Digital Services Tax (DST)

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| Warning - This article was written when the legislation had not been enacted and so it is subject to change. Please email the author at [Aleem.Islan@aat.org.uk](mailto:Aleem.Islan@aat.org.uk) if you think you have identified any inaccuracies. |

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It is proposed that from 1 April 2020, the government will introduce a new 2% tax on the revenues (“UK digital services revenues”) of search engines, social media platforms and online marketplaces which derive value from UK users. There is an allowance of £25million, which means a group’s first £25million of revenues derived from UK users will not be subject to DST. The DST will apply to revenue earned from that date.

HMRC will be responsible for the collection and management of DST.

**Summary**

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

**Why has DST been introduced?**

It is the government’s view that, “*the current corporate tax rules for businesses operating in the digital economy has led to a misalignment between the place where profits are taxed and the place where value is created. These digital businesses derive value from a user base where the users are in different countries.*”

Currently, the international tax framework does not take into account the value a business derives from user participation when allocating the profits of a business between different countries. The government’s view is that this measure will ensure that “*large multinational businesses make a fair contribution to supporting vital public services*”.

Businesses could make the counter argument that there is a virtually unlimited demand for public services and there is no rationale that large multinational businesses should pay for public services (e.g. unemployment benefits) that they largely do not use, and the public services that they do use they pay for in other ways (e.g. business rates on land and buildings, road tax on company vehicles, employer’s National Insurance etc).

The business may be paying taxes on its profits in another country so paying taxes on its UK digital services revenues would mean that it is being taxes twice. The government is aware of this issue and it was discussed <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-07-11/HCWS1713/> in Parliament.

The government still believes the most sustainable long-term solution to the tax challenges arising from digitalisation is reform of the international corporate tax rules and strongly supports G7, G20 and OECD discussions on the different proposals for reform. The government is committed to dis-applying the DST once an appropriate international solution is in place.

The announcement of the DST in Budget 2018 was followed by a consultation which closed in February 2019. The government is not consulting on the detail of the draft legislation.

Look out for the guidance that, according to the Treasury, will be published by April 2020 to advise of and support these changes. The purpose of this article is to give you some idea of what to expect in the meantime.

**Who will be affected?**

The businesses that will be affected will be “large” multi-national enterprises with revenue derived from providing a social media platform, a search engine or an online marketplace (‘in scope activities’) to UK users.

According to the draft legislation “large” multi-national enterprises are those above the “threshold conditions” which are:

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| Extract from the draft legislation |
| *(1) For the purposes of this Part “the threshold conditions”, in relation to a group, for an accounting period are—*  *(a) that the total amount of digital services revenues arising in that period to members of the group exceeds £500million, and*  *(b) that the total amount of UK digital services revenues arising in that period to members of the group exceeds £25million.* |

The draft legislation includes an anti-avoidance measure if the accounting period is shortened then the amounts mention in (1)(a) and (b) are proportionately reduced.

**What is “UK digital services revenues”?**

This is a group’s revenue for that period that is attributable to UK users. A “UK user” means any person who in the case of an individual, is normally in the United Kingdom and in any other case (i.e. in law, a limited company is a person) is established in the United Kingdom.

The “digital services revenues” are “*the total amount of revenues arising to members of the group in that period in connection with any digital services activity of any member of the group*”.

The legislation refers to “Digital services activity” as providing:

1. a social media platform, which means an online platform where the main purpose is to promote interaction between users and enable content to be shared
2. an internet search engine, which the draft legislation does not provide a meaning for, as the term is understood
3. an online marketplace, which means an online platform where the main purpose is to facilitate the sale by users of particular things to other users. The draft legislation specifically excludes ‘online financial marketplaces’ (e.g. an authorised person within the meaning of the Financial Services and Markets Act 2000).

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 £25million, which means a group’s first £25million of revenues derived from UK users will not be subject to DST.

The provision of a social media platform, internet search engine or online marketplace by a group includes the carrying on of any associated online advertising business. An associated online advertising business is a business operated on an online platform that facilitates the placing of online advertising, and derives significant benefit from its connection with the social media platform, search engine or online marketplace. There is an exemption from the online marketplace definition for financial and payment services providers.

