House of Commons

Committee of Public Accounts

The Digital Services Tax

Forty-Fourth Report of Session 2022–23

Report, together with formal minutes relating to the report

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The Committee of Public Accounts

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Summary

The government introduced Digital Services Tax in April 2020 because it was concerned that the existing international tax system did not recognise the value being generated for digital companies through UK online users. As long ago as 2012 this Committee called on HMRC to address the issue that multinationals appear to avoid UK corporation tax by moving money to other tax jurisdictions, so we are pleased to see progress in this area. We were also pleased to see an example of successful implementation of a new tax, and would encourage the government to gather lessons and apply them to future tax developments. The Digital Services Tax raised £358 million in its first year, 30% more than expected. However, we note the continuing uncertainty about how much tax should have been paid in its first year due to the tax's novelty and the effects of the pandemic. It remains unclear whether future revenues will meet or exceed the projected £3 billion by 2024–25.

The Digital Services Tax was only ever designed as an interim tax and operates relatively crudely – especially in relation to high-volume low-margin businesses. HM Treasury acknowledges that the tax is a 'second best' solution while it awaits the implementation of a series of reforms to international tax rules to ensure that multinational enterprises pay a fair share of tax wherever they operate. The first stage ('Pillar One') of these reforms, developed by the Organisation for Economic Co-operation and Development (OECD), are currently due in 2024. However, we saw little evidence to support the confidence expressed by the departments in evidence to us that the OECD reforms will be implemented to the current timetable. The proposed reforms are complex and rely completely on agreement being reached across around 140 tax jurisdictions. If the OECD reforms are delayed the Digital Services Tax is likely to have a longer life than it has been designed for. We are concerned that this may prompt businesses within the scope of the tax to consider using the huge resources and expertise at their disposal to circumvent the tax. HMRC will need to be ready for that scenario, with robust measures to ensure compliance in the longer-term if needed.

Introduction

HM Treasury and HMRC introduced the Digital Services Tax in April 2020 to capture the value added to major digital businesses by UK users interacting with online marketplaces, social media platforms and search engines. It is a tax on turnover, not profits, for business groups whose revenues from in-scope activities are more than £500 million and where more than £25 million is derived from UK users. HMRC collected £358 million for the year 2020–21 (30% more than forecast due to the unpredictable impact of the COVID-19 pandemic), with 90% coming from five business groups. Digital Services Tax is forecast to raise around £3 billion by 2024–25.

The UK is among many other countries seeking a multilateral solution to concerns about how the international tax system operates for global businesses. In mid-2023 OECD plans for around 140 tax jurisdictions to sign up to 'Pillar One and Two' reforms that are intended to allow countries where large multinational businesses derive income to tax them locally. This involves re-allocating some taxing rights over the largest and most profitable multinational business groups from their home countries to the tax jurisdictions where their customers and users are located. When the 'Pillar One' reform is introduced, the UK government will retire the Digital Services Tax. Legislation requires the tax to be reviewed by 2025.

Conclusions and recommendations

1. **HMRC has collected more Digital Services Tax than expected in its first year.** Revenues of £358 million in 2020–21 were 30% higher than projected by the OBR. Different businesses paid both more and less than expected, with positive and negative impacts from the COVID-19 pandemic creating significant variation against expectations. Fourteen businesses paid more than expected, while fifteen paid less than expected or nothing. However, HMRC is still identifying additional potential payers so there is continuing uncertainty about how much tax should have been paid in the first year. It is therefore difficult to know what a 'normal' year's revenues would look like, and how accurate is the current expectation of around £3 billion of revenues by 2025.

