

## Public Accounts Committee Inquiry: Digital Services Tax

### Response by the Chartered Institute of Taxation

#### 1 Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 The Public Accounts Committee (PAC) has opened an inquiry into the Digital Services Tax (DST) introduced by the government in April 2020, requesting evidence on the questions that it intends to explore with senior officials at HMRC and HM Treasury, as set out in the call for evidence. We note that the PAC is looking at the DST alongside a report by the National Audit Office (NAO), which is undertaking a similar review of the DST. The NAO published the report of its findings on 23 November 2022.
- 1.3 The DST was introduced as a temporary measure ahead of a multilateral solution to the challenges arising from the digitalisation of the economy. We welcome that the government expects to remove the DST when international reforms proposed by the OECD are agreed. We agree with this and think that national digital taxes should only be temporary stopgaps. However, although work on a multilateral solution is progressing, it is not clear when it will be possible to retire the DST. In the event that the so-called ‘pillars’ (and Pillar 1 specifically) of the OECD proposals (see paragraph 3 below) are not introduced globally, and the UK decides to continue this tax, the UK should take the opportunity to review it, with a view to making improvements.
- 1.4 As a revenue based tax, the DST is a blunt instrument that cannot accurately represent the tax on the profits related to user based value on all businesses on which it is imposed. Inevitably the computation of the tax relies heavily on information held by companies outside their accounting systems and, overall, in practice HMRC has to rely on companies to arrive at a ‘best estimate’ of the amount of the DST payable based on a just and reasonable estimate of the UK revenues liable to the DST, requiring a pragmatic approach to compliance. This can lead to inequity between taxpayers and an unstable tax base, which is a risk that must be managed.

- 1.5 We question whether the DST has met public expectations. It is not clear that the DST has produced results on a scale that has changed the public perception of the way that multinational enterprises (MNEs) are taxed. In relation to the implementation of the OECD reforms, and generally, we suggest that greater efforts are needed to improve public understanding around the international taxation of MNEs.

## **2 About us**

2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2 Our stated objectives are for a tax system that includes:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

Our comments below explore the questions asked by the call for evidence in light of these objectives.

2.3 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

2.4 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

2.5 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

## **3 What the DST is and why it was introduced**

3.1 The DST was introduced as a temporary measure ahead of a multilateral solution to the challenges arising from the digitalisation of the economy. The long-standing approach to corporate tax globally is to levy tax based on the profits or losses attributable to the physical presence of the company in a particular jurisdiction. In October 2021, the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) reached an agreement on a two-pillar solution to reform the international tax framework in response to the challenges of digitalisation. Pillar 1 for the first time attributes part of the value from digital transactions to the market where the consumers/users are based. It does this by firstly attributing a 'base' profit to the locations where physical activities take place and then allocates 'excess' profits to the 'market' countries. The proposal applies

only to the largest and more profitable multinationals (those with group sales of at least €20 billion and profitability greater than 10%). Pillar 2 intends to ensure that large MNEs pay a minimum rate of 15 per cent corporation tax (or their version of it) in every country they operate in (Pillar 2 will apply to groups that have an annual revenue of more than €750 million). This historic agreement is welcome in its aim to bring the international corporate tax framework up to date, as well as to introduce more transparency and fairness in the global tax environment.

- 3.2 The UK (and other countries) have introduced digital services taxes in advance of the adoption of Pillar 1. As noted in the call for evidence, the government expects to remove the DST when international reforms proposed by the OECD are agreed. Specifically, the proposals for Pillar 1 (that involves a partial reallocation of taxing rights over the profits of MNEs to the jurisdictions where consumers are located) include provision for the withdrawal of all existing digital services taxes and relevant similar measures, and say that there will be a commitment not to introduce these in the future.
- 3.3 We agree with this and have always said that national digital services taxes should only be temporary stopgaps ahead of the forging of an international consensus on how the digital economy – and MNEs in general – should be taxed. Uncoordinated unilateral measures like the DST inevitably lead to less alignment of tax bases globally, resulting in double taxation and a significant compliance burden for businesses, not to mention the risk of retaliatory action, all of which stifle economic growth and innovation. The United States, in particular, has considered retaliatory action and has reached agreement with the UK, France, Austria, Italy and Spain that DSTs will be withdrawn once Pillar 1 takes effect, with credit against Pillar 1 taxes for amounts paid under DSTs. However, we would also note that, although there is a blueprint for Pillar 1, a fully worked through global agreement for the new rules seems a long way off, and even once an agreement has been reached, a new multilateral treaty will be required to implement Pillar 1. The signing and ratification of this will take time to come into effect, alongside new domestic provisions. Thus the timetable for when the DST can be retired remains uncertain. Further, in the event that the Pillar 1 is not introduced globally in the short to medium term, and the UK decides to continue this tax for a longer time than currently anticipated, the government should take the opportunity to review the detailed provisions and practice in applying them; with a view to making improvements.
- 3.4 The overall aim of the DST (introduced before agreement on the two-pillar solution was reached) was to ensure that digital businesses pay tax reflecting the value they derive from the participation of UK users. This flowed from the principle, which we agree with, that the profit of an MNE should be taxed where the value that generates the profit is created.
- 3.5 At the time of the consultation on the design of the DST, we broadly agreed with the proposition that some interactions with ‘users’ can create value for certain highly digitalised businesses (although we noted there is not universal agreement on this<sup>1</sup>); and that the lack of taxation of user created value is a challenge to fairness and acceptability of the system. However, we also said that it should be recognised that the taxation of user created value is about the allocation of taxing rights over the global profits of a business and will not, itself, raise more taxes overall. The fact that user created value is not taxed in the country of the user does not necessarily mean that the profits attributable to it are not taxed, just that under the current framework the right to tax them rests elsewhere. Furthermore, whilst user created value may raise amounts of tax that are worth collecting for jurisdictions that have a large user base, it is unlikely to raise amounts that materially affect the country’s finances (especially when compared to the broader impact of implementing turnover

