



Response from ICAS

Digital Services Tax: Consultation

28 February 2019

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to contribute to the consultation "Digital Services Tax: Consultation" issued by HMRC and H M Treasury on 7 November 2018.
3. We welcome the recognition in the consultation document that the ultimate objective is to address the challenges posed by highly digitalised businesses through reform of the international corporate tax framework. We therefore also welcome the proposal for the inclusion of a clause in the DST legislation which will require a review of DST in 2025. It would, however, be preferable if the clause resembled the 'sunset clause' used in the Disincorporation Relief legislation, so that DST would automatically lapse in 2025 unless Parliament took action either to replace it with an internationally agreed alternative, or to ensure it continued.
4. We are concerned that companies will need to undertake significant amounts of work in order to comply with the UK's interim DST; the administrative burden and costs of compliance seem disproportionate for something intended to be a temporary measure. Depending on the approach adopted by the OECD, businesses could also face further significant administrative changes in order to comply with the internationally agreed replacement for DST. Every effort should be made to minimise the burdens on businesses.
5. Another disadvantage of introducing an interim DST is that is highly likely to lead to double (or multiple) taxation. Several other jurisdictions are planning to introduce unilateral measures of their own. The consultation states in paragraph 5.29 that 'the government would intend to negotiate an appropriate division of taxing rights with the other countries which are implementing a DST' but this could be problematic. We discuss this further below, but in summary, the resources which would be required to agree short term bilateral agreements could more usefully be devoted to achieving multilateral consensus for the long term.
6. A tax on revenue rather than profit is sub-optimal as it does not take into account the cost of doing business, and differences in DST policy design amongst different territories will be likely to lead to potentially mismatched positions that could become deeply entrenched in local legislation. Methods to restrict the application of the provisions (i.e. a de minimis threshold and definition of in-scope activities) would be welcomed. However, we believe that it will prove extremely challenging for some businesses to calculate the UK and activity-specific profit margins.
7. Some of the proposed features of the DST are likely to generate complexity and considerable uncertainty. It would be useful for HMRC to provide a formal clearance mechanism for businesses unsure whether they perform in-scope activities or not and to agree the methodology adopted for user allocation. This could also help to establish a consistent approach between businesses; otherwise there is a risk that different business could adopt different approaches to determining in-scope activities or user allocation, which could undermine the effectiveness of the DST and create distortions.
8. We have concerns about how HMRC will be able to audit information provided by businesses within scope and about possible inconsistencies of approach between different businesses. A clearance mechanism could help with consistency. However, HMRC will be very dependent on companies providing accurate data and all relevant information and it is difficult to see how HMRC will be able to perform meaningful checks.
9. Since the publication of this consultation document the OECD has published a consultation on various options for international action, divided into two groups. The first group looks at profit allocation and nexus rules and covers three possible options for changes to the rules based on user participation, marketing intangibles and/or significant economic presence. The second group looks at

measures to address continued profit shifting to no/low tax entities and covers the possible development of two interrelated rules on income inclusion and a tax on base eroding payments.

10. The OECD goal is to produce a final report in 2020 (with an update to the G20 in 2019). This raises the possibility that if the introduction of DST could be delayed by a year, it might be possible to take into account the likely outcome of the OECD discussions – or even to introduce a ‘final’ rather than interim measure in 2021 or 2022. The UK options and timetable should therefore be reviewed in the light of the OECD plans: it would be preferable for the Government’s entire focus to be on helping to produce a successful conclusion to the work of the OECD/G20 Inclusive Framework.
11. Finally, given the ongoing uncertainties presented by Brexit, we believe the Government should be focussed on promoting the attractiveness of the UK for business investment. We do not believe that the rapid introduction of a temporary DST is in line with the objectives of enhancing the UK’s position as an attractive investment destination, or of providing certainty for investors.

Specific questions

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

12. We agree that adopting the second approach (summarised in paragraph 3.3) is preferable to the other approaches outlined in paragraphs 3.2 and 3.4 of the consultation document. Defining scope by reference to business activities seems to provide the best opportunity for targeting the tax in line with government objectives. Option 3 in particular would be likely to affect businesses the government does not want to target with the DST – although it could potentially be simpler to operate. There are, however, problems with the business activities approach.
13. For some groups it may be obvious that their main activities fall within the business activities which will be in-scope, ie provision of social media platforms; provision of search engines and provision of online marketplaces. However, for others there could be difficult boundary issues, giving rise to considerable uncertainty.
14. It would be useful for HMRC to provide a formal clearance mechanism for businesses unsure whether they perform in-scope activities or not. This could also help to establish a consistent approach; there is a risk that different businesses could adopt different approaches to determining in-scope activities which could undermine the effectiveness of the DST and create distortions.