   Recommendation 1: ***HMRC should report to the Committee the final revenues for 2020–21 once it has completed its assessments to identify all the revenues for the baseline year of 2020–21, and thereafter report annually on the difference between the tax owed in theory and the amounts actually paid for this and future years (the tax gap).***

2. **HMRC implemented the Digital Services Tax with little cost, and the experience could provide valuable lessons for other new taxes.** HMRC implemented the tax on schedule for only £6.3 million, less than budgeted, though there will be ongoing compliance costs. The small population of payers (18 in 2020–21) means that HMRC has been able to build a relationship with each taxpaying business. It is also learning more about the population of digital businesses generally. HM Treasury says that the tax is delivering fairer outcomes, but some companies face potential double-taxation for the same transactions – first by Digital Services Tax taxing the revenue, then Corporation Tax taxing the profit. Businesses who operate a model of a high volume of transactions with lower profit margins also bear a heavier burden. HMRC has provision for businesses to be exempted from payment if they can demonstrate that the activities in question are not profitable.

   Recommendation 2: ***HM Treasury and HMRC should consider what lessons can be learned from the Digital Services Tax's introduction in terms of implementing tax systems efficiently and assessing the proportionality of its impact on taxpayers.***

3. **There are obvious challenges facing the OECD in implementing the multilateral Pillar One reforms to the planned timetable, which could have major implications for the future of the Digital Services Tax.** Some other countries, including France for example, have also introduced new taxes similar to the UK's Digital Services Tax, though they have varying scopes and tax rates. The introduction of such taxes reflects a wider desire for change and is a useful way of keeping up the pressure to introduce the OECD reforms. The timetable for implementation of the OECD reforms has already slipped once since the OECD announced agreement on the framework for the two-Pillar solution in October 2021. The OECD's current timetable is for a multilateral convention signed by 140 tax jurisdictions in mid-2023, leading to implementation of Pillar One in 2024. This looks challenging and the ability to get key players on board is crucial. HMRC has not yet produced an estimate of revenue to the UK from Pillar One, telling us that too much is still uncertain about the new

arrangements. HMRC says that the Office of Budget Responsibility's estimate for annual revenues of £2 billion through Pillar Two is in line with high-level estimates from OECD.

Recommendation 3: ***HMRC should update Parliament, within three months of international agreement on implementation of Pillar One, on progress with the implementation of the reforms.***

4. **HM Treasury and HMRC have a vital role in ensuring that the multilateral assurance framework for Pillar One of the OECD reforms will meet Parliament's desire for accountability and transparency.** The 140 jurisdictions involved in the development and implementation of the reforms will have very differing cultures around the transparency with which tax systems operate and the approach to tax compliance activity, and differing levels of commitment to the reforms. The OECD reforms will be administered and enforced through a multilateral administrative framework which will change tax administration for multinational businesses and determine the approach to compliance actions. Success will depend on cooperation between countries hosting users and those hosting the businesses. HM Treasury and HMRC have a vital role in ensuring that the framework meets their objectives and the expectations of Parliament around accountability and transparency, and that these are reflected in the international agreement and the compliance regime.

Recommendation 4: HM Treasury and HMRC should:

- ***alongside the Treasury Minute response to this report, write to the Committee setting out their objectives for the development of the multilateral administrative framework, including audit arrangements,***
- ***ensure they propose assurance arrangements that will provide the UK Parliament with sufficient accountability and transparency to provide assurance that the Pillar One and Pillar Two reforms are operating effectively, and***
- ***set out robust forecasts of expected revenues when details of the new regime are agreed.***

5. **There is a significant risk that the Digital Services Tax may require extension beyond its intended lifespan, and that this could prompt changes in taxpayer behaviour.** Should the OECD reforms be delayed beyond 2024, the Government is required by law to review the operation of the Digital Services Tax in 2025. We assume that the tax would continue in some form if possible but there is a question about its long-term sustainability. While there may be no evidence of active tax avoidance or evasion by businesses to date, this may change if the life of the Digital Services Tax is extended. Businesses such as those within the scope of the tax traditionally employ significant resources to ensure that their exposure to tax is minimised, and they may consider that the Digital Services Tax is more worthy of such attention if it is extended. Methods for ensuring compliance are untested and could require cooperation between countries.

