which does not directly generate revenue (for example, online communities, Q&A functions or blog features are likely to fall with the definition of a social media platform). As companies become increasingly digitalised, these activities are likely to increase over time.

In order to minimise the compliance burden, the attribution approach needs to respect the different ways in which businesses organise themselves, ensuring that the information required for the attribution is based upon information already collated for statutory reporting or management reporting purposes.

6. **Do you think there is a need for mechanical rules to guide apportionment in certain circumstances?**

We would not recommend mechanical rules are helpful in this regard. The use of mechanical rules could lead to an increased risk of double taxation and disputes.

8. **Do you think the proposed approach for determining user location for the purpose of the DST is reasonable?**

We do not believe that the proposed approach is reasonable.

It will not be feasible for businesses to determine the residence status of each individual user on their platform.

On the other hand, the flexibility suggested in paragraph 5.13 could, without setting out acceptable options, cause significant inconsistencies in application from one company to another. This would make it impossible for HMRC to verify the basis on which each business has calculated its DST liability.

While some businesses may well collate information on user location, this information often may not sit within tax compliance or financial reporting systems. The determination of the UK user base could therefore require information exchange across discrete parts of the business, which increases the compliance burden and could take time to set up.

There could, additionally, be legal and ethical issues relating to the tracking of user location.

9. **Do you think there is a need for mechanical rules to determine what is considered a UK user in certain circumstances?**

Mechanical rules may help in this regard.

10. **Are there any other circumstances where the treatment of cross-border transactions needs to be clarified?**

It is imperative to address risks of double taxation. All businesses should get their income taxed once and receive a deduction for expenses once. This is an area which the consultation document does not sufficiently address.

Paragraph 5.27 states that the value contributed by UK users would not be recognised in the taxable profits of marketplace platforms. This is incorrect. An online marketplace enabling a UK company to sell a widget to an individual abroad would already have been taxed on the related commissions and advertising revenue through corporation tax.

11. **Do you have any comments on this chapter, and are there any other issues the government needs to consider in relation to the rate, thresholds or allowance?**

We note that the intention is to restrict DST to a small population of highly-digitalised businesses that derive significant value from their UK user base.

It is important to undertake modelling and consult widely across the large business community beyond what may be considered to be digital businesses, to minimise the risk that more groups fall within the scope than the policy intended.

12. **Do you agree that the safe harbour should be based on a UK and business activity-specific profit margin?**

We do not believe that the safe harbour should be based on a UK and business activity-specific profit margin.

A safe harbour based on a UK and business activity-specific profit margin is extremely complex to determine. This requires a profit margin, independent of the group consolidated profit or any inputs into that figure, to be calculated on a basis which may not be related in any way to how the business organises its operations.

For the same reason, the formula set out in paragraph 7.9 would be extremely difficult for HMRC to verify.

ACCA would recommend that the safe harbour be based on the group consolidated profit before tax, as suggested in paragraph 7.21. (Note that the term ‘profit margin’ does not feature in IFRS or UK GAAP. For clarity and to ensure consistent application, the terminology used should be aligned with that of generally accepted accounting standards. Profit before tax would therefore be a more consistently understood measure).

13. **What approach do you think the government should take in relation to the issues identified in determining a UK and business activity-specific profit margin?**

See above.

14. **Are there other elements of how the safe harbour would operate that need to be clarified?**

See above.

15. **Do you agree with the government's characterisation on the circumstances of when the DST will be a deductible expense for UK corporate tax purposes? Are there other issues that require further clarification?**

The restriction of the deductibility of DST as an expense for UK corporate tax purposes to businesses which carry out in-scope business activities in the UK would seem to give rise to a mismatch that could be considered discriminatory. See our comments on Chapter 10 at the end of this document.

18. **Do you agree that the DST should be reported annually?**

Yes. It would not be practicable to require DST to be reported on a quarterly basis.

ACCA comments relating to Chapter 10

The consultation document does not set out any questions in relation to Chapter 10, but we have a number of concerns on this topic which are set out below.

As the commentary in Chapter 10 points out, the DST appears to sit outside of the scope of the OECD's Model Tax Convention (MTC), notably in relation to Articles 2 and 24. This increases the likelihood that the DST would not be governed by existing bilateral double taxation treaties, and therefore significantly increases the risks of double taxation and disputes.

In relation to Article 2 of MTC, the policy focus should not be to design DST such that it falls outside the scope of income taxes. Rather, in order to provide certainty to businesses, government should carefully consider the potential interactions and conflicts between the proposed DST and other taxes, including withholding taxes on royalties and interest.

In relation to Article 24, we note that paragraph 3 of the article states that a permanent establishment which an enterprise resident in a Contracting State has in the other Contracting State shall not be more unfavourably taxed than local enterprises carrying on the same activities. This would not seem to apply to the proposed DST, by virtue of

the fact that the tax is designed to be levied on enterprises regardless of whether they have a permanent establishment in the UK or not.

We are concerned that departing from the principle of taxing enterprises on the basis of the profits attributable to their permanent establishment would increase the risk of tax disputes.

This risk is all the more present, because the proposed DST allows corporation tax deductions to UK entities carrying on in-scope business activities for their DST expense, but denies deductions and credits to entities which do not have a permanent establishment in the UK, and those which have a permanent establishment that is not engaged in the in-scope business activities. The proposal to require non-UK groups to elect a Nominated Company to discharge the groups' DST obligations might also be considered to be discriminatory.

We note further that the revenues in scope set out in this consultation document contradicts the user participation model set out in the OECD's public consultation document published on 13 February 2019. The gross revenue approach set out in this consultation differs from the residual or non-routine profit approach set out in the OECD document (paragraph 24), whereby jurisdictions tax 'the profits that remain after routine activities have been allocated an arm's length return'.