UK publishes legislation and guidance on digital services tax

Tax Insights from International Tax Services

9 April 2020

pwc

In brief

On 19 March 2020, the UK tax authorities published as part of a **Finance Bill**[1] revised draft legislation for a digital services tax (DST) to begin from 1 April 2020. A series of explanatory notes and guidance materials have also been published up to and including 1 April.

The DST will apply at 2% of deemed UK revenues derived in excess of £25m per annum, where the group's total global revenues from in-scope activities exceed £500m per annum. In-scope activities are those that are derived in connection with providing users with **search engine, online marketplace**, or **social media services**, and includes revenues from **associated advertising businesses**. Thus UK revenues in scope are those linked to UK users but may not be derived from UK sources, and complex allocations may need to be performed by businesses conducting in-scope activities. A safe-harbour for loss making and low margin businesses exists and lowers the 2% rate where applicable.

The definitions included are likely to capture activities of businesses that do not consider themselves pure search engine, marketplace, or social media services. Two notable differences from the draft legislation published in July 2019 are **a revised scope for the definition of a marketplace** and the **reference in each case to services rather than platforms**.

In detail

In-scope activities

The activities in scope of the digital services tax are:

- **Social media activity** – defined to include a service that:
  - promotes interaction between users (including via content provided by other users); and
  - enables user created content to be shared with other users/groups of users.
- **Search engine activity** – not defined but should be considered to only cover an activity that allows users to search the internet: this means search for content outside of the website itself or closely related websites.
- **Online marketplace** – defined to include activity that:
  - facilitates the sale, and in some cases the purchase, by users of particular '**things**': '**things**' is broadly defined, and includes services, goods, or other property;
  - enables users to sell those particular '**things**' to other users, or;
  - advertises or otherwise offers to other users particular things for sale.

Any business undertaking any of the three in-scope activities detailed below will be in scope of DST if the global and UK deemed revenues for those activities (plus revenues from associated advertising businesses)[2] exceed thresholds of £500m and £25m respectively.

A business will not be in scope unless it carries on in scope activities in a **substantial commercial** way (not **incidental** way) and unless it is one of the **main purposes of its activity**.

A listings marketplace – which while not allowing for direct exchanges on the website is set up with the primary purpose of facilitating such exchanges – is regarded as within scope.

There is an exclusion from this category for online financial marketplaces if more than half of the relevant revenues arise in connection with the provider's facilitation of the trading or creation of financial instruments, commodities or foreign exchange, though a service that only trades financial instruments as a principal would not meet the marketplace criteria anyway. The requirement for regulatory approval of an entity in earlier draft legislation has been removed.

Revenues in scope and UK allocation

If the activities of a platform are within scope, it will be key for the group to identify the revenues attributable to each one of the in-scope activities globally, and in connection with UK users.

'**Revenues**' are those received in connection with any in-scope activities. This is intended to be broad, and to capture all monetisation of the activity.

- For a social media service this is most likely to include revenues from advertising, subscriptions/access fees, or sale of data.
- For search engines, this is most likely to include advertising revenues (whether embedded in the search results, or placed on third party websites, or other advertising revenues), and income from the sale of data.
- For online marketplaces, the most likely revenue sources will include commissions, other fees charged to service users, advertising income and delivery fees.

1. https://publications.parliament.uk/pa/bills/cbill/58-01/0114/20114.pdf.
2. Which in isolation would not be included unless the advertising were itself an online marketplace service, which it may often be.

A '**user**' will be any person who engages with a service. This includes individuals, and a non-natural person such as a company.

A '**UK user**' will be any person it is reasonable to assume is an individual **normally located** or a business **established in the UK**. This will require the use of judgement based on the information available to a company. If there are conflicts a company will be expected to use a balance of evidence approach.

In determining '**UK digital service revenues**', a business should seek to assess the revenues generated from an in-scope activity that are attributable to UK users.