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

15. We consider that the features, as proposed, are too broad and lack the necessary clarity, particularly around the relationship with user participation.
 - Social media platform: Business activities could be caught unintentionally; it is not clear how the ‘central part of the business offering’ tests should be applied. For example, a business might be caught where the business exhibits some of the features, such as sharing content through an online network, but the value created from these activities is insubstantial compared to the core business. Further tests would be required to show beyond doubt that only the intended targets are within scope.
 - Search engines: As with social media, the definition of ‘a central part of the business offering’ needs to be more clearly defined.
 - Online marketplaces: There is a risk that the listed elements could bring into scope businesses where most of the value is internally generated or where there is no strong or direct link between the marketplace activity by UK users and revenue: paragraph 3.19 refers to ‘direct or indirect monetisation’ of users’ engagement. Further tests would be helpful to narrow the scope.

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

16. No. It is not clear how businesses could have any certainty in identifying out-of-scope activities unless the legislation includes the exemptions. Paragraph 3.30 briefly summarises business activities which the government considers should not be within the scope of DST. These definitions will need to be expanded, clarified and included in the legislation; further consultation may be needed on the

details to ensure that they will provide certainty. The exemptions will need to be able to take account of the pace of change of business models in a fast moving sector.

17. As noted above it would also be useful to have a clearance mechanism.

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

18. The boundary issues identified illustrate the potential problems with the business activities approach – and the complexity likely to be involved in implementing it. There is scope for inconsistent approaches to be adopted and for uncertainty. As noted in our responses to Questions 2 and 3 above more clarity is needed on the proposed features for identifying in-scope activities and it will be essential to set out the exemptions clearly in legislation. A clearance mechanism would also help to address some of the issues.

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

19. See our response to Question 6.

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

20. Mechanical rules could be helpful in providing certainty and greater simplicity. It would therefore be advantageous to include them. However, as noted in paragraph 4.15 of the consultation they may cause difficulties for certain business models or could distort behaviour. It should therefore be possible for businesses to elect to adopt a just and reasonable apportionment, instead of using the mechanical rules.

Question 7: Do you have any observations on the proposed approach to defining a user?

21. See our response to question 8.

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

22. We have concerns about how HMRC will be able to check data provided and possible inconsistencies of approach between different businesses. Paragraph 5.23 invites suggestions on how businesses can be provided with certainty that their approaches to user identification and other areas (eg revenue apportionment) are acceptable.

23. As outlined in our response to earlier questions a formal clearance mechanism would be helpful in providing certainty to businesses and could apply to the methodology for determining user allocation as well as to other matters. It would also give HMRC the opportunity to review data provided in support of proposed methodologies. However, given the specialised nature of the data we question how far HMRC would be able to check the data effectively to ensure compliance with the legislation and to ensure that businesses are adopting a consistent approach to interpretation.

24. The 'difficult cases' listed in paragraph 5.20 illustrate the problems which might arise if different businesses adopt different approaches to making a just and reasonable apportionment; one business might choose to include 'difficult' users in a particular category as UK users, but another might exclude them.

25. Collecting and retaining the data which would be necessary to identify user locations, using the methods set out in the consultation document, could also give rise to conflicts with GDPR. Presumably, protection from GDPR could be written into the DST legislation but in view of recent controversy about the use of individuals' data by certain platforms, this might be unacceptable to the public. Further consideration needs to be given to data protection issues arising from these proposals before implementing them.

26. Another overarching concern is that there must be some way to ensure that the same revenues are not subject to multiple DSTs introduced by different jurisdictions. Some agreement with other

countries to ensure alignment on the definition of a country's users would be needed; we discuss this further below.

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

27. Mechanical rules could be useful and might help to ensure a degree of consistency. However, as paragraph 5.18 of the consultation document notes, the appropriateness of mechanical rules would vary by business and a balance would need to be struck between the impact of new information requirements and the need for rules that are as simple and certain as possible. The problem of how HMRC could check information provided would also remain.

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

28. As set out in our general comments an interim DST is highly likely to lead to double (or multiple) taxation. Several other jurisdictions are planning to introduce unilateral measures of their own – this possibility is recognised in the consultation document.
29. The proposed solution, set out in paragraph 5.29, is that 'the government would intend to negotiate an appropriate division of taxing rights with the other countries which are implementing a DST'. However, these arrangements are likely to take time to implement. They are also targeted at cross border transactions and it is unclear whether they would address other issues, such as different approaches to identifying users which might be adopted by other jurisdictions. If definitions of a user are not aligned between jurisdictions, businesses could find that a UK user is also treated as a user by one or more other countries.
30. The resources which would need to be allocated to achieving short term bilateral agreements with other jurisdictions could more usefully be devoted to achieving multilateral consensus for the long term, through working with the OECD/G20 Inclusive Framework.
31. There is a strong likelihood that disputes between different jurisdictions will arise, so MNEs will need access to some form of binding arbitration process to ensure that these can be resolved in a reasonable timeframe. Given that the expectation is that an internationally agreed solution will supersede these unilateral measures, we are concerned that tax authorities may be reluctant to provide the resources to ensure an adequate approach to dispute resolution.

