Response to HM Treasury and HMRC

Digital Services Tax: Consultation

On behalf of the UK Computing Research Committee, UKCRC.

Prepared by: Professor Chris Johnson,
School of Computing Science, University of Glasgow, Glasgow, G12 8RZ.
http://www.dcs.gla.ac.uk/~johnson

The UK CRC is an Expert Panel of all three UK Professional Bodies in Computing: the British Computer Society (BCS), the Institution of Engineering and Technology (IET), and the Council of Professors and Heads of Computing (CPHC). It was formed in November 2000 as a policy committee for computing research in the UK. Members of UKCRC are leading researchers who each have an established international reputation in computing. Our response thus covers UK research in computing, which is internationally strong and vigorous, and a major national asset. This response has been prepared after a widespread consultation amongst the membership of UKCRC and, as such, is an independent response on behalf of UKCRC and does not necessarily reflect the official opinion or position of the BCS or the IET.

Response to Questions

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

Yes. The proposals recognise that much value is derived by information bartering between users and corporations, and that much of this bartering is done on speculation by corporations, who cannot in advance anticipate the value they will derive from the data, as this requires insight and research, and may lag by years or even decades. Thus revenue per transaction cannot be the point to be taxed, but rather global revenue per annum divided by the proportion of business conducted in the UK. The following responses build on this concern together with the need to address the underlying principles of taxation - equality, certainty, convenience and economy, when addressing the companies considered to be in scope of the proposed DST.

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

Later sections of the proposal elaborate on the definition of “users” in relation to online market places when, for example, many of the larger Internet retailers allow third parties

to sell their products through the same portal. In such cases, there is a blurring in the distinction between direct sales to the user and an on-line market place, in these subsequent sections it is unclear how these hybrid businesses will be treated. · Further questions stem from whether on-line recommender sites that derive value through the contributions of their users might also fall within scope even though these arguably perform a pubic good in providing consumers with advice over a range of products. The complexity of the business models reinforce the problems in determining certainty over whether a particular business is covered when many existing sites lie in the "difficult areas".

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

No – the market is dynamic and evolving – there needs to be a process of appeal and adjudication with the expectation that this might lead to a list of exemptions, which might form changes to the digital service tax perhaps every 5-10 years with evolving business models for on-line activity. The complexity of the business models again reinforces the problems in determining certainty over whether a particular business is covered when many existing sites lie in the "difficult areas".

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

Yes, the proposals do not consider the practical difficulties in determining ownership when goods may be imported into the UK. How will cross-border issues be addressed? The costs of establishing the time and means ownership for any good traded over the Internet by the HMRC may outweigh any benefits in terms of revenue generation, especially when a transaction may itself be routed via other companies not based in the UK. Later sections refer to the need to establish global agreements under Articles 5, 7 and 9 of the OECD Model Tax Convention, and the associated guidance on transfer pricing and profit attribution – this would seem to be essential.

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

As in the response to previous questions, it is unclear how HMRC would be able to enforce the provision of the DST on companies registered outside the UK (but available to UK users through the Internet) when there may be legal barriers to enforcement of the disclosures required for attribution. How would HMRC obtain information about advertising revenues from a company based in another area of the world in order to levy DST relating to the "participation of its UK user base"? How would any "nominated Company" conduct due diligence to determine the validity of any subsequent report to HMRC? The UK Computing research communities can provide support and direction both on the technical issues that arise and also on potential mechanisms that might be used to overcome some of these potential barriers to the implementation of the DST.

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

Strongly yes – without such rules the HMRC will simply be ignored in many cases and lead to conflict if attempts were made to block UK users participation on sites that did not meet HMRC disclosure requirements.

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

No.

