28 February 2019

CBI RESPONSE

HMT and HMRC CONSULTATION DOCUMENT – DIGITAL SERVICES TAX

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Background

As the UK's leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

We welcome the opportunity to provide input into your policy making process for the introduction of a Digital Services Tax (the DST).

We have structured our response to set out initial comments on the consultation before responding to questions raised within the document. We have taken this approach because we believe there are some overarching points in relation to the introduction of the DST, which should be considered prior to delving into the specific detail on the scope, design and administrative requirements.

If you have any questions or would like any further detail, please do not hesitate to get in touch. We look forward to continuing to work with you as your work in this area progresses.

Key points

OECD Progress

The CBI understands the political desire to make progress on the question of how to reflect the increasing digitalisation of the global economy in the tax system, but we do not support the UK Government implementing unilateral measures at this stage. Whilst some members, that have limited, or no online presence, support action by the Government to level the playing field between wholly online and more traditional business models, the majority are opposed to this issue being addressed via unilateral and uncoordinated measures, including the introduction of the DST. Such measures risk creating a complex patchwork of tax policies that increase compliance burdens, uncertainty over tax positions and ultimately damage global trade, cross-border investment and growth. Therefore, it is the CBI's view that such measures should be avoided.

There is widespread consensus that the OECD is the right organisation to lead reform in addressing the tax challenges of the digitalisation of the economy, which is a view shared by both the UK Government and the CBI. The recent progress at the OECD[1], demonstrates a clear political

[1] Including the OECD policy note issued on 29 January 2019 and the OECD public consultation document issued on 13 February 2019, both entitled 'Addressing the Tax Challenges of the Digitalisation of the Economy'

commitment from the 127-member countries of the Inclusive Framework to work towards reaching a consensus on global long-term reform. We consider that the timeline set by the OECD (to achieve a consensus by the end of 2020) is necessary to ensure that time is spent on the important detailed work underpinning a sustainable solution. We would urge the Government not to lose sight of this and believe that the Government should postpone unilateral action at this time. Instead all efforts should be focused on the work being undertaken by the Inclusive Framework to reach sustainable long-term reform at the level of OECD.

Need for economic impact assessment

Revenue-based taxes are economically distortive and have many shortcomings - given the (potentially) distortive nature of the DST, it's important that the Government undertakes a thorough economic impact assessment on the introduction of the DST, including on the wider impact of the tax on the rest of the UK economy. We believe the following are fundamental areas of weakness with this proposal rather than simply questions of design which need to be considered in any impact assessment;

- ***Spill-over effects:*** The introduction of the DST not only impacts those businesses that fall within the scope of the DST, it will also impact those businesses that interact with or rely on in-scope business activities for their own business activity. For example, a business might advertise via a search engine, buy data from a social media platform or sell its products via an online marketplace. The CBI conducted a business survey[2] to examine this in more detail. It found that 51% of respondents anticipated they would be (or may be) within the scope of DST and over 80% of respondents that do not fall within the scope of the DST interact in some form with those that do.

  While there is not enough evidence from the survey to understand exactly what the pass on rate will be to consumers, there is evidence to suggest that in some cases there will be pass-through. In conjunction with evidence suggesting a large number of businesses, including SMEs, rely on in-scope business activities. This indicates that the indirect impacts on both businesses and on consumers could be fairly significant, and there could be distortions created across sectors where reliance is higher. We provide further detail on the results of the survey and the potential associated economic impact in response to question 28.

- ***Impact on UK Consumer Choice:*** Proposals based on taxing turnover create distortions in businesses' decision making which could damage growth. In addition, this proposal represents an increase in both potential reporting obligations and costs for companies making sales to UK customers in those instances where they are unable to pass on the cost of the DST to consumers. Consequently, we believe this could be damaging to UK consumer choice and could discourage multinational groups from operating in the UK, where there is the option for supply chains to be reorganised such that UK sales can be minimised.
- ***Impact on UK exports:*** Proposals based on revenue taxation set a precedent for other countries to follow suit with the potential to damage the competitiveness of UK businesses operating overseas. There is no reason to believe that another country choosing to implement a unilateral solution would apply the same scope and thresholds as the UK, meaning the impact has the

[2] The CBI conducted a survey between 9 January 2019 and 25 January 2019 to understand the wider impacts of a digital services tax. The survey had 210 respondents.

potential to be much wider in these countries (i.e. these unilateral measures could impact more than just technology based and digital activities).

- ***Potential for retaliatory action***: Interim solutions that are adopted by individual countries also risk prompting retaliatory action which could damage global trade and growth. There are specific concerns that the US has been very vocal in its opposition of unilateral digital service taxes[3] - viewing them as targeted at the US technology sector. Some specific concerns by members in this regard are as follows;
  - UK-US relationships are currently particularly relevant in light of the fact that the US would be one of UK's priorities for a free trade deal post-Brexit and implementing a tax of this nature may make negotiations more difficult and less advantageous for the UK.
  - The UK is in a position, that as a result of the decision to leave the EU, UK headquartered groups will no longer be able to rely on the Limitation of Benefits article in the US - European double tax treaties. Resolving issues such as this bilaterally with the US will be made more difficult by the introduction of the DST and the consequence of progress on this issue being delayed is the risk of UK headquartered groups suffering significant withholding taxes costs on dividends, interest and royalties.

Signals sent re. Technology

The Government's Industrial Strategy and its Digital Strategy "set a path to make Britain the best place to start and grow a digital business".

We consider that the DST proposal is not aligned with this broader objective. We consider these proposals could therefore have unintended negative consequences in light of innovation across the whole economy and would affect businesses across all sectors. The CBI acts in partnership Sharing Economy UK, the trade association for the Sharing Economy, many of the members are technology start-ups and share this concern.

[3] Comments made from US official condemning unilateral digital taxes include;

- On the 29 January 2019, the Chairman (Charles Grassley) and a Ranking Member (Ron Wyden) of the U.S. Senate Committee on Finance wrote to Secretary Munchin (U.S. Secretary of the Treasury) and cc'd Robert Lighthizer (United States Trade Representative) to express their "serious concern regarding unilateral action by foreign countries to establish digital services taxes designed to discriminate against U.S.-based multinational companies.". The letter also references that a multilateral solution is needed "that does not create a new transatlantic barrier to trade".
- Chip Harter (a senior U.S. Treasury Official) at an event on digital taxation held in Washington on 3 December 2018, explicitly criticised the UK approach on user participation and also made comments that the US would regard the UK DST as being a covered tax under the treaty. The impact of this would be that US companies would not get any expense relief for the DST and so would be deliberately discriminatory to US companies.
- On 25 October 2018, Steven Mnuchin (U.S. Secretary of the Treasury Treasury), issued a press release condemning the proposals for a specific tax on digital companies. "I highlight again our strong concern with countries' consideration of a unilateral and unfair gross sales tax that targets our technology and internet companies. A tax should be based on income, not sales, and should not single out a specific industry for taxation under a different standard. We urge our partners to finish the OECD process with us rather than taking unilateral action in this area."
- On 31 October 2019, Kevin Brady (House Ways and Means Committee Chairman) released the following statement after the United Kingdom announced plans to introduce a new tax on digital services: "The United Kingdom's introduction of a new tax targeting cross-border digital services – which mirrors a similar proposal under consideration in the European Union – is troubling. Singling out a key global industry dominated by American companies for taxation that is inconsistent with international norms is a blatant revenue grab." "The ongoing global dialogue on the digital economy through the OECD framework should not be pre-empted by unilateral actions that will result in double taxation. If the United Kingdom or other countries proceed, that will prompt a review of our U.S. tax and regulatory approach to determine what actions are appropriate to ensure a level playing field in global markets."

Whilst the UK has many cutting-edge firms at the forefront of technology, lower rates of technology adoption by many firms is holding back the UK's potential. Digital can help the UK to tackle its persistent problem of low productivity growth. Therefore, the Government needs to encourage this in all businesses and recognise the role that tax plays in businesses' decision making and as an enabler of technology. The DST sends a message contrary to this.

Compliance/systems burden

The DST is anticipated to create a significant compliance burden for business. Due to the unique and complex nature of the DST, businesses are likely to be required to invest substantial capital spend and resource in developing systems to capture the data required to assess whether the business is within the scope of DST and if so, the DST liability itself.

We consider that this burden will not be limited to those businesses within the scope of the DST but ultimately fall also those businesses on the peripheries of being within the scope of DST (i.e. on those businesses outside the scope or those on the margins, in view of the broad-brush and highly judgemental approach proposed to defining scope and allocating revenues (which we elaborate on further in our detailed response)). This increased compliance burden placed on businesses operating in the UK may have an impact on the attractiveness of the UK as a place to do business.

This compliance burden would appear disproportionate for a tax that is intended to be temporary and another reason why we would urge the Government to consider delaying the decision to implement the DST until the OECD has concluded its work.

We would hope that following the conclusion of the OECD work there would be no need to implement the DST. However, if the Government felt determined that it should be implemented, for the reasons outlined above it is important that businesses are given sufficient lead time (following detailed legislation and guidance being published) to put in place the necessary systems to ensure they are able to comply with the DST.