Question 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?

32. The threshold applies on a group-wide basis. However, no definition of group is proposed; this definition will also be important for reporting purposes (and potentially for the safe harbour calculations). In the interests of simplicity, it would be preferable to use a definition of a group which already exists for other tax purposes, rather than creating an entirely new one for the purposes of DST. We suggest that something similar to the SAO approach, which would include a meaningful requirement for UK revenues, should be considered.

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

33. A tax on revenue rather than profit is sub-optimal as it does not take into account the cost of doing business, and differences in DST policy design amongst different territories will be likely to lead to potentially mismatched positions that could become deeply entrenched in local legislation. Methods to restrict the application of the provisions (i.e. a de minimis threshold and definition of in-scope activities) would be welcomed. However, we believe that it would be extremely challenging for some businesses to calculate the UK and activity-specific profit margins.

Question 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?

34. We can see that the UK and business activity-specific profit margin could make sense, for the reasons set out in chapter 7 of the consultation. However, the issues listed in paragraph 7.20 would make it very difficult to ensure consistency of approach and to avoid distortion – and as noted above

we believe calculation would prove extremely challenging in some cases. It is also unclear how HMRC would be able to check the information provided in evidence to support the profit margin used.

35. The alternative approach of using the group's global consolidated profit margin would be simpler and (because it would rely on public accounts information) potentially less open to manipulation. As the consultation document notes it would be a less accurate measure of in-scope business activity performance and the value created by UK users but as the DST is expected to be temporary this might be an acceptable compromise to reduce the administrative burden of DST.

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

36. The proposed value for X in the safe harbour formula is 0.8 – which means that to fall within the safe harbour the profit margin would need to be below 2.5%. The consultation states that 0.8 is a minimum value for X but we believe that further consideration should be given to whether this meets the objective of ensuring DST is proportionate for businesses with very low profit margins.

Question 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?

37. We have no comments on the details of the proposals for making DST a deductible expense. However, we are concerned that adopting this approach, rather than one which would bring DST within double tax agreements and make it creditable, could lead to retaliatory measures from other jurisdictions. There may also be challenges to the government's view (set out in Chapter 10) that the DST complies with its international obligations.
38. There is also a lack of clarity around how the DST would interact with other taxes, for example Diverted Profits Tax and the new tax on offshore receipts arising from intangible property.

Question 16: Do you have any observations on the proposed review clause?

39. As indicated in our general comments our preferred option would be to wait for international agreement on a new approach to taxing highly digitalised businesses. This would avoid many of the problems likely to arise from the unilateral introduction of the proposed DST.
40. We have significant concerns about the additional administrative burdens and compliance costs for businesses which will arise from the need to implement the DST - followed in a relatively short timeframe by an internationally agreed solution.
41. The OECD consultation mentioned in our general comments above had not been issued when the DST consultation was published. The UK options should therefore be reviewed in the light of the OECD plans.
42. If the introduction of DST could be delayed by a year it might be possible to take into account the likely outcome of the OECD discussions – or even to introduce a 'final' rather than interim measure in 2021 or 2022. An international approach to the challenges of taxing highly digitalised businesses is the only realistic long term option. We therefore believe that the Government's entire focus should be on helping to produce a successful conclusion to the work of the OECD/Inclusive Framework.
43. We appreciate that this may not be the government's preferred option, even though the OECD plans include a timeline. We therefore welcome the inclusion of the proposed review clause for the DST. It would, however, be preferable if the clause resembled the 'sunset clause' used in the Disincorporation Relief legislation, so that DST would automatically lapse in 2025 unless Parliament took action either to replace it or to ensure it continued.
44. This would ensure that a proper review of the DST and international developments took place in 2025; otherwise there is a risk that the 'temporary' DST could simply be allowed to continue indefinitely.

Question 17: Do you foresee any difficulties for individual entities to calculate whether the worldwide group is in scope, and if so, how could they be overcome?

45. We believe that the challenges that business will face in trying to determine whether they have in-scope activities cannot be underestimated. As noted in our responses to earlier questions a clearance mechanism for businesses should be provided. Without one we consider that in some cases there will be considerable difficulties in determining whether the group is within scope.
46. A small company which is a member of a large international group might find it difficult to access the information needed to assess whether the group as a whole is within scope or to identify its taxable revenues accurately – particularly if the company is not UK resident and is not responsible for group tax matters. The Nominated Company arrangement might address this problem for many companies.