Companies will have to apportion revenues affecting both UK users and non-UK users on a **just and reasonable basis**. The legislation allows for any necessary apportionment to be done on this basis. Where one of the users in relation to a transaction is not a UK user, but instead a user of a jurisdiction which applies to the transaction a tax which corresponds to the DST, the business can claim that the revenues from the transaction will be reduced by 50%.

Marketplace transactions that concern the provision of UK land, property and accommodation will be considered UK-linked transactions.

Observations:

Where a service is in scope, incidental revenues from that service will be included.

Businesses in scope of multiple DSTs should note that the allocation of revenues to each country may not be seamless. For example the UK seeks to tax revenues connected to users **normally** located in the UK, whilst the French DST seeks to tax revenues attributable to users' interaction with the service while they are **physically** located in France.

Thresholds and rates

There are two thresholds below either of which a group will not be exposed to UK DST. Both are determined by reference to global group revenues per annum:

- £500m from in-scope activities (whether UK or non-UK revenues).
- £25m from in-scope UK revenues: this amount will also act as an allowance so that only any UK revenue in excess of £25m is chargeable.

A group will consist of a parent company and all its GAAP consolidated subsidiaries (IAS, US, Canada, China, Japan, South Korea; or UK GAAP).

Observation:

The global threshold and the allowance are for a 12 month period. They are prorated for any shorter accounting period. This may include the first nominal period from 1 April 2020 to the next accounting reference date. For example, a business with calendar year accounts will have a nine month nominal period to 31 December 2020 for which the threshold will be £375m and the allowance £18.75m).

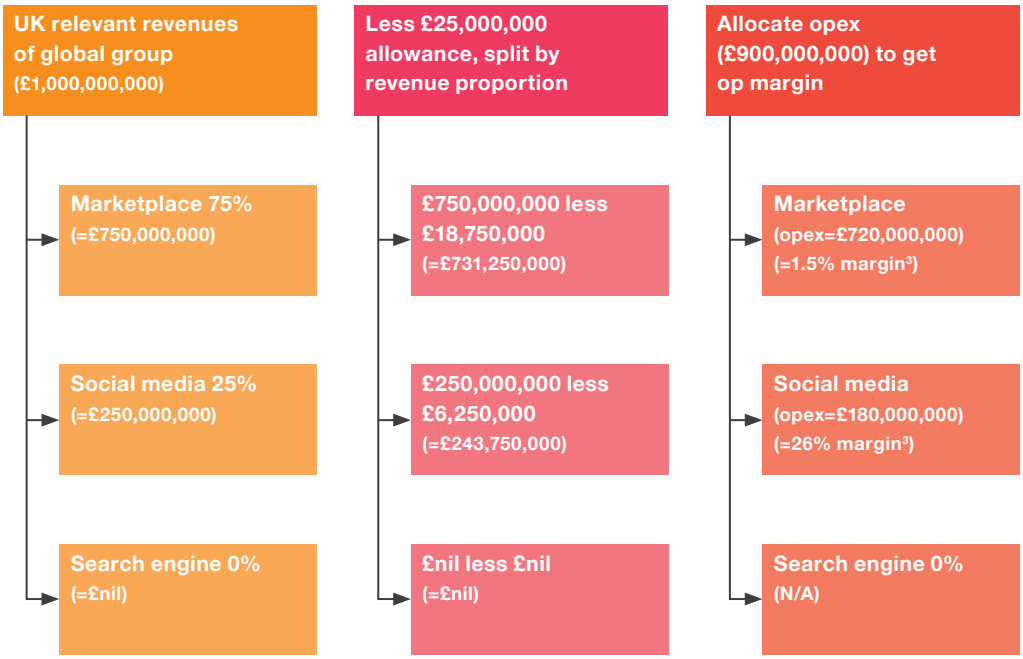
Alternative basis of charge for low margin businesses

A group can make an election to apply instead to any of the three categories of activity a **safe harbour** or **alternative basis** for the charge. Under the alternative basis of charge the DST liability will be calculated as 80% of deemed UK profit related to UK in-scope revenues.