GDPR and data ethics

There is an ever-growing spotlight on technology businesses, and in particular on many of the businesses which will be subject to the UK DST, regarding the level of data they store on their users. Tracking user locations is increasingly being seen as ethically wrong, and in some cases legally wrong (as a result of GDPR). Businesses will therefore be presented with a difficult challenge of balancing their obligations in respect of a UK DST alongside wider obligations on data ethics. The consultation is currently silent on these points and we consider that the Government needs to give further thought to these issues prior to implementation.

Our recommendations

Based on the evidence and views of the CBI's membership we are making the following recommendations:

1) We recommend that the Government should continue to focus its efforts on achieving long-term reform through the OECD.

2) The Government should avoid pushing forward with a solution based around the taxation of revenues unless necessary and at a minimum should delay the introduction of the DST until after the OECD has concluded its work, which may render the DST unnecessary/duplicative. The UK may wish to defer consideration of this until 2022 at the earliest. We consider this timeline would provide time for the outcome of the OECD work at the end of 2020 to be considered and following which, sufficient lead time for business to implement the required systems to enable them to comply with the DST.

3) If it is determined that the DST will continue to be implemented, in advance of the OECD conclusions, the design of the DST should be proportionate to its temporary nature and be easy to comply with. We therefore recommend the following changes to its design which would reduce some of the significant challenges we observe:

   - The scope of the DST should be refined to align the scope of the DST with those revenue streams which could foreseeably have a connection with value created by users (i.e. targeted advertising and commissions in the case of online marketplaces). This would ensure that the DST remains in line with the Government's policy objectives "to ensure tax is paid that reflects the value derived from UK users".

     We consider that this would be best achieved by a two-step definition of scope as follows;

     Step 1 – whether a business generates specific revenues streams, being targeted advertising and commissions.

     Step 2 – whether a business carries out an in-scope activity (based on refined definitions to those currently proposed) and that activity is directly monetised to generate either of those revenues outlined in step 1 on a stand-alone basis.

     Incorporated within the scope should be a further exclusion for those businesses where in-scope activities form an insignificant part of the complete business offering, that business would fall outside the scope of the DST.

     We consider these 2 proposals would simplify the compliance burden for some businesses and reduce the judgement and uncertainty in calculating the liability to DST.

   - The safe-harbour design is amended to reduce the multiplier from 0.8 to 0.02. We consider this is necessary to address the fact that the DST will be a disproportionate burden on low-margin businesses and to reduce the instances of the DST being passed-on to consumers where low margin businesses are unable to absorb the tax. We do not consider that the

current availability of the safe-harbour election to just those business models with a profit margin of less than 2.5% is sufficient to address these issues.

- A 'sunset clause' is introduced with effect from 2025. We consider that a legislated end to the DST is needed to represent a clear commitment from Government that the DST will be a temporary measure.

Consultation question response

Chapter 3 – Business activities in scope

Q1: Do you agree the proposed approach of defining scope by reference to business activities is preferable to alternative approaches?

We consider that the proposed UK approach remains broader than intended, with the consequence that in some circumstances there is a disconnect between the scope of the DST and the policy objective "to ensure tax is paid that reflects the value derived from UK users".

We observe two main concerns with the UK approach over alternatives;

- Those businesses with any in-scope activities will be more broadly taxed than under a revenue stream-based approach (such as those proposed by the European Commission and other European jurisdictions in their measures), as for these businesses the DST will apply on **all** revenue streams deemed to be derived from UK users.
- There are additional practical complexities in the design of this approach, over and above an approach that identifies specific revenue streams. These include the challenges surrounding defining in-scope actives and attributing revenue specifically to these activities (we elaborate on these complexities further throughout this consultation response). This in turn creates the potential for a significant compliance burden to be placed on business to comply with the DST, even if they ultimately pay little or no DST.

Definition of in-scope business activities

In part, these concerns arise as the defining features of the in-scope business activities, as currently drafted, can be interpreted as applying to a wide range of business models (which we elaborate further on in response to Q2 below).

User participation is not a proxy for value creation

The second main contributing factor is that, where a business has in-scope activities, the DST as currently drafted will be levied on all revenue streams attributed to that activity, irrespective of whether those revenue streams have any connection to user value. This approach oversimplifies the way in which businesses interact with their user bases and ignores the diverse spectrum and quality of user participation. It assumes where a business undertakes an activity which is heavily reliant on user participation, this is a proxy for value created by these users. We consider that the result of this

oversimplification in the application of the DST is that businesses which have in-scope activities are disproportionally taxed based on the value generated from their users. For many multinationals, users are not the key driver of value but rather other factors such as intellectual property are significant factors in attributing value.

We consider that to meet the policy objective and the DST paid reflects the value derived from UK users, it is necessary to also give consideration to the types of revenue which derive their value from user participation. In the absence of considering revenue streams, alongside in-scope activities, there will be a disconnect between revenues which are driven by user participation and total revenues which are subject to the DST. This is best explained by the following examples.

1) Where a business operates an online marketplace it may generate revenues from both commissions received for the sale of goods and delivery fees. Delivery fees relate purely to fulfilment and logistical activities, and the taxation of this auxiliary function is clearly contrary to the policy objectives of taxing those activities from which users generate value. We observe also that such fees generally represent a lower margin (and often loss making) activity and therefore when applied to gross revenues, this exacerbates the issues of the DST being disproportionately high for these businesses compared to user contribution.

2) In other businesses the in-scope activity may be auxiliary in their entirety to the core business, which is the revenue generating activity. For example, many businesses have a (free) "social media" platform as part of their engagement strategy with their customers. This may take the form of online communities, Q&A sections of websites where users can share knowledge regarding the product offering by the platform or blog features. These (free) "social media" functions are not monetised via advertising but form part of a wider offering and create brand awareness. However, this activity is an auxiliary feature rather than a fundamental part of the product offering (which will be monetised by other means). We observe from the CBI business survey that businesses undertaking such activities are common and we only expect this to increase over time as businesses become more digitalised and respond to consumer trends .[4]

Administrative burden

As the DST is based on business activities rather than revenue streams, this will add a compliance burden for all large businesses to document that they have assessed their activities to confirm whether they have any in-scope activities. There is a high degree of judgement required for business to determine whether they have in-scope activities (with reference to the key elements which would define such activities) in comparison to other alternative approaches (i.e. by reference to specific revenue streams). This issue is in some part exacerbated, by the degree of ambiguity in the proposed definitions (which we discuss further in response to Q2).

As outlined in the example above there are a wide variety of business models that can fall within the social media definition (by virtue of them having some kind of online community including users). Under the current definition of in-scope business activities, particularly the social media definition in this example, irrespective of the purpose of this online community and even though these businesses don't directly 'monetise' their users the business would appear to be within the scope of the DST. Targeting instead the advertising revenues from social media models would take these business

[4]9% of respondents said that some of their activities **would** fall within the social media definition and 16% said some of their activities **may** fall within the social media definition outlined in para 3.14 of the consultation document.

models out of scope and save a huge administrative burden of 'proving a negative' i.e. that users aren't monetised.

Secondly, where businesses have integrated in-scope and out-of-scope business activities they will be required to attribute revenue to the in-scope activities (which in some cases has substantial practical complexities and can create significant uncertainty over approach taken, as outlined further in respect to Q5). This exercise would be simplified where a business would only be required to attribute specific revenue streams to these in-scope activities.

CBI Recommendation

We consider that the introduction of an additional step in determining the scope of DST, by reference to revenue streams which generate most value from user participation would mitigate these adverse issues for some businesses. It would ensure the DST is narrowly targeted on taxing revenues which derive their value from user participation. Secondly it would ease the compliance burden for many businesses who would not have to proceed to the more complex analysis of determining whether they have in-scope activities.

Step 1: To determine whether a business has in-scope revenues, based on revenues streams that derive material value from user-participation (i.e. targeted advertising or commissions from online marketplaces). We consider that advertising should be restricted to targeted advertising only (not static) to ensure this remains aligned with the user value principle.

Step 2: Where a business has in-scope revenues, to determine whether these revenues relate to the in-scope activities (we have outlined in response to those questions raised in the remainder of Chapter 3 of where refinement is needed to the current drafting of these definitions).

We consider that by virtue of market forces there would be little scope for companies to manipulate revenues between different revenue streams in order to avoid DST. We demonstrate this through the following scenarios;

- For an online marketplace, delivery is a developed market where there is a genuine third-party pricing structure for delivery fees. It would be commercially unfeasible to manipulate the level of delivery fee charged as it would quickly become transparent to customers/sellers. In addition, many online marketplaces currently provide sellers with the choice of whether to pay for delivery/logistics or they can provide these services separately. Therefore, if the price for delivery goes beyond market norms, sellers would simply decide to undertake the activity themselves.

- For search engines/social media platforms these business models are often based on offering a free service to users and therefore businesses are unlikely to fundamentally change their business model to start charging a subscription fee to users to supplement a reduction in advertising revenue. Any business that started charging for these services, would be expected to lose market share quickly as users would simply shift to competitors who continue to offer a free service.