Recommendation 5: *Ahead of the formal requirement to review the tax in 2025, HMRC should develop a contingency plan for what happens if the Digital Services Tax needs to be extended, including a robust process for addressing non-cooperation with its compliance regime.*

1 Design and implementation of the Digital Services Tax

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from HM Treasury and HM Revenue & Customs (HMRC) on the Digital Services Tax.[1] The government introduced the Digital Services Tax in April 2020 because it was concerned that the existing international tax system did not recognise the value being generated for digital companies through UK online users.[2] For many years members of this Committee have been raising concerns about multinationals using corporate structures to avoid paying UK tax.[3]

2. The Digital Services Tax is designed to tax business groups that derive large revenues from UK users of search engines, social media platforms and online marketplaces. It is not a tax on the online sale of goods. Services within scope are those which monetise users' engagement with online platforms, such as: search engines, which allow users to view webpages beyond the platform; social media platforms, which allow users to interact with, and share user-generated content with, other users; and online marketplaces, which allow users to advertise or sell goods and services to other users.[4]

Implementation and first-year performance

3. In its first year, 2020–21, HMRC received £358 million in Digital Services Tax receipts. Altogether, 18 business groups paid Digital Services Tax. Around 90% of HMRC's receipts for 2020–21 were provided by five business groups.[5] Fourteen businesses paid more than expected (nine of those were not expected to pay anything). Four paid something but less than expected. Eleven who were expected to contribute paid nothing. In most cases, those who paid less than expected or nothing did so because of the impact of COVID-19. Thirteen of the 18 payers paid more in Digital Services Tax than in Corporation Tax. In September 2022, 46 business groups were still being assessed for their liability to pay the tax for 2020–21, so the total amount of tax payable for 2020–21 is still not finalised.[6]

4. Receipts for 2020–21 were 30% more than the £275 million forecast.[7] It is, however, difficult to judge whether this means the tax has been a success.[8] The Departments told us that Office of Budget Responsibility forecasts for the first year of the tax had proved inaccurate because the revenues of some large businesses had benefited considerably from the COVID-19 pandemic causing people to spend far more time online, while some businesses such as those in the travel business, suffered large falls in revenue.[9] It is inherently difficult to predict the first year of a new tax, while the forecast also made

1 C&AG's Report, *Digital Services Tax*, Session 2022–23, HC 905, 22 November 2022.
2 C&AG's Report, para 1
3 For example: Committee of Public Accounts, *HM Revenue & Customs: Annual Report and Accounts 2011–12*, Session 2012–13, HC 716, 3 December 2012
4 C&AG's Report, paras 1.8, 1.10
5 C&AG's Report, paras 6, 7
6 C&AG's Report, paras 2.4, 2.10, 3.8
7 C&AG's Report, para 2.3
8 Qq 52, 53
9 Qq 8–11, 52

a 20% allowance for tax avoidance measures by businesses which do not seem to have materialised.[10] The latest estimate, in November 2022, for the cumulative receipts from the Digital Services Tax to 2024–25 (the intended life of the tax) was just under £3 billion.[11]

5. HMRC did well to implement the tax at a cost of £6.3 million, which was below the budget both for IT and personnel.[12] HMRC told us that another positive result was the ability to form good relationships with the key business groups that supply a large proportion of the takings, including being able to work with them on implementing robust methods for calculating liability.[13]

Impact of the tax

6. The Digital Services Tax is an interim solution to meet a perceived a lack of 'fairness' in the current system, and is not on its own intended to deliver a 'fair' system, or to level the playing field between online retailers and the high street, although the additional receipts are obviously welcome.[14] The Digital Services Tax is set at 2% of turnover for firms whose worldwide revenues from in-scope digital activities are more than £500 million, and who derive more than £25 million of revenue from UK users.[15] The Departments told us that these criteria were a sensible compromise in order to avoid capturing smaller firms, using a rate broadly in line with that used in other countries' Digital Services Taxes.[16] Its design also reflected the opposition to the Digital Services Taxes by the United States, which is the headquarters for many of the largest business groups within scope of the tax.[17]

