ICAEW
REPRESENTATION 87/19

DIGITAL SERVICES TAX CONSULTATION

Issued 5 September 2019

ICAEW welcomes the opportunity to comment on the Digital services tax consultation in particular the draft guidance and legislation published by HMRC on 11 July 2019, copies of which are available from this link.

This response of 4 September 2019 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 150,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

ICAEW Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)20 7920 8100 **icaew.com**

GENERAL COMMENTS AND OVERVIEW

1. We welcome the opportunity to comment on the draft legislation and guidance published for consultation on 11 July 2019. This consultation follows up on the earlier consultation document published on 7 November 2018, to which we responded as ICAEW REP 26/19. As we noted in our previous response, we believe that there needs to be clear principles that underpin the taxation of all, and in particular international business, which would otherwise be subject to multiple taxation and an increased level of disputes between the countries in which they operate as to the appropriate taxing rights.
2. In the absence of international agreement we can understand the Government's dilemma about whether it should take pre-emptive action but we are concerned that the draft legislation, although highly complicated, does not set out a sufficiently clear set of principles to underpin this tax and that it contains a number of flaws, some of which are then sought to be addressed through guidance rather than through the legislation itself. As reported below, members believe that the balance between what is in the draft legislation and what is in the guidance needs further consideration and the draft legislation needs to be amended in preference to the guidance.
3. We understand the policy objective to address the current corporation tax rules which can lead to a misalignment between the place where profits are taxed and the place where value is created within the digital economy. In particular, we appreciate the need to consider how the allocation of profits between countries could be more linked to the interaction and engagement with a user base.
4. We welcome HMRC's acknowledgement that the most sustainable long-term solution to the tax challenges arising from digitalisation is reform of the international corporate tax rules and that it strongly supports G7, G20 and OECD discussions in this regard. We note that although it does include a "review" in 2025, a specific sunset clause has not been included in the draft legislation. We would reiterate our earlier recommendation that the legislation should clearly state that at the end of the relevant period, DST is repealed. It would then be necessary to bring separate action, through a Finance Bill, to maintain DST in place if at that time the government considered that to be appropriate.
5. We question whether a tax on revenue can be linked in any meaningful to the actual profits derived from any user base. However, we appreciate that it is a balance between the need to await a comprehensive global agreement and the need to take action now. The introduction of a safe harbour is welcomed, although we are still concerned that low margin businesses could still face a very high rate of tax on UK allocated profits.
6. There is a wider concern over the broader impact which the measure may have. The implementation of DSTs is facing global scrutiny and, in certain cases backlash, from major world economies. For example, the US government have expressed strong concerns about the proposed French DST and although it appears the two parties have reached a compromise about its implementation, the long term future of such unilateral measures remains highly uncertain. Further, given Brexit, the timing for this new tax is not ideal. There is a concern that the introduction of DST could be viewed as a protectionist measure in the wake of already uncertain international trading conditions which could have a wider impact on investment and trade. However, as mentioned earlier we appreciate the Government's longer-term goal of reaching an agreed multi-lateral measure.
7. There has already been global reports that large digital businesses will simply pass on the cost of DST to users in its entirety. Many of these users are in fact smaller businesses themselves. The likely impact of this is not yet clear but it does appear at odds with the policy objective as the increased tax burden is being borne by the users rather than those companies who are generating value from a UK user base. Such an outcome appears to be much more likely where turnover taxes are employed to achieve policy objectives rather than, for example, a charge on profits. However, we appreciate the measures that HMRC has proposed to mitigate the impact of DST.
8. As for the rate of DST, that is a question for government but in accordance with our ten tenets it is important that the rate is set at a fair and reasonable level. The 2% rate is lower

than that proposed in other jurisdictions but whether it is fair and reasonable may only become apparent over time. Similarly, given the potential compliance burdens imposed by the DST, it is important to ensure that smaller digital businesses are not burdened by DST, so the inclusion of a £25m allowance looks reasonable but should be kept under review.

9. More generally, given our comments above about the lack of clarity around the scope of the legislation, we are concerned that and companies may have to incur significant costs, both in professional fees in assessing whether they are within the scope of DST and also reviewing their own internal records (eg, to split revenue streams). More detail is contained on this at [15] where we suggest that it might be more straight forward if internal revenues (ie, sale of own product or search engines within an entity's own website) could be removed from the scope of DST entirely and such exclusion was defined in legislation. Similarly, changes could be made around deadlines and reporting to reduce the compliance burden on affected businesses.