We therefore consider it very unlikely that businesses would look to/or even be able to change their business models to mitigate (or reduce) their charge to DST. However, the Government

could consider including a purposive anti-abuse test if they remained with concerns that there may be rare scenarios in which this could happen.

Q2: Do you have any observations on the proposed features used to describe the business activities in scope of the DST?

The definition of in-scope activities is fundamental to narrow targeting of the DST, and (just as importantly) in providing clarity to business where they are not in-scope. This clarity should be provided through well drafted and targeted legislation and supported by HMRC guidance. Given the unique nature of the DST, this will be essential for providing businesses with greater stability, predictability and simplicity in the tax system, which is an important pillar of the competitiveness of the UK's business environment.

We observe that the described in-scope activities by reference to key elements are vague and can be interpreted to apply to an extremely broad range of business models. This highlights member's concerns that the DST will not be a targeted tax as envisaged and could directly impact many businesses operating in the UK.

It is envisaged that most of these businesses will not ultimately have a DST liability however, the DST will create a substantial compliance burden for these businesses in undertaking analysis and evidencing their conclusion that they do not have in-scope activities or, reach the relevant revenue thresholds. This challenge and resource intensive burden of determining whether a business model is in or out of scope would apply equally to HMRC and our members have significant concerns that they are unlikely to have the technical/business resource to address this complex question in a timely and efficient manner to give business the necessary certainty over their tax affairs.

Social media

The definition of social media has the potential to capture numerous situations where there is not a direct link between revenues and user contributions. We observe that the current definition could capture the following scenarios;

- Platforms which provide free content (e.g. online publishers of content), if the authors of that content also happen to read content on the platform.
- Platforms used by businesses for the purposes of engagement and relationship-building with their customers, but which are peripheral to the core business and not directly monetised.
- Arrangements involving sharing or pooling of data across an industry sector via an intermediary platform owner, e.g. insurers pooling insurance claims histories or drivers contributing their own telematics data.
- Business platforms allowing customer reviews of the business's products or services in order to help promote those products/services rather than to target advertising at users.
- There is also currently uncertainty whether telecoms providers could be interpreted as a social media platform given they enable users to share media content such as photos or videos.

CBI Recommendation

We would recommend the definition of social media platform should be narrowed such that it only captures situations where users are generating content through their active participation/interaction with others on the platform **and** where the owner of the platform is able to monetise that content through advertising targeted at users.

Search engines

The proposed definition of a search engine includes "where a central part of the business offering" is to "view webpages beyond those provided by the platform itself". The current terminology with reference to "a central part of the business offering" is ambiguous and could capture external links even where they are an ancillary part of a broader website. Where a link is contained to a third-party site, in some instances it may be difficult for business to conclude this is not part of "a central part of the business offering" as an active decision will have been made to include that link. We understand it is not the policy objective to capture a substantial number of business websites, which do not operate a search engine as their core function, but the current drafting would seem to have that effect.

Furthermore, where businesses do provide links to third party sites, in most instances revenue will not be directly generated from this link. However, the requirement to attribute revenue on a 'just and reasonable' basis to this in-scope activity, will result in an administrative burden for companies to document that revenue apportioned to these in-scope activities does not exceed the revenue thresholds. As we outline further in response to Q5, where businesses have closely integrated functions this process will be highly judgemental, administratively burdensome and costly.

CBI Recommendation

We would recommend the following amendments are made to address this;

- The definition of a search engine should be refined and refer only to those businesses where the operation of the search engine is **the core function** of the business.

- The wording "it generates revenue by monetising users' engagement with the platform and with other closely integrated functions e.g. websites accessed through a web browser" is refined to just capture those instances where the search functionality links to third party sites and those links are **directly monetised** (by way of targeted advertising or commission).

Online marketplaces

We observe that the online marketplaces definition has potential to capture a wide variety of businesses. We observe three specific concerns;

- There are an increasing number of businesses which allow others to use their existing platform and customer base to sell their products, giving rise to an in-scope activity. In many cases, there is very little differentiation, if any, between customers buying products owned by the marketplace, and those owned by a 3rd party selling through the marketplace. It therefore appears very artificial to draw a line between these two activities and say one is in scope and the other out

of scope. Since marketplaces for physical goods are a low margin activity with very minimal user value contribution, we would question whether there should be a specific carve-out from UK DST of physical goods marketplaces, to ensure the DST remains in line with the policy objectives.

- The definition of an online marketplace refers to the vague concept of "indirect monetisation" which could bring into scope ancillary functions. For example, the current definition of an online marketplace may capture franchising arrangements, where it's common for a franchisor to provide a central website to sell the goods of their franchisees. This would be a central part of a business model, as it provides a cohesive brand and seamless customer experience but is not a pure profit activity.

- It will be difficult to achieve consistency in the application of the DST between online marketplaces as the impact will vary significantly based on whether they recognise total revenue from the sale of the good to the customer or they only recognise the commission element of the sale as revenue.

  As recommended in response to Q1, the scope of the DST should be narrowed only to capture those revenues connected to user participation (i.e. direct commissions earned or targeted advertising revenues). This will provide greater clarity for businesses regarding whether they have in-scope activities and target business models that actually monetise the transactions on an online marketplace.

CBI Recommendation

We would recommend the following;

- Specific exemptions are provided for business models which are not anticipated to be in-scope of the DST but there is potential for ambiguity (we elaborate on this further in response to Q3).

- References to indirect monetisation are removed and only activities which are **directly monetised via specific revenue streams** (i.e. by way of targeted advertising or commission) are within the scope of the DST.

Legislative drafting of the key elements

Clarity is also needed on whether each of the key elements, which define each in-scope business activity, need to be met to give rise to an in-scope activity.

We would assume that to meet the definition of a social media platform, search engine or online marketplace a business would at a minimum need to meet all three of the relevant features listed in respect of delivery, functions and monetisation. Furthermore, the example provided in para 3.46 with reference to boundary issues indicates that each of the functions would also need to be met for a business to have an in-scope activity however, this is a point which requires clarification.

Q3: Do you think the approach to scope negates the need for a list of exemptions from the DST?

No. As a first priority we consider that the approach to scope should be refined to ensure the scope is narrowly targeted to only those business models where there is significant user value contribution

(we refer to our comments made in Q1 and Q2). This is fundamental as a specific exemption list is unlikely to capture every business model not intended to be captured by policy objectives of the DST. This will be particularly true in the technology sector where innovation is prevalent, and therefore any exemptions list could quickly become obsolete.

However, we do consider that specific exemptions will complement a refinement in scope and provide additional certainty to a substantial number of businesses, helping to minimise unnecessary compliance burdens. The Government should ensure that statutory powers are maintained to amend the exemption list as needed.

In drafting exemptions, the following should be considered in respect of specific business models.

Financial and payment providers

The consultation paper outlines that financial and payment service providers are not envisaged to be within the scope of the DST however, the current definition of an online market place is not precise enough to exclude financial and payment services activities. Digital activities in the financial services sector are developing all the time and it does not take a particularly broad interpretation of the definitions to catch existing financial services, in particular trading venues.

The consultation paper currently does not provide any commentary on what an exemption for financial and payment service providers would include and our members have concerns that it would be difficult to draft an all-encompassing exemption that reflects all current (and future) financial services business models. We consider that this is another example highlighting the difficulties in defining a narrowly targeted tax by reference to business models and demonstrates the potential for unintended consequences of the DST.

Whilst we don't consider that any exemption list will be sufficient enough to cover all financial services business models, we would recommend the following is included;

- The supply of regulated financial services by regulated financial entities. As is acknowledged in para 3.19 of the consultation document financial services should not be in scope as they "are not considered to derive significant value from user participation and are often subject to unique tax and regulatory regimes already." This would make the position clear and provide certainty for regulated financial entities.
- This exemption would need to include regulated trading venues (whether regulated by the Bank of England, Prudential Regulation Authority or Financial Conduct Authority etc) but unregulated exchanges (such as commodity exchanges and spot FX trading platforms, which are often unregulated) should also be included in this exemption. Many businesses, especially those which extract or deal in commodities, trade products on commodity exchanges as part of their risk management processes to reduce exposure to volatile shocks in commodity prices. This is a particular concern, as whilst the DST would be incurred by the platform (i.e. trading venue), the cost is anticipated to be passed onto the user in this scenario. This would significantly increase the cost of risk management functions which form part of good governance for these industries if only regulated exchanges were exempt.
- We consider that our suggestions in respect to Q7, to refine the definition of 'user' to just include individuals, would limit the number of financial services transactions caught by the tax as business to business transactions would be excluded.

The provision of online content

We consider that an exemption for the provision of online digital content should include the sale of software, apps, eBooks etc and be applicable regardless of whether a business owns the content. This would be necessary to include instances where software/online digital content is sold under an agency or commissionaire arrangement (or even where it is provided for free). We would note as currently drafted the example on this (example 5) is unhelpful in providing clarity on this, as it is restricted to situations where content is created or bought in by the company and thus the example would need to be updated in any future HMRC guidance.

Cloud computing

There should be a specific exemption for cloud computing in the legislation, to ensure there is no uncertainty surrounding whether the provision of such services is in the scope of the DST.

