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The U.K.'s Digital Service Tax: What Businesses Should Be Aware Of

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The U.K. government confirmed in their 2020 Budget, that they would press on with the implementation of the U.K.'s Digital Services Tax (the "DST") and the final provisions of the DST are contained in the Finance Bill 2020. Although the Finance Bill 2020 has yet to receive Royal Assent, businesses must continue to ensure that they have compliance measures in place as the DST applies to applicable revenue from 1 April 2020.

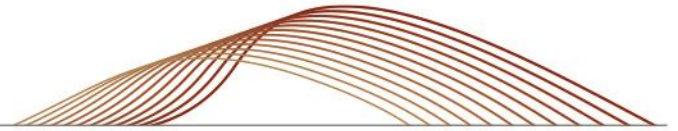
The DST is intended to be an interim measure—the U.K. government believes that the most sustainable long-term solution is the reform of the international corporate tax rules. It intends to repeal the DST once an appropriate global solution is in place, however, achieving a global consensus in relation to a tax that has been the subject matter of international criticism and debate, especially in the current political and economic climate, will no doubt be a difficult and drawn-out task. As such, it is critical that businesses become familiar with the DST as despite its supposed temporary nature, it might be in place for longer than expected.

Broadly, the DST is a tax that is levied at 2% on a group's U.K. digital services revenue which is above the annual allowance (namely, £25 million) and is derived from in-scope digital business activities, this includes: (i) the operation of social media services; (ii) internet search engines; and (iii) online marketplaces. Note, the DST also bites on associated online advertising services.

The DST will only apply where a group's: (i) worldwide revenue from the aforementioned activities exceed £500 million; and (ii) U.K. digital services revenues exceed £25 million, in each case, in the applicable accounting period.

Online Marketplace

There is an important exemption from the definition and scope of "online marketplace" which applies to certain online financial marketplaces. We note that the requirement in the draft legislation that an entity must be a regulated entity in order to qualify as a financial marketplace has not been included in the final legislation. The exemption is intended to be broad and provides that where more than half of a marketplace's revenue in the accounting period arises in connection with facilitating the trading of financial instruments, commodities, or foreign exchange, the online financial marketplace in question will be outside the scope of the DST (unless, of course, it is within the scope of the other possible digital activities, namely, social media service and internet search engine). Some businesses provide several different services to users on a single platform or website. In order to determine whether such a business is providing one singular service or multiple divisible services, the facts and circumstances of each particular case will have to be assessed.



U.K. User

The DST only applies to revenue that is attributable to U.K. users. A U.K. user is defined as any user (an individual or legal person) for which it is reasonable to assume is normally located or established in the U.K. However, the provider of the digital service activity, any member of the same group as that provider and any employee of that group (provided they are acting in a professional capacity) are excluded from being considered as a U.K. user. It is up to the businesses themselves to make a judgement as to whether a user is a U.K. user and this needs to be done based only on the information available to them. The legislation does not specify what is an acceptable source of evidence, however, the most commonly collected information which may be used to identify whether a user is a U.K. user includes but is not limited to the following, the user's: (i) IP address; (ii) payment details; and (iii) delivery details.

Land or Property

There are special rules that apply where the transaction in question relates to an online marketplace that derives revenue in connection with the provision of land or property. Broadly, the location of the property is the factor considered on the supply side and not the location of the owner of the property. Therefore, if a transaction involves a non-U.K. user and land or property that is located outside of the U.K., the revenue attributed to such a transaction will be outside the scope of the DST, this is regardless of whether the owner of that land or property is a U.K. user.

GDPR

Businesses should also continue to be aware of their GDPR responsibilities. As mentioned above, the DST requires businesses to assess whether their users are U.K. users based on the information available to them. The DST does not require businesses to collect additional personal data from their customers and the obligation to ensure that personal data is being collected and processed in a lawful manner continues to rest on the businesses themselves.

Cross Border Relief Claim

Businesses should note that the DST does provide some relief in relation to cross-border transactions. Broadly, a group's U.K. digital services revenue which is derived from online marketplace transactions can be reduced by 50% if such revenue is also subject to a similar tax to DST in a foreign jurisdiction. HMRC are intending to provide a list of foreign taxes it believes to be similar to the DST.

Compliance

From a compliance perspective, businesses should be aware that although the DST considers the activities and revenues of a group as a whole, the liability to DST actually falls on the individual entities within the group. As such, the group revenue will need to be allocated to each individual group member in relation to their proportion of the U.K.-digital services generated revenue. A group must designate an entity to be its "responsible member" and it is such entity who will, going forward, be responsible for carrying out reporting and other obligations.

Commentary and Next Steps

As the scope of the DST is potentially very wide, it is crucial that businesses are aware of their potential exposure to the DST. In addition, businesses will need to consider the additional administrative and compliance aspects of the new tax, for example, the cost and administrative implications of assessing whether users are U.K. users as this will involve collecting, filtering, analysing, and recording information relating to such users. The position in relation to a global consensus should be monitored.

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