Question 18: Do you agree that the DST should be reported annually?

47. Yes, we agree that annual reporting would be preferable to quarterly reporting.

Question 19: Do you see any difficulties applying the CT rules for accounting periods for DST, and if so how could they be overcome?

48. No, this seems like a sensible approach.

Question 20: Are there any other issues relating to reporting the government should consider?

49. We do not believe that the proposed notification period of 3 months from the start of the first DST accounting period provides sufficient time for businesses to assess whether they are within scope. This will also present problems for payment in the initial period, as discussed in our response to Question 21 below.
50. As with other aspects of the proposals, we have significant concerns about the administrative burden and the costs of compliance, which seem particularly disproportionate for an interim measure.

Question 21: Do you agree that mirroring the CT framework is the correct approach to minimise the compliance burden? If not do you have a preference for an alternative framework and can you give details of why this is preferred.

51. We broadly agree that mirroring the CT framework makes sense to try to minimise the compliance burden (although that will still be significant). However, the recent changes to the Quarterly Instalment payments rules, to require earlier payments, could present some problems initially. Businesses will need time to establish whether they are in scope (including resolving any uncertainties with HMRC) and to put in place procedures for recording the necessary information.

Question 22: Do you agree that allowing a Nominated Company to act on behalf of the group will reduce the compliance burden?

52. Yes, we agree that allowing a group to appoint a Nominated Company would be helpful in reducing the compliance burden. We can also see the attraction of making the appointment of a Nominated Company mandatory – and making the availability of the allowance contingent on this appointment. Otherwise the nominated company could easily experience difficulties in accessing the information necessary to calculate the DST liability for the entire group.
53. As the consultation document notes in paragraph 12.20, there could be complexity where companies do not have the same AP as the Nominated Company. If the appointment of a Nominated Company is optional, or if companies with different APs could be excluded from the nomination this would be less of an issue. However, if appointing a Nominated Company is mandatory further consideration needs to be given to the treatment of companies with different APs to arrive at an optimal approach.

Question 23: Do you foresee any difficulties with the Nominated Company calculating DST liability on behalf of the whole group?

54. See our response to Question 22.

Question 24: Are there any practical issues around the Nominated Company accessing information from the rest of the group?

55. See our response to Question 22.

Question 25: Would specific rules be needed for companies whose AP does not coincide with the Nominated Company's AP?

56. See our response to Question 22.

Question 26: Do you have any observations on either of the proposed anti avoidance provisions, or other avoidance risks?

57. As noted in our responses to earlier questions it is hard to see how HMRC will be able to check calculations submitted in any meaningful way. Data used for identifying users will be particularly hard to audit as it will depend on a detailed understanding of individual companies' systems. There will be similar issues with revenue apportionment and boundary issues.
58. Even where there is no avoidance intention, different groups could adopt different approaches to identifying users, allocating revenues etc, giving rise to inconsistencies and uncertainty. A clearance mechanism would assist HMRC and businesses and could help to produce a degree of consistency in approach - but would not address the fact that HMRC will be very dependent on companies providing accurate information which HMRC will find it difficult to verify.

Question 27: Do you think it will be necessary to introduce additional rules to ensure compliance with the tax?

59. It is not clear what additional measures could be introduced which would address the problems raised in our responses to earlier questions.

Question 28: Do you have any comments on the summary of impacts?

60. The impact assessment notes that the DST is not expected to directly impact individuals, households and families. It also explains that the measure is expected mainly to affect large multinational businesses. However, it seems likely that the large MNEs paying DST will pass on some or all of the costs.
61. Smaller businesses outside the scope of DST will therefore face increased charges (for example for advertising, or for selling items via a marketplace). These will be passed on to their customers (ie individuals and households) in the form of higher prices.
62. Where they can, large MNEs are also likely to pass on the cost directly to individuals and households, for example, through increased subscriptions (or the introduction of subscriptions). The impact assessment is therefore incomplete.
63. There has already been controversy about the use of individuals' data by certain platforms; if the cost of DST pushes platforms to seek higher returns from exploitation of data there could be unintended and undesirable consequences.
64. Some of the user tracking required for DST could itself conflict with GDPR requirements; as noted above this could presumably be overcome by including protection from GDPR in the DST legislation but this might be unacceptable to the public.
65. A combination of cost and GDPR issues could cause some entities to decide to block access for UK users to some or all of their services, if they conclude that the cost and legal risks of DST mean that UK users become non-viable.