Additional exemptions needed

We consider that the following exemptions would also be required, in addition to those outlined on paras 3.30 – 3.32 of the consultation document.

- ***Pre-installed apps:*** Revenues derived in respect of certain pre-installed apps may fall within the scope of the DST currently. Pre-installed apps can be included on mobile and fixed devices (mobile phones, tablets, laptops, TV's, Cars etc).
- ***Exclusion of Telecoms providers*** – as outlined in response to Q2 above, there is currently ambiguity as to whether telecoms providers could fall within the current definition of a social media platform.
- ***Franchising arrangements –*** please refer to comments in Q2.

Role of HMRC Guidance

The legislation should be drafted in a sufficiently clear manner to remove the ambiguity surrounding the scope of the DST. Whilst secondary to this, HMRC Guidance will play an important role of complementing the specific exemptions provided by legislation. Due to the complexities and intricacies of specific business models it will be essential that HMRC draft this guidance in collaboration with businesses as specific industry knowledge will be required to ensure this is of practical relevance to business.

We would recommend that at a minimum this guidance should provide comprehensive examples of where multinational enterprises will and will not be within the scope of DST. Furthermore, it may be helpful for this legislation to provide specific exemptions for the major industry classifications, this would provide more general assistance to taxpayers in reviewing their business models.

CBI Recommendation

The CBI recommends that refined definitions of in-scope activities should be complemented with specific exemptions to ensure the DST legislation aligns with the intended policy objectives.

These legislative exemptions should be drafted in a sufficiently clear manner to remove the ambiguity surrounding the scope of DST, this legislation should be complemented with comprehensive HMRC guidance. It is essential that a collaborative approach between HMT/HMRC and business is adopted in drafting this legislation and guidance, for it to be of practical relevance specific industry knowledge will be required.

Boundary between marketplace and the selling of own goods

We observe that this boundary issue leads to concern by some members that this could create market distortions. Where businesses provide effectively the same service, how the supply chain is legally structured will determine whether revenues are subject to DST. Care would need to be taken that any approach to address this does not draw an artificial line between business models and the focus remains on the economic substance of the arrangement. This is essential to mitigate the risk of substantial distortions in competition arising.

We believe that there will be significant other challenges faced by business as a result of boundary issues, which are not easily resolved. Some of these challenges are best illustrated by an example, as in the box below.

Example: Challenges arising from boundary issues

A business has two business models:

1) It provides online content and technology tools to institutional customers by way of subscription agreements (the 'paid-for offerings'). The agreements entitle the employees and other affiliates ('users') of the customers to access the content via a platform.

2) The business also provides a separate but related platform for users to share their work, join communities and interact with one another. The business does not charge a fee or otherwise (directly) monetise this activity; rather the value to the business is in encouraging users (and therefore their employers) to maintain or upgrade their subscription agreements for the paid-for offerings.

The users of and contributors to the first platform include considerable overlap with, but are not identical to, the users and contributors to the second platform. In both cases, the business does not track where users are located, it only knows where the customers (i.e. their host institutions) are located. Nor is there any ready means of tracking which users or contributors to the first platform are also users or contributors to the second platform.

In relation to the first business model, ordinarily the business might gain some comfort from the specific exemption for online content but a) the content is not 'bought' from third parties but contributed for no fee to the platform under separate contracts between the business and the contributors and b) some of the contributors of content may – independently – also be users of the platform (though there is no easy way to track whether an individual user is also a contributor). Hence the provision of online content itself could (under the broadest interpretation) be regarded as falling within the proposed definition of a social media platform.

Cont…..

Example cont….

In relation to the second business model, it is unclear whether the platform for the provision of content/technology and the platform for sharing work, communities and interaction would be 'closely integrated functions', so that even if the former (the paid-for offerings) fall outside the scope, some of their revenues be allocated to the second platform (we elaborate on the difficulties of attributing revenues on a 'just and reasonable' basis further in response to Q5).

On one level this example seems similar in concept to other examples provided in the consultation paper, where the benefit to the business is in improving/enhancing its own product offering. However, it is unclear whether either business model described above (or a subset of either) would be regarded as a social media platform and, if it were, it is even more unclear how any revenues might be allocated to it on a 'just and reasonable' basis.

Chapter 4 – Revenues in scope

Q5: Do you have any observations on the proposed approach for attributing revenues to business activities?

The consultation paper observes that in many cases "it will be clear what revenues are generated from an in-scope business activity". Whilst we recognise and appreciate that this would be the case in some instances and therefore the proposed approach will be relatively straight-forwards, we consider that there is currently an underestimation of the complexities many businesses will encounter in this process, especially in highly integrated business models.

'Just and reasonable' apportionment

We note the merits of apportioning revenue to specific business activities on a 'just and reasonable' basis, as this will provide the most economically accurate outcome and for some business it may be simple and clear how to undertake this apportionment. However, the consultation underestimates how challenging it will be for many businesses where they may carry out in-scope activities as part of their business models (please refer to our example in Q4, which outlines the complexities that will arise in just one business model). In these instances, where in and out-of-scope activities are integrated together to form a holistic business offering, it is unlikely that the business will currently be tracking an isolated revenue stream which arises from the in-scope activity alone.

The consultation paper outlines in paras 4.8 and 4.9 that these businesses will be required to undertake an exercise to apportion revenue between in and out-of-scope activities on a just and reasonable basis. This will add a significant compliance burden for these businesses, which will have to incur significant spend and time in developing and implementing systems and processes to hypothetically allocate a portion of the revenue streams to in-scope activities. This exercise will need to be re-performed annually (or more often as business models evolve) and the subjective nature of the exercise will inevitably result in further discussions being necessary with HMRC.

Whilst not removing the administrative burden and additional complexities in entirety, we consider that the following would be of assistance to business;

- There is a refinement of scope, as proposed in our comments in response to Q1 and Q2, to narrowing the current definitions of in-scope activities and isolate specific revenue streams within the scope of DST. This will reduce the burden on business arising from these issues to a degree.

- Further examples on the application of the 'just and reasonable' criterion are provided in HMRC guidance to substantiate how this approach should be applied in practise (including a comparison of methods that would be acceptable/unacceptable). This guidance should also provide clarity of instances where no revenues should be attributed to the in-scope activity (for example cost centre activities).

- Optional mechanical rules are available for the taxpayer to elect to apply where there' just and reasonable' approach which leads to high level of uncertainty (and we discuss this in further detail in response to Q6).

Disproportionate administrative burden

It is anticipated that the process of attributing revenue to in-scope activities will be comparatively easier for those businesses that solely carry out in-scope activities. The process will be disproportionately more complex for those businesses that the DST is not necessarily intending to target (i.e. where the in-scope activities are closely integrated and do not directly drive revenue streams, it's more likely that the apportionment of revenue to in-scope activities will fall below the revenue thresholds). However, there will remain a requirement for these businesses to carry out the relevant revenue apportionment to substantiate and document this position.

We recommend that a further threshold test is included to exclude businesses from the scope of the DST where an insignificant proportion of their revenue is derived from in-scope activities. This would provide an additional safeguard to remove the unnecessary administrative burden of artificially allocating revenue to in-scope activities for businesses that do not derive a substantial part of their revenues from user participation. The level at which insignificant is set should be determined with the ultimate policy objective in mind (i.e. to link tax to values created by UK user participation). We consider that a suitable threshold would be where revenues derived from in-scope activities equate to less than 10% of total revenues. A 10% threshold allows enough margin for those business that have minimal in-scope activities to not have to undertake substantial additional work to determine if they fall below the threshold, whilst not being too high that it starts to exclude those businesses that do derive significant value from in-scope activities.

CBI Recommendation

HMRC should provide comprehensive guidance on the application of 'just and reasonable' revenue apportionment.

A further threshold test is included to exclude businesses from the scope of the DST where an insignificant portion (less than 10%) of their revenue is derived from in-scope activities.

Q6: Do you think there is a need for mechanical rules to guide apportionment in certain circumstances?

We consider that businesses should be able to elect to apply mechanical rules, to assist those businesses which may encounter significant complexities and uncertainty in applying a 'just and reasonable' approach to revenue apportionment. However, we consider that 'just and reasonable' apportionment will in most instances be the best approach and therefore mechanical rules should not be the default position.

We also observe that mechanical rules for revenue apportionment could not be drafted in a manner which provides clarity and certainty to the taxpayer, without first determining the revenue stream which should be apportioned. We therefore consider that our proposal in response to Q1, of defining specific revenue streams, would simplify the drafting and subsequent application of mechanical rules for revenue apportionment.

Chapter 5 – UK Revenues

Q7: Do you have any observations on the proposed approach to defining a user?

We observe that the definition of user in the consultation document (which includes individuals, companies and other legal persons) is broad given the basic premise is to tax value derived from users. We consider that this definition should be refined to just include individuals. This could include individuals which participate with an in-scope business activity both via a personal or business technological device.

Including companies and other legal persons in this definition creates additional complexities and uncertainties over the scope of the tax (i.e. has consideration been given to whether there is an intention to tax value derived through robots interacting with platforms which carry out in-scope activities).

