SLAUGHTER AND MAY

Taxing the Digital Economy

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How should digital businesses be taxed? It seems that everyone is currently trying to answer this question.

The international tax system currently works on the basis that the profits of a business should be taxed in the countries in which the business creates value. The international tax system has not kept pace with the changes in business models caused by the spread of digital technology. We still have a tax system that relies on a physical presence in a country in order for that country to tax the profits. A digital business model may require little physical presence and/or create value via user participation.

There is therefore a strong global movement to update the international tax rules, although there are differences of opinion on how best to do this and how quickly it needs to be done.

So what are the proposed solutions?

Separate proposals for long-term change have recently been published by each of the UK, the European Commission and the OECD, although it is acknowledged that this may take some time to agree. The UK and the Commission have also proposed interim solutions where significant value is derived from user participation. The table below summarises the various proposals.

	LONG-TERM SOLUTION	INTERIM SOLUTION
UK	Reform international tax framework to tax the profits attributable to user participation. Profits should be allocated to user jurisdictions only where there is a material user base being monetised by the business.	UK tax on the revenues of digital businesses deriving significant value from UK user participation. Likely to be aimed at particular categories of business (such as social media platforms, search engines and on-line marketplaces) and/or particular revenue streams (e.g. from on-line advertising and digital intermediary platforms).
EU	Tax profits of a digital platform which has a "significant digital presence" in a Member State, measured by reference to any of annual revenues from digital services, number of annual users or number of business contracts for digital services created.	A new Digital Services Tax at a rate of 3% of revenues created from activities where users play a major role in value creation (such as on-line advertising, digital intermediary platforms and sales of data generated from user-provided information). Worldwide and EU minimum annual revenue thresholds will apply.
OECD	Undertake a coherent and concurrent review of the profit allocation and nexus (allocation of taxing rights) rules. Should digitalised business be singled out or are the challenges broader?	No interim measures are recommended because there is no consensus on either the merit of, or the need for, them. If countries do want to introduce unilateral interim measures they should be temporary, targeted and compliant with a country's international obligations.

It is worth noting that only the Commission has worked up detailed legislative proposals, although, given the need for unanimity, it is unlikely that the Commission's proposed directives will be adopted in their current form. Ireland, in particular, has spoken out against the Commission's proposal for an interim measure on the basis that it would put small countries at a disadvantage.

What next?

These issues are complex and global consensus is necessary for any change to be properly workable. It is therefore disappointing that, yet again, the UK and the Commission both want to push forward with changes rather than wait for the OECD to come up with a solution upon which there is international consensus.

Businesses affected by these proposals need to make their views heard. HM Treasury is keen to engage with business on the UK's proposals and this will have an impact on the UK's discussions with the EU and the OECD. The OECD would also like to test the feasibility of different options. Now is the time to help determine what should be the basis for international taxation for the next hundred years.

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