7. HMRC did not take the view that the tax was significant enough to have a noticeable additional burden on businesses. However, evidence submitted to us by one travel business complained of the greater impact on those operating high-volume, low-margin businesses.[18] HMRC also acknowledged that a business will be taxed twice – on the revenues received from UK users (through the Digital Services Tax) and on the profits derived from that revenue (through Corporation Tax, either in the UK or elsewhere).[19] Payers of the tax can, and are, passing the cost on to users.[20]

10 Q 36
11 Office for Budget Responsibility, *Economic and fiscal outlook*, 17 November 2022, table A.6
12 Q 54
13 Q 55
14 Qq 5, 20, 45, 92
15 C&AG's Report, para 1.9
16 Qq 12, 13, 17
17 Qq 14, 82
18 Q 90
19 Qq 24, 25
20 Qq 30, 64, C&AG's Report, para 1.11

2 The OECD Pillar One and Pillar Two reforms

The nature of the reforms

8. Since 2013, the Organisation for Economic Co-operation and Development (OECD) and the G20 group have worked together under the 'Base Erosion and Profit Shifting' project, and subsequently with around 140 countries and tax jurisdictions under the 'Inclusive Framework on Base Erosion and Profit Shifting', to reform international tax rules.[21] These reforms consist of two 'pillars':

- Pillar One will reallocate the taxing rights over the largest and most profitable multinational business groups from their home countries to the tax jurisdictions where their customers and users are located.
- Pillar Two introduces a global minimum corporate tax rate.[22]

Differences between the Digital Services Tax and Pillar One of the reforms

9. The Digital Services Tax is intended to fill the gap until the implementation of Pillar One, albeit as a 'second-best' solution.[23] Other countries have also introduced a Digital Services Tax, including France, Italy, Spain and Austria.[24] HM Treasury told us that this reflected the widespread feeling among members of the OECD that taxing the digital economy was "unfinished business."[25] The administrative approaches—such as the scope and frequency of returns—vary, as do the rates charged, which increases compliance costs for businesses. Stakeholders told the NAO that they viewed the UK's approach to implementing the tax favourably compared to some other countries.[26] The United States, home to many of the businesses most affected, has opposed these taxes and threatened sanctions in response.[27]

10. Pillar One's scope will differ from that of the Digital Services Tax. First, it will be a tax on profits rather than revenues. Second, it will apply to a much broader range of activities as it is not simply aimed at online business groups. However, unlike the Digital Services Tax, it will cover online sales. Requirements for global turnover of more than €20 billion and profits exceeding 10% of turnover will effectively limit coverage to around 100 of the world's largest and most profitable businesses.[28] More businesses will pay Pillar One because the tax is scoped more widely than the Digital Services Tax, but it is also likely that some businesses paying Digital Services Tax will not pay Pillar One. HM Treasury and HMRC do not think that experience with the Digital Services Tax will help with the implementation of Pillar One due to likely differences in the design, not least that Pillar

21 C&AG's Report, para 1.4
22 C&AG's Report, para 1.12
23 Qq 5, 46
24 Q 94
25 Q 16
26 Qq 12, 96 ; C&AG's Report, paras 1.7, 3.6
27 Qq 14, 82
28 C&AG's Report, para 1.13

One will be a tax on profits.[29] This is despite HMRC explaining to us that the introduction of the Digital Services Tax provided the opportunity to work closely with a group of likely future Pillar One taxpayers.[30]

11. It is unclear how the receipts from Pillar One will compare to the Digital Services Tax as HMRC has not yet modelled the likely receipts from businesses liable to pay Pillar One, prior to agreement being reached on how profits will move between countries.[31] The Office of Budget Responsibility has estimated revenues of over two billion pounds a year from Pillar Two by 2027–28.[32] The Chartered Institute of Taxation has expressed scepticism about achieving this level of receipts, although HM Treasury stated that the estimate is not inconsistent with OECD projections.[33]