Impact of the supply chain

As outlined in the 'Key Points' section of this response, the results of the CBI business survey highlight the breadth of companies that interact with businesses that provide in-scope activities and that in some instances the cost of the DST may be passed on to these businesses. This is supported by various economic studies carried out historically on revenue taxes, which find that such taxes are often passed on, in full or in majority, to the consumer or through the supply chain.[5] A detailed economic impact assessment of the introduction of the DST is needed to establish the wider consequences on the UK

[5] Besley and Rosen 1999, "Sales taxes and prices: An empirical analysis". Detailed study of the pass-thru of sales taxes to prices at the item level, for the US. Finds high rates of pass-thru.

Bergman and Hansen 2012, "Are excise taxes on beverages fully passed through to prices? The Danish evidence" Danish study which finds that excise tax hikes on alcoholic beverages are mostly passed through to prices.

Benedek, De Mooij, Wingender 2015, "Estimating VAT Pass-Thru" IMF study of VAT pass-thru in Eurozone countries, following the general framework of Poterba, and Besley and Rosen (above). Finds 100% pass-thru for changes in the standard VAT rate, lower pass-thru for changes in reduced VAT rates.

economy however, by limiting the scope of the DST to only business to consumer transactions only would limit the impact to a degree.

Application to group companies

Where in-scope activities are closely integrated within the business model and relate to ancillary or support functions, the user of the in-scope activity may often be another group company. There should be a clear statement provided in the legislation that UK DST does not apply to transactions between affiliated entities (this would be in line with the comments made in para 4.1 of the consultation document).

We would note that often in these instances where the 'UK user' is a group company, revenue relating to the functions and value of the UK company (or UK Permanent Establishment) will already have been allocated to the UK tax net under transfer pricing legislation. It therefore appears unnecessary to apply DST on intra-group transactions.

CBI Recommendation

The definition of users should just refer to individuals which participate in an in-scope business activity (both via a personal or business technological device).

Q8: Do you think the proposed approach for determining user location for the purposes of the DST is reasonable?

Determining user location for the purposes of DST poses some complicated questions. We observe that there will be an increased burden on businesses to identify and collect this data, many of whom do not currently record this data due to the complex and technical obstacles surrounding identifying user locations and ultimate users. Consideration should also be given to interaction with other data protection measures including the General Data Protection Regulations (GDPR).

It's noted that the extent to which the proposed approach is reasonable, and the complexities encountered by business, will vary across in-scope activities and the means by which these activities are monetised.

In-scope activities which are monetised through payments from users

The proposed approach may be simpler for those business models which directly monetise their in-scope activities through payments made by users (for example a purchase made via an online marketplace). It is envisaged in these instances that billing information/delivery addresses will be available to assist in determining user location. However, whilst information on user location may be more readily available in these scenarios there will remain many issues which would need to be addressed.

Administrative burden and cost

While businesses may to some extent know where their users or customers are located, there is a key distinction to be drawn between the level of data accuracy required to inform strategic decisions versus that required to be compliant with UK law in calculating a DST liability.

This burden will extend beyond those businesses which ultimately have a liability to DST. Any business on the peripheries of the scope of the DST will be required to track user location to demonstrate that revenues attributable to in-scope activities and deemed to be derived from the participation of UK users, do not exceed the revenue thresholds.

Implementing such systems to capture this data will add a significant administrative burden to doing business in the UK.

Just and reasonable approach

We agree with the outlined approach that the need for mechanical rules, which assist the taxpayer in providing certainty, needs to be balanced with ensuring that the approach for identifying UK users is just and reasonable. However, we observe that this is a difficult balance to reach.

A just and reasonable approach is appropriate where businesses currently have high quality data on user location however, there are some areas where this could create significant uncertainty for business.

One area of particular concern is where the information provided by the user may in itself be contradictory, for example if the billing address and delivery address are in different jurisdictions. The requirement outlined in para 5.16 "that the assessment is undertaken on a just and reasonable basis, having regard to the facts" places a significant burden on business to verify user location where they are presented with contradictory evidence.

In a business that undertakes millions of transactions a year, it would be overly burdensome to expect business to review data on a transaction by transaction basis and seek additional information to verify user location. It is therefore essential that clear guidance is provided on the extent of measures business will be required to take to verify user location where there is contradictory evidence. In this instance mechanical rules may assist business in determining which information should take precedence and mitigate the uncertainty of potential challenge. However, as highlighted mechanical rules may distort the true user location and therefore the application of them should always be optional.

GDPR and data ethics

There is an ever-growing spotlight on technology businesses, and in particular on many of the businesses which will be subject to the UK DST, regarding the level of data they store on their users. Tracking user locations is increasingly being seen as ethically wrong, and in some cases legally wrong (as a result of GDPR). Businesses will therefore be presented with a difficult challenge of balancing their obligations in respect of a UK DST alongside wider obligations on data ethics. Data protection points are yet to be addressed in the consultation paper.

Whilst we understand that it is assumed that the Government can legislate for companies to retain such data for the purposes of DST compliance, which in effect will override GDPR obligations, we have specific concerns with this in practise;

- The legal obligations to maintain data on users will not mitigate the perception by users that it is ethically wrong for companies to retain this data. This could have a negative impact on user perceptions of businesses required to do this and change user behaviour.

- As the DST is a unilateral measure, we understand that any override of GDPR will only apply to UK users and not to users located in EU member states or outside the EU. Consideration must also be given to data privacy regulations outside the EU. For example,
    - In cross-border transactional scenarios where there are multiple users in the same transaction, e.g. Chinese seller selling to a UK customer via an online marketplace, there will be a need to prove where the non-UK party is located for the purposes of DST, and so the UK can apply the appropriate taxation to the revenue (i.e. 50% where there are 2 users, 1 of whom is UK – see further comment below on this in Q10).
    - In an advertising scenario, impressions are often served to users in a variety of different countries accessing the same website. It will be necessary to have data on the location of those users to prove the appropriate portion of advertising revenue that relates to the UK.
    - Where users access platforms near the UK border (in particular near the border between Northern Ireland and the Republic of Ireland), in order for business to demonstrate that revenues are not in the scope of DST by virtue of them arising from a user located in the Republic of Ireland they would need to retain this data in order to substantiate this point in any future enquiry. Our understanding is that this will not be possible and therefore, we would urge the Government to confirm the legalities of this point and consider how this will be addressed.

We would welcome further consideration from Government on how businesses should deal with these challenges and obligations under UK DST interacts with legislation on data protection (including GDPR). This will require HMT and HMRC to link with other Government departments responsible for these issues.

In-scope activities which are monetized via other means

Where users do not pay the platform directly for services/goods, but the in-scope activity is monetised via other means (most commonly advertising), we observe that there will be further difficulties with the proposed approach. In a significant number of cases where the user is not entering into a transaction with the platform, they will not be required to provide details regarding their location, this will exacerbate a lot of the issues outlined above and provide additional complexities.

These issues will be unique to any other compliance requirements for tax matters (such as identifying jurisdiction for VAT purposes) given that the DST will be applied to revenue streams in the absence of the UK user making a payment for the services provided.

Use of Virtual Personal Networks (VPNs), proxy servers and other mechanisms to mask locations

Where users are not required to provide the platform with any information on their location, often the only means to identify user location will be via reference to the user's IP address.

The use of VPNs, proxy servers and anonymity software (such as 'Tor') all seek to mask a user's location. The use of these are widespread and therefore, in some instances businesses will simply be unable to determine the location of users by reference to their IP address, or it will provide an incorrect determination.

YouGov research undertaken in 2017[6] found that 16% of British adults had used a VPN or proxy server, with the main motivation (48%) being to access regional based content which would not otherwise have been available, followed by 44% of VPN users citing security reason. This research evidences that there is a not insignificant proportion of the British population actively seeking to ensure their location remains undetectable.

A separate analysis undertaken by Wombat Security[7] indicated that from 1,000 UK working adults surveyed, 44% of those surveyed in the UK use a VPN on a corporate and/or personal device.

In reality we believe this may be an underestimation as many users are likely to unknowingly have their location masked. For example, many multinational enterprises have a single server for operations spanning several countries. When these users engage with in-scope activities via their work computers, which we understand based on the proposed definition of users will be in scope, reference to IP addresses will also provide an incorrect determination of user location.

Furthermore, the introduction of DST which will require users to be tracked by organisations may, in itself, lead to increased activity by users to mask their location for reasons of online safety. Attempts to geolocate by organisations will therefore become increasingly less effective. Whilst organisations can use software to block logins that can't be tracked e.g. from anonymity software such as 'Tor', commercially this will have an adverse impact on their business.

Advertising models

We observe that there are specific difficulties for advertising revenues to be tracked based on user location. As part of the CBI business survey we asked business who earn revenues from advertising to customers/users based on their location through one of the in-scope business activities (i.e. search engines, social media platforms or online marketplaces) whether they currently track those revenues based on the location of the customers/users. 62% of those business surveyed that do earn such revenues responded that they currently do not track/split out advertising revenues based on the location of customers/users or they do hold some data on the location of customers/users but would face the following difficulties in accurately splitting out the advertising revenues based on customer/user location.

