

Digital Services Tax

April 15, 2020

Background

The Spring 2020 Budget included confirmation that a new UK digital services tax (DST) comes into effect from 1 April 2020. DST was originally announced in the 2018 Budget as a new tax designed to ensure that the amount of tax paid in the UK by large digital businesses is reflective of the value generated from their UK users. The Finance Bill 2020 (FB) provides legislation bringing DST into force. Taking the legislation along with the new HMRC DST manual guidance, clients are now able to get a clearer picture of the scope of the DST.

There had been industry speculation that the UK Government would quietly drop DST, due to pressure from the Organisation for Economic Co-operation and Development (OECD) (who encouraged the UK to wait for a multilateral digital services tax, supposedly forthcoming), and from the United States (who were generally hostile to a tax likely to affect large US businesses). However, the Government has pushed ahead, albeit while stating that DST will be repealed following the introduction of a suitable global digital services tax. There is to be a formal review into DST and the future of international taxation by HM Treasury before the end of 2025.

The New Legislation

Broadly, DST taxes large international businesses that provide online marketplaces, internet search engines or social media (e.g., Amazon, Google and Facebook) on the value that they derive from UK users. DST can be levied on businesses with no UK company or permanent establishment.

The basic threshold for DST to apply is that a company or group's total digital services revenues (not profits) must exceed £500 million in the company or group's accounting period (pro-rated if the accounting period is less than a year), and of that figure at least £25 million must arise from UK revenues. UK revenues above a £25 million threshold will be taxed at 2 percent.

Digital service revenues within the charge are those revenues attributable to UK users derived from digital services activities, namely the provision of a social media service, an internet search engine or an online marketplace. Financial online marketplaces are excluded.

DST can be charged in one of two ways. The first head of charge to DST is on UK digital services revenues arising in an accounting period. Digital service revenues will be attributable to UK users (and thus potentially within the charge to DST), if the revenues: (1) come from an online marketplace and the transaction either involves a UK user, or UK accommodation land; (2) come from online advertising paid for or viewed by a UK user; or (3) are generally revenues from a digital services activity that arise in connection with UK users.

Alternatively, companies or groups within the charge to DST can elect to be charged on an alternate, 'safe harbour' charge. The basis of the alternate calculation looks at the UK operating margin of the activities in question, and would typically be used where the company or group in question has a very low or negative UK operating margin, thus ensuring that no DST needs to be paid where a UK digital services activity is loss-making.

There is a relief of 50 percent available in certain circumstances where a foreign digital services tax is levied due to a foreign user being party to a transaction, in order to mitigate a double tax charge.

Filings and Administration

DST must be paid nine months from the end of the relevant accounting period, and each group company is liable to a proportionate amount of DST based on the amount of UK DST revenue attributable to the individual company.

A group of companies that is within the basic threshold for DST must provide HM Revenue and Customs (HMRC) with certain information through a nominated entity, and has an ongoing obligation to notify HMRC if that information changes, within 90 days from the end of the relevant accounting period or from the date of change. The nominated entity has a duty to keep and preserve records regarding DST.

A return also must be filed by the nominated entity in respect of each accounting period. This return must contain a self-assessment of DST payable. There are interest provisions built into the legislation which engage in the case of late payment and overpayment. Finally, Schedule 7 to the FB contains provisions regarding appeals, assessments and penalties.

Conclusion

The UK Government intends this to be a temporary tax, and work is underway to implement a multilateral tax on the digital economy. However, the introduction of such international legislation is likely to be considerably further down the line, if it appears at all. One of the effects of the COVID-19 pandemic is likely to be that any international agreement on the form and implementation of a digital economy tax may be further delayed.

As such, DST may well be a tax which lasts for several years. Clients should be aware of the implications and obligations arising from falling within the DST charge, and monitor their revenue streams if necessary to assess whether they will be impacted by DST.

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