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

No – the proposal lacks any detailed technical underpinning. The only way of determining "participation" of a UK user would be to monitor and presumably then disclose to HMRC when a machine with an IP address located in the UK requested or uploaded material related to an in-scope activity. The practical issues involved in doing this undermine the principal of convenience that should guide any taxation system. In addition, there are ways of undermining such mechanisms and many companies might then require the use of these to access their services within the UK. For instance, routing all requests through a server that prevents the company from determining the location of any user (similar to TOR) or encouraging users to
access the site via overseas proxies.

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

Such mechanical mechanisms need to be very carefully assessed for technical feasibility. There is a strong concern that rules will be developed that could not be enforced given the incentive companies will have (and users also) to find ways around them.

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

There are a host of other situations – where the UK user buys a good from a company in a third country through a marketplace site hosted in a second country. This is one level of indirection but there could be more. The resolution of such situations would seem to require a multi-lateral e-trade agreement. Also, the principal of economy is again called into question when the collecting agency might need not only the commercial but also the technical knowledge to resolve such special cases.

11 Question: 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?

The 2% rate and its application to companies with global revenue over £500M raises the importance of the equity and economy of the proposals. The focus will be on relatively large companies who are, therefore, likely to follow the long-established practice of altering their technical and logistic mechanisms to minimise their tax liabilities. There is a danger that the proposals generate considerable opposition from both users and companies without generating significant revenue.

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

Yes but with the caveats raised above about the technical implications of indirection over digital networks and the very real barriers to determining the accuracy of any assessment submitted by a company with access to proxies etc.

13 Question: 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?

Does HMRC have sufficient technical staff with appropriate levels of digital competency to determine the accuracy of evidence submitted under the election process? Could other arms-length or third party organisations be called on to assist HMRC? UK research bodies are well placed to develop the technological means necessary to resolve such issues.

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

N/A

15 Question: 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?

In general, this is a good characterisation –the complexity of the case studies and the likelihood that there will be further variations in these scenarios stress the importance of *certainty* as a core principle in the design of any taxation system. There is a danger that overseas partners will simply expect UK based companies to meet or contribute towards their wider liabilities under DST as part of the cost of doing business in the UK.

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

This is an essential provision, given both the international dimension raised in the proposal but also the dynamic business models being considered. The date of 2025 is appropriate.

17 Question: 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?

Digital services are unique in the geographical scope of the number of entities involved – these go well beyond dual taxation mechanisms. How would a social media platform cope if every country in which users "participated" were to claim a 2% DST? Earlier responses have also alluded to the practical barriers created by indirection when determining the geographic location of participants in the first place; when growing privacy concerns motivate participants not to disclose this information. The UK computing research community could help HMRC in running a pilot to determine what is and what is not technically feasible within the proposed provisions of the DST.

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

Yes this seems appropriate.

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

There may be a miss-match between overseas accounting periods relevant for determining global liability and the CT assessments used by UK partners. Given the dynamic nature of companies within scope, many companies may become liable for DST part way through a year in which they had not anticipated that liability – it may be necessary to determine whether the imposition of DST might create significant threats to the future health of a rapidly expanding UK company?

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

No

21 Question: 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.

Yes this seems appropriate.

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

Yes

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

There is a lack of detail in terms of the obligations that must be met by a nominated company. Given the ability of companies in scope to minimise existing tax liabilities, there is a concern that nominated companies should have not only the obligations to ensure compliance but also guidance on the level of due diligence that is expected – both in terms of the relevant UK legislation but also in terms of the technical measures that might be used to reduce liability.

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

See previous answer.

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

Yes – see previous comments about the dynamic revenues and margin associated with many companies in scope, the principals of certainty and economy will be even more difficult to sustain when mapping between their Aps and those of overseas partners.

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

The objectives of the anti-avoidance measures seem clear but the mapping between those and the technical underpinnings of network technologies seems to be far less certain. The indirection noted as a concern throughout this response is not simply the result of avoidance but a mechanism that promotes individual privacy and, in other contexts, supports the efficiency/robustness of computational systems. Hence, there will be a host of cases that lead to sustained appeals.

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

Yes this is certain.

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

No.