- Users do not need to provide location information when an ad impression is viewed – therefore in order to track user location, it is likely that IP address would need to be used, but this is imperfect for the reasons set out above.
- Information on the location of users is not typically provided to advertisers, often for data privacy reasons. There is no reason why these businesses would need to accurately track the location of users that view ads, and track revenues based on user location
- A number of advertising models involve facilitating the sale of advertising inventory programmatically between third parties, under a business-to-business model. In these scenarios, whilst the location of the business customer may be known, the location of the end viewer of the ad would not necessarily be known.

[6] https://yougov.co.uk/topics/politics/articles-reports/2017/05/17/almost-half-vpn-users-are-accessing-region-based-c
[7] Wombat Security Technologies- 2017 User Risk Report
https://info.wombatsecurity.com/hubfs/2017%20End%20User%20Risk%20Report/Wombat%202017%20User%20Risk%20Report.pdf?submissionGuid=3b127e11-45a8-4427-a760-88a7fce9e675

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

Please refer to our comments in respect of Q8, which outline where we consider certain scenarios in which mechanical rules may be of assistance in providing greater certainty to the tax payer.

However, mechanical rules may distort the true user location and therefore the application of them should always be optional. Taxpayers should have flexibility to adopt their own approach if it is a just and reasonable one.

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

We observe that a wave of countries have followed the UK in introducing unilateral digital taxes. There is significant uncertainty as to whether DST would be considered a covered tax within the scope of the UK's tax treaties or not. Whilst the UK may consider it not to be a covered tax, this position would appear to be open to challenge, and bilateral treaty partners may not take the same view as the UK. This will inevitably lead to increased uncertainty and potential disputes.

If these taxes are not covered taxes for the purposes of double tax treaties, which serve to reduce instances of double taxation, double (and multiple layer) taxation will inevitably arise - this is a complication of revenue taxes.

In the absence of the DST being covered by the existing tax treaty framework, a separate and bespoke process will be required to ensure that double taxation does not occur and there is an appropriate allocation of taxing rights. We consider it highly important that there are dispute and resolution mechanisms integrated in any such agreement which allows for timely settlements of any disputes that arise. The current consultation is silent on what these mechanisms would look like and an area which needs further consideration. We would highlight our concern regarding the input of resource required by tax authorities to establish and negotiate with other jurisdictions on this matter, which would be highly disproportionate for a temporary measure. There is also significant concern over the timeframe it would take to achieve agreement on these matters.

These concerns will be exacerbated where the principles on which other jurisdictions calculate the equivalent digital tax differ. These differences are expected to be prevalent given other jurisdictions are focusing on revenue stream-based approaches and differing revenue recognition-based principles to the UK (i.e. a cash basis versus following accounting accruals-based principles of revenue recognition). The UK taking a significantly different approach to DST compared to other countries raises further challenges for taxpayers having to manage different incidences of DST.

We believe that double taxation is an area of weakness with an interim revenue-based tax which moves away from the existing tax framework of taxing profits and why they should be avoided. However, at a minimum we consider that where a transaction involves a UK and a non-UK user, the UK should only seek to tax a proportionate share of the revenue to DST (e.g. 50% where there are 2 users, one of whom is in the UK).

CBI Recommendation

We recommend that the DST is only levied on a proportionate share of revenues where users are located both in the UK and outside the UK.

Q11: 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 allowances?

As outlined above we envisage that business will encounter significant complexities and administrative burdens in determining whether they meet the thresholds. The CBI business survey indicated that 85% of businesses for which all (or part) of their business would (or may) fall within the definition of an in-scope activity[8] did not feel they would be able to accurately compute revenue subject to the DST or it would require substantial changes to current reporting systems.[9]

We also observe that the Government should not consider user participation as a proxy for value creation. This is an imprecise metric that is extremely difficult to value given the diverse spectrum of user relationship. We therefore consider that the 2% rate is arbitrary in nature and being a revenue-based tax, the effective tax rate as a result will varying significantly across businesses depending on their profit margins (as outlined in our comments in response to Chapter 6) being particularly burdensome for low margin businesses. However, rather than this being a function of the rate set we consider this is a fundamental flaw of a revenue-based tax and another reason why we would urge the Government to reconsider its implementation before the conclusion of the OECD work.

Chapter 6 – Safe harbour

Q12: Do you agree that the safe harbour should be based on a UK and business activity-specific profit margin?

Q13: 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?

Q14: Are there other elements of how the safe harbour would operate that need to be clarified?

The response below covers our comments in response to Questions 12, 13 and 14.

As set out in Chapter 7 of the consultation document, the Government acknowledges that DST should "remain proportionate for businesses with very low profit margins". Whilst the fact that the UK is proposing such a measure is welcomed, a number of members have concerns that the design of the safe harbour does not meet this objective, and it in fact produces highly distortive effects.

In particular, the fact that taxpayers are required to calculate a UK-only business activity-specific P&L solely for the purposes of the UK DST safe harbour, when this would not be required for any other purposes, is highly disproportionate for a tax that is only designed to be a short-term measure in anticipation of long-term tax reform. We believe that taxpayers should be allowed to use readily available and audited financial data to perform the safe harbour calculation as the closest available proxy in order to make the calculation more straightforward for taxpayers and HMRC.

[8] 51% of respondents (being 107 out of 210 respondents in total) answered that all (or part) of their business would (or may) fall within the definition of an in-scope activity.

9 Respondents who thought their business (or part of their business) would be or maybe in-scope were asked whether they felt they will be able to accurately compute your revenues from in-scope business activities which would be subject to UK DST and given the following options;

Yes, based on current reporting systems we have this information readily available – 8.4% of respondents chose this option.

Yes, however this will require simple changes to current reporting systems – 6.9% of respondents chose this option

Yes, however this will require substantial changes to current reporting systems – 28.5% of respondents chose this option

No, we have answered based on an estimate and in practice it will be very difficult to accurately compute – 56.2% of respondents chose this option.

We address in more detail below the following factors of the safe harbour and provide suggestions of how the proposals can be improved to be simpler to apply and more proportionate: (1) calculation of the profit margin, (2) "X" (the multiplier), and (3) election and timing.

(1) Calculation of the profit margin

The design of any new tax should ensure that it is easy to comply with, in particular as it is only supposed to be a temporary tax. This is for the benefit of both taxpayers, who should not be required to incur significant spend and employee time in developing new technology, systems and processes, and also for tax authorities, who should be able to audit financials in a straightforward manner without incurring significant incremental time and cost. This means that the financial information used for DST should be financial data that is readily accessible for both taxpayer and tax authority, rather than taxpayers being required to produce a bespoke UK-only in-scope P&L specifically to implement these rules.

A reasonable proxy to calculate the profit margin would therefore involve using published and audited financial statements, either:

> (1) published and audited global consolidated financial statements (under U.S. GAAP/IFRS per the taxpayer's parent company accounting standards), or
> (2) published and audited financial statements by segments (under U.S. GAAP/IFRS per the parent company's accounting standards).

If a bespoke UK-only business activity-specific P&L is required, the financial information would not be audited (unless a separate audit was undertaken solely for the purposes of DST, which would add unjustifiable incremental time and cost). HMRC would need to devote significant resource to review this unaudited financial information. Without a third-party auditor to express an opinion on the financials, there is a risk of disagreement between taxpayer and tax authority, as well as between different tax authorities in cross-border scenarios (i.e. with other countries who implement a DST). Given this increased risk of dispute, there would be an increase in controversy/litigation activity in order to reach a mutually agreed position.

A full value chain analysis would need to be performed in order to carve out a country-only or business-only P&L where this is not already in place, which would be a highly complex exercise that would not be justified for DST only.

Further, in an integrated business model, where there are many interconnected businesses, there are a number of highly challenging issues. Consideration would need to be given to how to allocate a relevant portion of central/shared costs to the in-scope P&L, which is complex, and unlikely to be something that businesses would do today. Significant additional work would be required to create bespoke financials solely for the purposes of DST.

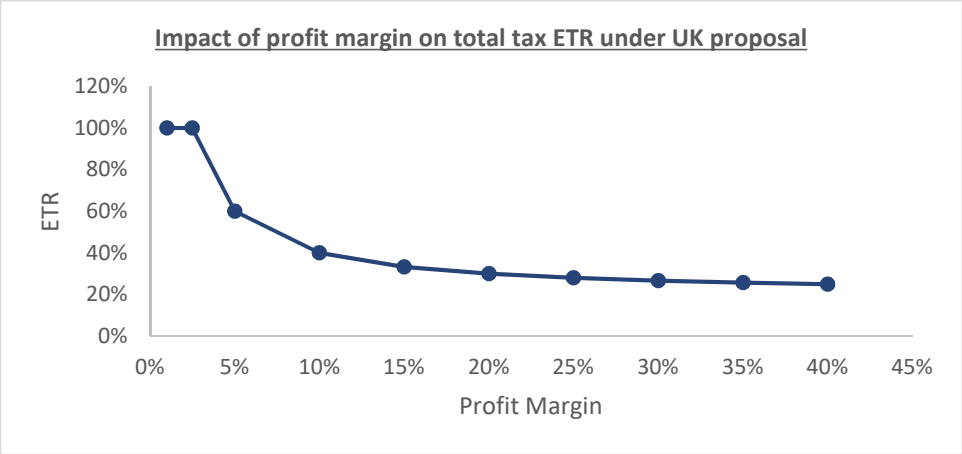
For the above reasons, we do not consider it practical that taxpayers would be required to produce a UK-only business activity-specific P&L. At a minimum, taxpayers should be able to choose to do this as a taxpayer option. However, we consider that financial statements should be the default basis for the calculation, but with the bespoke calculation to be performed only at the choice of the taxpayer.