SPECIFIC POINTS

Imbalance between the legislation and guidance

10. There was consistent feedback that the balance between the content of the legislation and the guidance needs to be improved. Members thought that the guidance was seeking to address omissions from the legislation rather than illustrating or explaining terms of the legislation. While we appreciate that this is a completely new tax, it is important that the legislation provides sufficient certainty to taxpayers to enable them to plan their activities knowing how much tax they will have to pay. There is also the issue that guidance cannot be relied on: it can be amended at will by HMRC. It is not satisfactory that taxpayers and their advisers will be relying on guidance in order to address deficiencies in the original drafting of the law.
11. Whilst there are a number of examples which could be drawn upon to illustrate this we have highlighted below some of the key terms which are not defined in the legislation.
    a) A user
    b) The meaning of activity
    c) An online platform
    d) An internet search engine
12. Whilst we recognise that these are common terms and in the absence of any definition it would be reasonable to follow their ordinary meaning, members have highlighted that there will be issues with this in practice. For example many businesses will have multiple domain names or different websites for different jurisdictions. There may be internal traffic between the sites. It is not clear whether the collection of websites would be 'an online platform' or whether the internal activity would form part of one of the defined activities.
13. Of particular concern is that 'activity' is not defined in the legislation. Whilst we appreciate there is some guidance on this, the use of activity is a new concept with most advisors being familiar with descriptions of 'business' and 'trade'. It appears that an activity is more substantive than a business. Whilst there is guidance around this point, we consider there is still significant confusion around what might be caught. The operation of DST relies heavily on businesses being able to correctly identify in-scope activities, not only to assess whether the thresholds are met but also the quantum of any revenues. Given the level of importance of this particular term and lack of any relevant precedent, we do not consider the legislation and guidance to be properly targeted. The legislation and guidance on this aspect needs further work.
14. Conversely, the definition of a UK user in para 5 of the draft legislation is very broad and without the guidance, it would be very difficult for advisors to interpret the legislation to any meaningful level.

15. We welcome confirmation that DST is deductible for corporation tax purposes. While we welcome this statement, for the avoidance of doubt it should be confirmed in legislation. However, there are other areas of uncertainty, for example, will payments of other jurisdictions' DSTs be deductible? Whilst it might meet the 'wholly and exclusively' test, some further guidance would have been welcomed. We would welcome clarification as to what will be the tax treatment if entities are reimbursed DST?

Definition of digital services activities: online marketplace; social media platform and internet search engine

16. Clause 4(4) defines an online marketplace and in the draft legislation there appears to be a lack of clarity as to whether both conditions (a) and (b) need to be met (ie, the 'main purpose' and 'enabling conditions'). If it is both we would suggest including an 'and' after 4(4)a.
17. There is a similar issue at 4(3) in respect of the definition of a social media platform.
18. The definition of an online market place as defined in the legislation could capture internal sales of goods (for example where a platform enables the sale of third party goods but also its own products to users) and is in our view too widely drawn. From reading the guidance we understand this is not the policy objective but as the legislation currently stands there is a lack of clarity.
19. Whilst it may be possible to apportion these revenues to other activity (ie, non digital services activity) on a just and reasonable basis and the legislation does permit this, we think the definition could be tightened to include only the facilitation of sales between external buyers and sellers.
20. Similar issues arise with digital services revenues from an internet search engine. Clearly this is not designed to capture internal search functionality to maximise internal revenues but this is not clear from the legislation as there is no definition included.

Deadlines

21. We welcome the change to make DST payable on an annual basis rather than in quarterly instalment payments.
22. Given the complexities which a business could encounter in identifying and quantifying DST revenues, we are concerned that notification within 90 days of the accounting period is unhelpful. It would make sense to tie this notification into the deadline for filing accounts – 6 months for a plc or 9 months otherwise.
23. We do not think that the legislation should require HMRC to be notified before the payment deadline. If this was a straight-forward tax and the scope of it was clear, we can understand why this route might be the preferred approach eg, income tax or corporation tax. However, this is a very different proposition and we consider businesses will require more time to review their accounting records, analyse and quantify revenues to decide whether they are caught. Clearly there will be some very large digital businesses where this will not be the case but we suspect there will be a number of marginal cases where advice and review will be required. We therefore recommend that the notification deadline should be aligned with the payment date.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).