Progress in implementing the reforms

12. Legislative decisions, implementation decisions and the operation of compliance regimes for Pillars One and Two will be carried out in line with agreed conventions and frameworks.[34] In July 2022 the OECD announced that the multilateral convention which will implement Pillar One globally will be open for jurisdictions to sign in mid-2023, with the aim of the Pillar One reforms coming into force in 2024. This represents a slippage of one year since the initial announcement in October 2021, although HM Treasury said it still expects the timetable to be met.[35] It has proved easier for countries to agree on the destination of reallocated profits than where they should move from.[36] HM Treasury considered that the main challenge would be to ensure that the key signatories to the Convention actually implemented it.[37] Most of all, the cooperation of the United States is crucial, given its opposition to existing Digital Services Taxes.[38]

29 Qq 6,7
30 Qq 55, 56
31 Q 28
32 HM Treasury, *Autumn Statement 2022*, 17 November 2022.
33 Qq 60–62
34 Qq 56–58
35 Qq 42, 43; C&AG's Report, para 1.4, 1.12, 1.14
36 Q 28
37 Qq 18, 59
38 Qq 82, 100–102

3 Future challenges in taxing digital businesses

Consequences of delay in introducing the OECD reforms

13. Legislative decisions, implementation decisions and the operation of compliance regimes for Pillars One and Two will be carried out in line with agreed conventions. As previously stated, the OECD's Pillar One is due to supersede the Digital Services Tax in 2024, and HM Treasury is keen for this to happen as quickly as possible.[39] Pillar One would require new legislation, which would include the repeal of the Digital Services Tax.[40] We asked what would happen if a multilateral consensus on implementation of the reforms was not achieved. The Departments explained that the legislation required a review of the Digital Services Tax in 2025, and there would be interest in what other countries were doing.[41] What happens next would depend on whether the reforms were held up by a glitch or had fallen by the wayside completely, as the Digital Services Tax might not be sustainable in the long term.[42]

14. The Chartered Institute of Taxation describes the Digital Services Tax as a 'blunt instrument'.[43] There are aspects of the tax's design that are tolerable in the short-term but would need to be addressed if its life was to be extended appreciably:

- The Digital Services Tax is a tax on revenues. If the activities are profitable, the business may also pay corporation tax or corporate income tax on those activities in the country where those profits are taxed.[44] HMRC does have provision for businesses to be exempted from payment if they can demonstrate that the activities in question are not profitable (called the alternative basis of charge).[45]

- The Expedia Group, one of the payers of the tax, pointed out to us in written evidence that for high-volume low-margin businesses such as themselves and other travel firms, a 2% tax on revenues effectively wipes out any profit.[46]

15. As long as Pillar One is introduced at some point, these issues will be partly offset by the fact that those businesses paying Digital Services Tax and Pillar One will be able to reduce their Corporation Tax payments by the amount that their Digital Services Tax payments exceeded what they would have paid under Pillar One during the 'transition' years of 2022 and 2023.[47] It also the case that the tax does not seem to have had any observable impact on businesses to date.[48] HMRC is not separately measuring the specific impact on UK-based businesses.[49]

39 Q 19
40 Q 105
41 Qq 22, 23, 103, 104
42 Qq 44, 91
43 Evidence submitted by the Chartered Institute of Taxation
44 Qq 24, 25
45 Qq 26, 27
46 Q 90; Evidence submitted by the Expedia Group,
47 Qq 81, 83; C&AG's Report, para 15
48 Qq 31–33
49 Q 35

Business' compliance with the Digital Services Tax

16. HMRC's compliance work on 2020–21 payments of the Digital Services Tax was ongoing when we took evidence in December 2022.[50] This has proved a much larger task than anticipated, as the number of business groups within the scope of the tax requiring review has grown to 101, covering 216 online services. HMRC was still engaged with 46 groups covering 104 online services as of September 2022.[51] HMRC told us that it pursues a resource-intensive one-to-one relationship with the businesses that provide the large majority of tax receipts, which involves approving the methodology used by businesses for allocation of taxable revenues to the UK.[52] Setting a high threshold for businesses to qualify for paying a tax is a lesson that HM Treasury is applying to other taxes. It allows focus on a smaller number of large payers while sparing smaller businesses from the administrative burden.[53]