(2) Safe harbour multiplier "X"

As drafted with X as 0.8, in order to fall within the safe harbour, a group must have a profit margin of below 2.5%. We consider this to be too low, and even groups within the safe harbour face hugely disproportionate impacts from DST. For example, a group with a profit margin of 2.5% or below can in very high revenue business end up with an effective tax rate of near 100% under the UK's proposal

(taking both UK corporation tax at 17% and UK DST into account). This is clearly not proportionate and does not meet HMT's stated acknowledgement that DST should "remain proportionate for businesses with very low profit margins".

The graph below illustrates how high revenue, low profit margin groups bear a much higher tax burden than groups with higher profit margins[10].



For low margin businesses, the consequence of DST being a revenue based tax is that these businesses will have to choose whether to absorb the cost of the DST or to pass on the cost to the consumer or companies within the supply chain (many of whom will be SMEs who are not the target of the DST and who themselves are unlikely to be able to absorb the cost). Where X = 0.8, the DST will represent a significant portion of the profit margin when combined with CIT (as outlined in the graph above) and it may become unsustainable for low margin businesses to absorb this cost of the DST. We consider there is a reasonable risk these businesses will have no choice but to pass on the tax if their business model is to remain sustainable. Whilst the competitive nature of the market may drive down demand as a result, if the DST is applied and enforced effectively across the board, competitors are likely to take similar action seeing an overall rise in prices. This scenario is one of the distortive effects of revenue-based taxes however, reducing the value of X for the purposes of the safe harbour should reduce the impact of this flow through effect as the DST burden would be lower for these low margin activities.

Considering the objective of the measure, i.e. to reflect the value of user participation in certain business models, "X" should be representative and a proxy for user value contribution and the UK corporate tax rate of 17%.

There is no explanation as to how 0.8 has been derived as a value for "X", or why 2.5% is considered as the level of profit that is sufficiently low to be within the safe harbour.

In order to reduce the distortions, members would propose setting the multiplier at a much lower level that reflects a more realistic value of user participation. If a generous rate of user value contribution of 10% is considered, at a corporation tax rate of 17%, would suggest a multiplier of 0.017. A multiplier at in this region would have a significantly more proportionate effect.

Alternatively, the safe harbour could be adapted to be a gateway test to fully scope out loss making and low margin businesses from DST. This could be, for example, for all groups with a profit margin

[10] Please note for simplicity this graph is based on a 20% CIT rate and assumes that the first £25m of revenues (which are not subject to DST) is insignificant in the context of total revenues. It is recognised that the distortions between profit margins will be less pronounced for those businesses where £25m is a significant portion of total revenues, given that the first £25m of revenues will not be subject to the DST.

below a set percentage, say 10% (based on audited financial statement data), and including loss-makers. The rationale for this would be that these businesses do not benefit from any material user value because they are loss-making or making small margins, and the impact of DST is particularly disproportionate below this profit margin as can be seen in the graph above.

(3) Election and timing

Consideration should be given to the timing and duration of a taxpayer's election to use the safe harbour. We believe that the election should be made on an annual basis, given that a taxpayer's profit margin could vary significantly between years. In order to prevent taxpayers paying a rate of DST above 2%, HMT should clarify that the level of DST should be capped at 2% of revenues, regardless of which method is used to calculate the DST.

In terms of payment, we understand that HMT intend for a quarterly payment regime to apply for DST, and as such taxpayers will need to calculate the estimated DST liability for a given year based on forecasted data. Consideration needs to be given to at which point in any given year an election is required for the safe harbour. Flexibility needs to be introduced into the election and payment mechanisms in order to provide flexibility for taxpayers whose profitability may change above and below 2.5%.

CBI Recommendation

We recommend the following is applied in the design of the safe harbour;

- Financial statements should be the default basis for the calculation, but with the bespoke calculation to be performed only at the choice of the taxpayer.

- X should be reduced to 0.02 or alternatively the safe harbour could be adapted to be a gateway test to fully scope out loss making and low margin businesses from DST.

- The safe harbour election should be made on an annual basis and flexibility should be provided on the timing of this election annually.

Chapter 8 – Deductibility and crediting

Q.15: Do you agree with the Government's characterisation on the circumstance of when the DST will be a deductible expense for UK corporate tax purposes? Are there other issues that require further clarification?

We observe that the DST will result in double taxation as it is not covered by the existing tax treaty framework which provides a means to eliminate double taxation in cross-border scenarios.

Double (or multiple layer) taxation is highly likely to arise for foreign-parented multinationals, given that the residual profits are likely to be earned outside the UK. As a result, there would be limited, if any, expense relief available for the UK DST suffered, even if the UK entity earns an arm's length return on which it pays UK corporation tax. In contrast, a UK-based group that earns residual profit in the UK and which is able to benefit from full expense relief from UK DST will be paying a lower effective tax

rate globally and will suffer less from double taxation. This may be considered discriminatory in comparison.

Double taxation will be particularly apparent for those businesses with low profit margins, higher margin businesses will have the ability to absorb more of the tax. We refer to our comments made in response to chapter 6 regarding the implications of the DST being passed on through the supply chain and the distortive impacts this would have. Conversely, if other countries follow the UK's proposal, UK multinationals making sales overseas and paying foreign DST and foreign corporate income tax would find themselves of incurring double taxation, where they are not able to benefit from relief – this will make UK groups less competitive and may mean they incur higher effective tax rates.

Consideration also needs to be given to how the DST interact with other taxes (such as the Diverted Profits Tax) and the anticipated tax on offshore receipts in respect of intangible property. We consider that there could be potential overlaps, for example revenues facilitated by UK users could include payments for the use of IP rights, particularly in the case of subscription fees for the use of online marketplaces.

Whilst on a separate point, we would urge the Government to consider where other countries follow the UK's proposals, would HMRC treat the equivalent DST (arising in the foreign jurisdiction) as deductible. If DST becomes widespread around the world, which appears to be a possible outcome as many countries are considering copying the UK and implementing their own DST, and some at rates much higher than 2%, there may be a significant impact on UK corporation tax take if UK companies are incurring significant foreign DST cost which is treated as a deductible expense. As noted previously, the UK must seriously consider the possible knock on consequences and retaliatory measures from other countries.

Link with 'just and reasonable' revenue apportionment

Where businesses do not solely carry out in-scope activities, there will need to be a just and reasonable allocation of revenues attributed to in-scope activities. These in-scope activities may not represent a separate and distinct trade. Therefore, consideration should be given to whether the 'wholly and exclusively' terminology needs to be broadened in this instance to ensure that DST continues to be deductible.

Deductibility for recharges

Where a UK company incurs and pays DST on behalf of its worldwide group this DST may need to be re-charged under transfer pricing principles. It is assumed that any revenue generated would be taxable but correspondingly the full expense deductible however, this point should be clarified in HMRC Guidance to provide certainty on the matter.

Q16: Do you have any observations on the proposed review clause?

We welcome the intention for the DST to be dis-applied on reaching an appropriate global agreement to this policy challenge.

In the absence of such certainty, there is a risk that the distortive impacts of the DST will be amplified, with more businesses taking measures to re-arrange their operations and the markets they operate in response. For example, serving the UK market will ultimately come with additional costs, where businesses are unable to pass on the cost of the DST it will impact their return on capital in the UK market which feeds into businesses investment decisions. Certainty that the tax is temporary in

nature will not eliminate the impact of the DST in such appraisals, but it may dampen the impact on long-term investment decisions.

In order to provide business with this certainty, we would strongly recommend that at the 2025 date, the default position is that the DST is to be dis-applied. If it was still deemed to be required then an active decision by Parliament would be required to continue it, rather than a passive decision as currently intended. However, at this point we would recommend a more sustainable long-term solution is sought.

We believe this clear commitment from Government is needed to signal to business the DST will be a temporary measure. There is currently a concern that an interim DST could easily become long-term due to political inertia and the fact that the question over whether an international solution has been reached will be subjective. There are a variety of fundamentally different proposals being put forwards at the OECD level, each would result in a differing allocation of taxing rights between jurisdictions. To reach a consensus-based solution at this multi-lateral level will inevitably require compromise between countries and we welcome the Government's active engagement in this arena.

Alongside this, there is a concern that future Governments will wish to retain the revenues generated from the DST and therefore this may be a difficult revenue stream to justify losing. This policy objective of the DST is clearly not to raise revenue but to address the balance of how differing businesses pay taxes. It is essential that sight of this policy objective is not lost over time and this is reflected in the design of the tax upfront.

There is also a wider concern that interim solutions act to delay and discourage debate of a long-term solution rather than expediate it. Having a fixed date for its end will ensure that momentum is maintained in finding a solution.