The revenues from the business activity will include any revenue earned by the group which is connected to the business activity, irrespective of how the business monetises the platform. If revenues are attributable to the business activity and another activity, the business will need to apportion the revenue to each activity on a just and reasonable basis.

Revenues are derived from UK users if the revenue arises by virtue of a UK user using the platform. However, advertising revenues are derived from UK users when the advertisement is intended to be viewed by a UK user.

A UK user is a user that is normally located in the UK.

Where one of the parties to a transaction on an online marketplace is a UK user, all the revenues from that transaction will be treated as derived from UK users. This will also be the case when the transaction involves land or buildings in the UK. However, the revenue charged will be reduced to 50% of the revenues from the transaction when the other user in respect of the transaction is normally located in a country that operates a similar tax to the DST.

Businesses will be able to elect to calculate the DST under an alternative calculation under the ‘safe harbour’. This is intended to ensure that the tax 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

The total DST liability will be calculated at the group level but the tax will be charged on the individual entities in the group that realise the revenues that contribute to this 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 thresholds even if they are recognised in entities which do not have a UK taxable presence for corporation tax purposes.

A single entity in the group will be responsible for reporting the DST Tax 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.

**How is it calculated?**

There are two methods.

The group amount of tax is 2% of “UK digital services revenues” above an allowance of £25million. This means a group’s first £25million of revenues derived from UK users will not be subject to DST.

In Example 1 below, the Worldwide digital services revenue is £520million and the UK digital services revenue is £55million.

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| **Example 1 - Charge to DST** |  |
|  | £ |
| Worldwide digital services revenue | 520,000,000 |
|  |  |
| Total amount of UK digital services revenue | 55,000,000 |
| Less allowance | -25,000,000 |
| Taxable amounts | 30,000,000 |
| Tax at 2% x Taxable amount | 600,000 |

There is an alternative basis of charge.

According to the Explanatory Notes to the draft legislation, “*The alternative basis of charge or “safe harbour” will be of value where a relevant activity has a very low or negative UK operating margin. Where an election is made to calculate DST liability for a relevant activity under the alternative basis of charge, it will typically result in a lower rate of DST applying to the revenues attributable to that relevant activity, or where the relevant activity has a negative margin, there will be no liability at all.*”

Example 2 – Please refer to the Spreadsheet (DST Business Y.xlsx) which contains an example that may be used in the HMRC guidance (when it is published) that refers to Business Y.

**Current law**

There is no current law in this area so new legislation will be introduced in Finance Bill 2019-20 to establish a DST.

**Economic impact**

The Treasury estimates that this measure will raise £275million in 2020-21 when the measure beds-in and then expected to continue to increase over time and hit £440million in 2023-24.

The overall impact on business is expected to be negligible.

According to the TIIN, “This measure is not expected to have any significant macroeconomic impacts” and “Other impacts have been considered and none have been identified.” However, according to an article <https://www.telegraph.co.uk/politics/2019/08/02/tax-tech-giants-will-rule-us-trade-deal-us-warns-britain2/> on The Telegraph website the United States administration is warning Britain that it will not get a free trade deal unless a new tax affecting US tech giants is dropped.

**Impact on business including civil society organisations**

The measure is expected to have an impact on a small number of large multinational groups by bringing them into scope of DST the proportion of their revenue that is derived from UK users of social media, search engines or online marketplaces.

The impact will include one-off costs of familiarisation with the new rules and ongoing costs may include keeping records of revenue referable to UK users and calculating and paying the amount of tax due. Businesses in scope will also use a new service in the future to make their annual return of the tax due.

The overall impact on business is expected to be negligible.

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| **Digital Services Tax – useful links** |
| Introduction of the new Digital Services Tax <https://www.gov.uk/government/publications/introduction-of-the-new-digital-services-tax/introduction-of-the-new-digital-services-tax>  Draft legislation (Warning – This article was written when the legislation had not been enacted and so it is subject to change.) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816361/Digital_services_tax.pdf>  Explanatory notes <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816359/Digital_Services_Tax_-_ENs.pdf> |