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<sup>1</sup> It is still debated precisely how the value is created: is the value created by the demand in the market or is it created by the intellectual property, technology and ideas developed in the residence jurisdiction? A digital services tax focuses on the market. It does not allow for the taxation of the value created by the intellectual property or the development of a technology (for example, a platform and smart codes).

based taxes to supply chains, of moving away from the international consensus and the potential impact of retaliatory measures).

- 3.6 We remain of the view that the DST is not an accurate or consistent representation of the user value that is being targeted. We also understand that there is an economic perspective that turnover taxes are distortive for investment as they are gross taxes and, hence (differently from VAT) they do not allow the deduction of input costs. This feature provokes cascading effects on the economy (multiplying the tax where the final output for the consumer is the product of more businesses' efforts) which can be harmful for investment. There is also anecdotal evidence showing that the DST has been passed on to customers, as is the case with VAT, which challenges its policy intention of taxing MNEs.

#### **4 How HMRC managed risks when implementing the DST**

- 4.1 When it was being designed, we welcomed that the government sought to ensure the DST would be narrowly targeted, and be set at a relatively low rate of tax (for example, compared to what was proposed at EU level). As we say above, in our view any revenue based tax is a blunt instrument that cannot accurately represent the tax on the profits related to user based value on all businesses on which it is imposed, therefore a lower rate of tax is ultimately less damaging to the economy, whilst still raising additional revenues for government.
- 4.2 We broadly supported the proposed design of the tax, as the most practical approach available to achieve the policy aims. However, being a tax on revenues, we said that the DST would over-tax some companies and under-tax others. Inevitably the computation of the tax relies heavily on information held by companies outside their accounting systems. The information that is available to companies in order to arrive at the amount of DST payable varies from business to business. Although some companies may have had sufficient information available to them to provide a detailed method of allocating value/income to users, many did not, and had to invest and change their systems to be able access the data necessary to calculate the DST tax base. In any event, the information available to each company will be different and it will come from a variety of sources across the business records and systems of companies. Our overall conclusion was that in practice HMRC would have to rely on companies to arrive at a 'best estimate' of the amount of the DST payable based on a just and reasonable estimate of the UK revenues liable to the DST. There would be no third party data available to HMRC to support its compliance activities. To date HMRC has not begun to challenge the DST liability of taxpayers and it is not clear, therefore, what HMRC's approach will be to the data that has been used by businesses.
- 4.3 We encouraged HMRC to deal with these inevitable risk factors by ensuring a pragmatic approach to compliance. We note that the NAO report says that most businesses noted that HMRC tended to be helpful when contacted and took a flexible and proportionate approach to how groups calculated their DST and we understand that is also the experience of our members. However, we also understand that HMRC have progressively adopted a stricter interpretation of their own guidance whenever there is no clarity on how the rules should be applied in practice.
- 4.4 At the time of the introduction of the DST we suggested that a tax operating in this way will inevitably lead to inequity between taxpayers and an unstable tax base: taxpayers with very similar businesses may end up paying different amounts of DST, either as a result of different levels of information available to them or by simply arriving at different just and reasonable answers. This dynamic was seen when the patent box moved to a nexus approach in 2016 which resulted in a difference of treatment depending on whether or not companies were able to track the necessary data. HMRC's approach seemed to be that if a company has the

data and systems in place to track it they must use that data. If not, a just and reasonable position is accepted. This can lead to unfairness between taxpayers due to the different approaches being taken as a result of the underlying systems of companies. The NAO report notes that HMRC have not audited the data underlying DST returns for any group so far, as the focus has been on supporting groups to calculate their liability accurately.