17. HMRC and HM Treasury said that they have not seen any evidence of tax avoidance so far, for example by changing business models, as businesses have not regarded it as worth their while. But they assured us that they are aware of the risks and that anomalies would be investigated.[54] Neither has HMRC found any evidence of tax evasion, which it told us is not unexpected given the profile of the major players in this type of business.[55] Crypto assets are within scope for the Digital Services Tax. They are a rapidly developing area with little regulation. HMRC told us that it is one of the first tax authorities to produce comprehensive guidance on crypto assets and that the multilateral nature of Pillars One and Two will make compliance work on crypto transactions more straightforward.[56]

18. As stated above, HMRC has not yet faced the situation where an overseas-based business refuses to pay the correct amount of tax as assessed by HMRC. HMRC told us that it has bilateral and multilateral agreements with other countries that would allow it to ask the tax authority in the relevant country to assist in the collection of a tax debt. HMRC acknowledges that whether such cooperation would be forthcoming is debatable, given that the tax is a controversial one in some countries.[57]

Ensuring compliance with the OECD reforms

19. Pillar One will operate within a multilateral administrative framework, with the emphasis on international cooperation. This will be very different to how HMRC currently ensures compliance with its tax regime.[58] Getting 140 tax jurisdictions to agree on a framework for administering the new system will be a key challenge, but it may be even more of a challenge for some jurisdictions to then operate the system as intended. HMRC and HM Treasury acknowledged that work will be needed to increase the capacity of some

50 Q 37
51 C&AG's Report, figure 13
52 Qq 49–51
53 Qq 34, 56
54 Qq 65–68, 70–75
55 Q 69
56 Qq 38, 39
57 Qq 82, 84
58 Q 56

jurisdictions, while pointing out that the cooperation of some jurisdictions (such as those where Pillar One payers are headquartered or those that will be required to reallocate tax receipts under Pillar One) will be more important than others.[59]

20. There is a delicate line to tread between accountability, transparency and the maintenance of taxpayer confidentiality. The Digital Services Tax illustrates how difficult it is to talk about these issues in a way that protects confidentiality when you are dealing with a tax covering a small number of high-profile payers. This will also be an issue with Pillar One.[60] Nevertheless, the Departments told us that they are aware of the importance of other tax jurisdictions providing transparency to Parliament around calculations affecting UK receipts, including ensuring that the National Audit Office has the access it needs.[61]

59 Qq 18, 85, 86
60 Qq 76–80
61 Qq 87–89

Formal minutes

Monday 20 March 2023

Members present:

Dame Meg Hillier

Olivia Blake

Dan Carden

Mr Jonathan Djanogly

Mrs Flick Drummond

Peter Grant

Anne Marie Morris

Nick Smith

The Digital Services Tax

Draft Report (*The Digital Services Tax*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 20 read and agreed to.

Summary agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Resolved, That the Report be the Forty-fourth of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Adjournment

Adjourned till Thursday 23 March at 9.30am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Monday 8 December 2022

Jim Harra, Chief Executive and First Permanent Secretary, HMRC, **Jon Sherman**, Director of Business, Assets and International directorate, HMRC, and **Mike Williams**, Director Business and International Tax, HMT Q1–105

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

DST numbers are generated by the evidence processing system and so may not be complete.

1 Expedia Group (DST0001)

2 Information Technology Industry Council (ITI) (DST0006)

3 Internet Advertising Bureau UK (IAB UK) (DST0002)

4 The Chartered Institute of Taxation (CIOT) (DST0004)

5 techUK (DST0007)

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All publications from the Committee are available on the publications page of the Committee's website.

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