If a group has two in-scope business activities (e.g. an internet search engine and an online marketplace), it could choose to apply the alternative safe harbour basis of charge to one, both or neither of these activities.

Observation:

Under the safe harbour election, the DST tax rate is calculated by reference to the UK operating margin of the activities regarded as in scope. This ensures that if an in-scope activity is loss making, then no DST needs to be paid on the revenues attributable to that activity.



Full rate	2% * 731,250,000 =£14,625,000
SH	0.8 * 1.5% * 731,250,000 =£8,775,000
Safe-harbour election would be made for marketplace revenues only	
Full rate	2% * 243,750,000 =£4,875,000
SH	0.8 * 26% * 243,750,000 =£50,700,000

[3] Rounded to one decimal place for simplicity and ease of understanding.

Payment and compliance

DST is calculated with reference to the revenues earned in an accounting period, in line with the group's financial accounting periods. However, like UK corporation tax rules, if this period exceeds 12 months then this will require two periods of account to be calculated for this purpose instead. The first accounting period begins on 1 April 2020, as noted above, so where groups have to calculate a short period from this date to the end of their accounting period for the first year of application, they will have to allocate revenues accordingly.

While every company receiving in-scope revenues within the group will be liable and responsible for making payments in relation to that share of the revenue, the ultimate parent of the group must deal with all administration in relation to its group (or nominate and resource another nominated company to do so).

The first DST payment is due 9 months after the end of the financial year. For example, a 31 December 2020 year end would be required to pay nine months' worth of DST by 1 October 2021.

This administration includes:

- Registration within 90 days of the end of the first accounting period where the group has sufficient revenues in scope to be liable for DST payments.
- Submission of returns within 12 months of the end of the first accounting period where the group has sufficient revenues in scope to be liable for DST payments (and subsequent amendments in the following two years).
- Correspondence with HMRC in relation to the group's DST liabilities.

The nominated company must determine the group's liability. This includes through calculation of any reduction due to election of the safe-harbour, and deduction of the £25 million allowance. This liability must then be apportioned across group members in proportion with the relevant revenue recognised.

Accruals

Although the first payment for the UK DST is due 9 months after the end of the financial year, companies will need to accrue the tax in the accounts for 2020. At the time of writing, it is still unclear when the Finance Bill will be approved by Parliament (possibly May/June 2020) and subsequently receive Royal Assent (most likely July 2020).

Deductibility of the DST

DST will be an allowable expense for UK corporation tax purposes where it would be under normal rules, as described below. Normal UK corporation tax rules will typically imply that the DST is deductible where it was incurred wholly and exclusively for the purposes of the particular trade subject to UK corporation tax.

The takeaway

The DST is a novel new tax that requires businesses to think about where they digitally interact with other businesses and individuals, not just about where they have physical presence or financial relationships. Businesses that do not consider themselves a social media service provider, search engine or online marketplace may undertake some in-scope activities, and will therefore need to carefully consider these rules to ensure that they are compliant.

The UK is clear that it intends to retain the DST until an acceptable international agreement is reached on reforming the international corporate tax rules – you can see our bulletins and alerts on this **here**[4].

Let's talk

If you would like to discuss how these developments may affect your business, please contact:

London

Giorgia Maffini
M: +44 (0) 7483 378124
E: giorgia.maffini@pwc.com

Phil Greenfield
M: +44 (0) 5953 414521
E: philip.greenfield@pwc.com

Aamer Rafiq
M: +44(0) 7771 527309
E: aamer.rafiq@pwc.com

Mo Jamei
M: +44 (0) 7706 284735
E: mo.jamei@pwc.com

Charlotte Richardson
M: +44 (0) 7793 580784
E: charlotte.d.richardson@pwc.com