CBI Recommendation

We recommend that the DST should incorporate a 'sunset clause', to provide a clear signal to business that the DST will remain a temporary measure.

Chapter 11 – Reporting

Q17: 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?

As outlined in this consultation response, we observe that there are practical difficulties for multinational enterprises in assessing i) whether they have in-scope activities and ii) the allocation of revenues to these in-scope activities. We have proposed safeguards (including an additional revenue stream test) which we consider would simplify this process for a number of businesses.

In addition to this we would recommend that the following routes could be provided to give business certainty over whether they have a liability to DST.

- ***HMRC Guidance –*** as outlined in response to questions 3 and 5 it will be critical to provide extensive and comprehensive guidance on both those businesses that are expected to be in-scope (and those that are exempt) alongside guidance on how business should attribute revenue to in-scope activities.

- ***Customer Compliance Managers*** – CCMs should be empowered to be able to provide decisions to business on a real-time basis regarding whether they have in-scope activities and the method by which they attribute revenue to this activity on a 'just and reasonable' basis.

- ***Clearance mechanism*** – Given that business models in the technology sector are often characterised by being novel and constantly evolving it will be difficult to provide guidance that will be applicable to all organisations. We therefore believe, there should be a clearance mechanism available for business to provide certainty on whether they have an in-scope business activity and if so, the basis under which they attribute revenue to that activity. We would expect in return that as part of any clearance there could be critical assumptions that put the onus on taxpayers to contact HMRC in the event that their business model changes (similar to conditions typically found in advance pricing agreements regarding appropriate transfer pricing methodology).

As outlined in this document, there is a significant burden for businesses to implement additional systems to capture the necessary information to comply with the DST. If and when legislation and HMRC guidance is issued, there should be sufficient lead time for businesses to design and implement the necessary systems. We would anticipate that at a minimum 6 months would be required, although 12-18 months would be more reasonable.

Q18: Do you agree that the DST should be reported annually?

We are in agreement with the proposed approach that DST should be reported annually. In order to ensure that the administrative burden is not increased further, it is important that this reporting period is aligned with company financial accounts as proposed.

Q19: Do you see any difficulties applying the CT rules for accounting periods for DST, and if so, how could they be overcome?

We have no additional comments.

Q20: Are there any other issues relating to reporting the Government should consider?

Reporting requirements

It is not appropriate to follow the corporation tax notification requirements for the purposes of the DST. Whether a business will be within the scope of the DST will be a detailed assessment, first on whether there is an in-scope activity and secondly whether revenues exceed the relevant thresholds. The latter will not be possible to determine until after the end of the accounting period, having to notify prior to this could only be done on an estimated basis.

It's important that business feel able to comply with the requirements of DST and as such require more time to assess their activities and attribute revenue. We would therefore recommend on this basis that notification should be done at the same time as filling the DST return.

Furthermore, paragraph 11.24 of the consultation document talks about consideration being given to requiring businesses to provide aggregate global revenue from in-scope business activities which would then need to be broken down per in-scope business activity. Such an exercise creates a heavy administrative burden/cost on business which seems unnecessary where a business' revenue is below the £25m threshold of UK taxable revenues. Similarly, for businesses that are clearly within the scope of UK DST, a simpler approach could be to have a tick box for companies to indicate whether they are in-scope for DST, without the need to analyse global revenue from in-scope business activities.

Penalties

As outlined, there are several areas where members are concerned regarding the ambiguity and complexity of the DST. We would, therefore, urge HMRC to consider taking a light touch for penalties, especially in early years.

Chapter 12 – Payment and Compliance

Q21: 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.

We disagree that the DST compliance should be administered through the corporation tax framework, given the DST is a revenue-based tax.

In particular, the new quarterly instalment payment (QIP) deadlines, which accelerate the deadline for payment of corporation tax, are very tight. Given the compliance issues outlined in this response for businesses to calculate the DST, the requirement to calculate the DST on forecasted data will amplify these issues. In addition, being a revenue-based tax (which could represent a significant proportion of a businesses' profit as outlined in the diagram included in response to Chapter 6) would present substantial cashflow businesses where the DST is required to be paid on a real-time basis in line with the QIP deadlines.

Q22: Do you agree that allowing a Nominated Company to act on behalf of the group will reduce the compliance burden?

Yes, we agree with this.

Q23: Do you foresee any difficulties with the Nominated Company calculating DST liability on behalf of the whole group?

We have no additional comments.

Q24: Are there any practical issues around the Nominated Company accessing information from the rest of the group?

We have no additional comments.

Q25: Would specific rules be needed from companies whose AP does not coincide with the Nominated Company's AP?

We have no additional comments.

Q26: Do you have any observations on either of the proposed anti-avoidance provisions, or other avoidance risks?

We have no additional comments.

Q27: Do you think it will be necessary to introduce additional rules to ensure compliance with the tax?

We do have concerns relating to the ability of the UK to implement and enforce the DST against non-UK/non-EU taxpayers. In particular, given that many of the in-scope business models are able to be carried out remotely to some extent, members are concerned that there may not be a level playing field if foreign taxpayers are not subject to the same compliance obligations. In particular, this is a larger concern in business models where there is high substitutability, e.g. physical goods, where foreign imports not subject to DST would be cheaper. This cannot be in line with policy intent and it would be UK SMEs who would suffer further due to cheaper imports being available. The UK should give further thought to how DST can be robustly enforced against foreign taxpayers, and measures such as published lists of offenders should be considered.

Chapter 13 – Assessment of impacts

Q28: Do you have any comments on the summary of impacts?

It is clear that the introduction of the DST will impact those businesses that fall within the scope of the tax. However, it could also indirectly impact those businesses that interact with or rely on in-scope business activities for their own business activity. For instance, a business might advertise via a search engine, buy data from a social media platform or sell its products via an online marketplace. The extent to which these businesses are impacted will depend on the pass-through rate i.e. how much of the tax is passed onto its customers in the form of higher prices.

The CBI business survey examined this in more detail. It found that over 80% of respondents that do not fall within the scope of the DST interact in some form with those that do. Of the SMEs[11] surveyed, 75% stated interaction with in-scope business activities. This is a fairly large proportion, suggesting the DST could have wider economic impacts.

The nature of this interaction appears to vary by sector and the tax could therefore create distortionary impacts across the economy. For example, the survey finds that businesses in sectors such as accommodation and food, agriculture, arts and entertainment, other services, and transport, all stated they interact with in-scope business activities in some form, while sectors such as human health and social work interact very little with the in-scope business activities. In addition, the survey indicates that a business in the accommodation and food sector is more likely to advertise and buy

[11] This survey defines an SME, as a business with less than 250 employees and turnover below or equal to EUR 50 million.

data from all in-scope business activities whereas a business in the agriculture sector is more likely to advertise via search engines and social media platforms.

While some businesses may interact with in-scope business activities, they may not necessarily be reliant on them to perform their own business activity. The level of reliance should therefore be considered when understanding the magnitude of the wider economic impact. The survey finds that the extent to which businesses rely[12] on in-scope activities is the highest for social media platforms. Of those businesses that interact with in-scope business activities, over 40% are reliant[13] on social media platforms, falling to just under 40% for search engines and almost 20% for online marketplaces.

As is the case for interaction, reliance appears to be more pronounced in certain sectors. The survey indicates that a business in the accommodation and food services sector is more reliant than the average business across all in-scope business activities, placing significant reliance on search engines and social media platforms in particular. On the other hand, while a business in the arts and entertainment sector is more likely to interact with in-scope business models, these businesses are unlikely to be reliant on such activities. Furthermore, for both search engines and social media platforms, the level of reliance is higher when looking at SMEs in isolation, with almost 70% of SMEs surveyed reliant on social media platforms in particular.

While there is evidence to suggest businesses do rely on in-scope business activities and could therefore be indirectly affected by the DST, the extent to which these businesses are affected will ultimately depend on how much of the tax is passed on through the supply chain in the form of higher prices. Of those businesses that fall within the scope of the DST, 30% of businesses surveyed stated they would pass on 50% or more of the tax to business customers, with 15% claiming the pass on rate would be 100%.[14]

Where there is pass-through, this will ultimately hit the end customer through the supply chain i.e. the consumer. Those in-scope businesses who sell either wholly or partly to consumers were mostly not sure how much of the tax would be passed on to consumers (94%), with 1% stating they would pass on at least 50% to consumers.

While there is not enough evidence from the survey to understand exactly what the pass on rate will be to consumers, there is evidence to suggest that in some cases there will be pass-through. In conjunction with evidence suggesting a large number of businesses, including SMEs, rely on in-scope business activities, this indicates that the indirect impacts on both businesses and on consumers could be fairly significant, and there could be distortions created across sectors where reliance is higher. In light of this, it is recommended that a full impact assessment is carried out by Government to understand the significance of these impacts as well as other impacts that have not been considered as part of this analysis.

[12] Respondents were asked whether they were very reliant, moderately reliant, reliant, not that reliant or not at all reliant on each of the in-scope business activities.
[13] The definition of reliance here is based on those that responded very reliant, moderately reliant or reliant.
[14] It should be noted that 67% of respondents did not know how much would be passed on in B2B transactions.