- 4.5 We also said that it was important for the government to consider the public perception of the taxation of the largest digital businesses and the impact of the DST in order to manage expectations as to what it is intended to achieve and what it can achieve. It seemed unlikely, based on the government's estimates of the tax that would be raised, that addressing the user created value issue in this way would remove the public sense of unfairness driven by the fact that many digital businesses (although they have global tax charges at around the UK headline rate) pay very little tax in the UK, despite having a large turnover here. Although the NAO's report notes that HMRC received more in DST receipts than initially forecast<sup>2</sup>, it is not clear that the DST has produced results on a scale that has changed the public perception. It is recognised that these issues continue to be addressed by the two-pillar solution, and this is a lesson which should be learned when implementing the OECD reforms (and is discussed below).

## **5 The lessons HMRC has learned from implementing the DST and how it intends to use them in implementing the OECD reforms**

- 5.1 We mention above the public perception of the taxation of MNEs. We suggest that a public education exercise is still required around the international taxation of MNEs and where their tax burdens fall. The original international tax reforms from the Base Erosion and Profit Shifting project have resulted in much better alignment between the people-based activities of an MNE and its allocation of profits. The UK undoubtedly raises additional corporation tax from the changes. However, there remains a tension between a popular expectation that taxing rights should follow the source of the revenues and the fact that revenue flows have had little impact on the internationally negotiated allocations of taxing rights for decades. As part of this debate it is important to recognise, firstly, that the allocation of taxing rights internationally are a negotiation and, as a result of this, do not necessarily fully follow any particular principle, and, secondly, so far as there has been a prevailing principle, it has been a different one (from following revenue flows), of allocating taxing rights to where the value of the business has been created.
- 5.2 The government announced in the Autumn Statement that it will implement the globally agreed Pillar 2 framework in the UK. This will require that UK-headquartered companies pay additional UK tax where their overseas operations have an effective tax rate of less than 15%. Further, it would set a minimum 15% effective tax rate for UK operations. We – and other commentators - are doubtful that Pillar 2 will raise over £2 billion annually, as the government is predicting. Although the Treasury has not published the detailed calculations, the projections instinctively seem on the high side, given it is likely that most other countries will do as the UK is proposing and 'top up' their own corporate tax before letting the next country up in the chain collect it. It would, in our view, have been more helpful if such detail had been published to support confidence that the UK is indeed likely to collect over £2 billion a year from the change. Another source of uncertainty in relation to Pillar 2 is that the measures that will determine whether a company is above or below the 15% still have not been fully agreed internationally. Our understanding is that while companies' tax experts are expecting an increase in compliance administration as a result of these complex new rules, few of them are expecting to pay significant extra sums in tax as a result. None of this is to say that a global minimum tax is a bad idea. If

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<sup>2</sup> NAO Report (23 November 2022) says 'HMRC received £358 million in DST receipts for the 2020-21 tax year, which was 30% more than forecast. HMRC's initial forecast, in July 2019, expected DST receipts of £275 million for 2020-21'.

sufficient international agreement is obtained the whole process will result in a more level playing field, which should work to the advantage of countries like the UK.

- 5.3 Further, in relation to Pillar 1, there is significant ongoing work and the progress reports published this year (in July and October) by the Inclusive Framework identify numerous open issues. Therefore a fully worked through global agreement remains some way off. Also, Pillar 1 is intended to result in a re-allocation of profits of an MNE to jurisdictions in which goods or services are supplied or consumers are located; it is not intended to give rise to an overall increase in taxation for the MNE.
- 5.4 As noted above, the consultations on the design and introduction of the DST prompted debate around the differences that can arise between what information is required in order to apply the tax and the information that businesses actually have available to them. There is also an underestimation of the time and effort that it takes businesses to re-design their systems, or even build new systems, in order to be able to collect the data that is required. It was recognised by HMRC that, given the nature of the DST, a pragmatic approach would be required in order for it to be implemented effectively.
- 5.5 The two-pillar solution is vastly more complex than the DST from an administrative and compliance perspective. The Pillar 2 rules (expected to be introduced with effect for accounting periods beginning on or after 31 December 2023) will present a huge administrative and compliance challenge for HMRC, as well as for taxpayers, exacerbated by the fact that these are still being developed in some respects by the Inclusive Framework. Pillar 1 will add a further significant compliance burden on MNEs, and we are also concerned about the resourcing burden that will be placed on HMRC as the pillars introduce a whole new level of complication around achieving tax certainty and dispute resolution.
- 5.6 In implementing the OECD reforms we hope that HMRC will build on its helpful, flexible and proportionate approach adopted in relation to the DST around working with businesses in order to assist them with their compliance to the greatest extent possible. However, we recognise that it will be more difficult for HMRC to exercise pragmatism as the UK's rules will be based to a significant extent on the OECD's Model Rules (to achieve global consistency) and the new multilateral treaty.

## **6 Acknowledgement of submission**

- 6.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation  
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