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Section 301 Investigation
**Report on the United Kingdom's
Digital Services Tax**

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REPORT ON THE UNITED KINGDOM'S DIGITAL SERVICES TAX PREPARED IN THE INVESTIGATION UNDER SECTION 301 OF THE TRADE ACT OF 1974

EXECUTIVE SUMMARY

The Organisation for Economic Co-operation and Development (OECD) and G20 countries began negotiations in 2013 to address tax matters related to the digitalization of the economy as part of a broader review of international tax rules. Additional multilateral negotiations in that area are ongoing at the OECD.

On July 22, 2020, despite ongoing negotiations at the OECD, the United Kingdom adopted a Digital Services Tax (DST). The UK's unilateral DST applies a two percent tax on the revenues of certain search engines, social media platforms and online marketplaces. The UK DST applies only to companies with "digital services revenues" exceeding £500 million and "UK digital services revenues" exceeding £25 million. Companies became liable for the DST on April 1, 2020.

On June 2, 2020, the U.S. Trade Representative initiated an investigation of the UK DST under section 302(b)(1)(A) of the Trade Act of 1974, as amended (the Trade Act). Section 301 of the Trade Act sets out three types of acts, policies, or practices of a foreign country that are actionable: (i) trade agreement violations; (ii) acts, policies or practices that are unjustifiable (defined as those that are inconsistent with U.S. international legal rights) and burden or restrict U.S. commerce; and (iii) acts, policies or practices that are unreasonable or discriminatory and burden or restrict U.S. commerce. If the Trade Representative determines that an act, policy, or practice of a foreign country falls within any of the categories of actionable conduct, the Trade Representative must determine what action, if any, to take.

As discussed in this report, the investigation identified unreasonable, discriminatory, and burdensome attributes of the UK DST.

The UK DST discriminates against U.S. companies. UK Chancellor of the Exchequer Philip Hammond introduced the DST as "a narrowly-targeted tax" on revenues from "specific digital platform business models" that would be "carefully designed to ensure it is established tech giants – rather than our [UK] tech start-ups – that shoulder the burden of this new tax."¹ Such references to "established tech giants" by the UK allude to successful U.S. companies and indicate the intention to target U.S. companies while excluding similarly situated UK digital service companies. The UK DST, as adopted, is structured to target leading U.S. companies. Because the UK DST only pertains to three specific categories in which U.S. firms are marketplace leaders—namely, certain search engines, social medial platforms and online marketplaces—the UK DST unfairly targets U.S. companies. Additionally, companies which meet the DST's thresholds are expected to be exclusively, or predominately, U.S. companies.

The UK DST is unreasonable as it is inconsistent with prevailing principles of international taxation. By applying to certain gross revenues instead of income, the UK DST is inconsistent with prevailing principles of international corporate taxation. Application to certain gross revenues also results in double taxation, which is inconsistent with the principle of avoidance of double taxation. Because the UK DST incurs liability prior to its date of

¹ Chancellor of the Exchequer Philip Hammond, Budget 2018: Philip Hammond's speech (Oct. 29, 2018).

enactment, even if for a period of months, the UK DST is inconsistent with the principle of retroactivity. The UK DST is also structured to extend corporate taxation beyond the international tax principle of a permanent establishment, making the DST unfairly extraterritorial.

The UK DST is burdensome for affected U.S. companies. The DST is a burden on covered U.S. companies. The UK DST also incurs administrative, compliance, and cost burdens. Additionally, the UK DST adds to already high audit risk and uncertainty, which leads to additional costs. Because the UK DST imposes burdens and costs on covered companies, the UK DST burdens or restricts U.S. commerce.

Conclusions

As described in this report, the results of this investigation indicate that:

- (1) The United Kingdom's DST, by its structure and operation, discriminates against U.S. digital companies, including due to the selection of covered services and the revenue thresholds.
- (2) The United Kingdom's DST is unreasonable because it is inconsistent with principles of international taxation, including due to application to revenue rather than income, extraterritoriality, and retroactivity.
- (3) The United Kingdom's DST burdens or restricts U.S. commerce.

I. BACKGROUND

A. MULTILATERAL NEGOTIATIONS AND THE UNITED KINGDOM'S ADOPTION OF THE DIGITAL SERVICES TAX

The Organisation for Economic Co-operation and Development (OECD) and G20 countries began negotiations in 2013 to address tax matters related to the digitalization of the economy as part of a broader review of international tax rules.² Some outcomes were reached: the OECD and G20 countries decided on actions countries should implement to improve the operation of the international tax system.³ Additional multilateral negotiations in that area are ongoing at the OECD.⁴

On October 29, 2018, while OECD negotiations continued, the UK Chancellor of the Exchequer announced the creation of a new tax on digital services.⁵ Public consultations within the UK raised concerns regarding the proposed DST,⁶ including that: “revenue-based taxes can generate high effective rates of tax on profits, [and] risked being economically distortive[.]”⁷ “the scope of the DST by reference to business activities was too complex or ambiguous, and would make it difficult for businesses to know if they were in scope or not[.]”⁸ and the “degree to which this [the UK’s DST] would differ from DSTs being implemented in other countries, which would increase administrative burdens and the risks of double taxation[.]”⁹

Despite these concerns, the UK DST was introduced as part of the Finance Bill 2020.¹⁰ Written evidence received during the bill’s consideration again reflected significant concerns, including: “over some uncertainties in its application, but mostly that it risks contributing to a tide of unilateral measures, which bring compliance cost, complexity and double taxation, and ultimately also a less effective basis for combatting avoidance than full multinational

² See OECD, Action Plan on Base Erosion and Profit Shifting, July 19, 2013.

³ See OECD, OECD presents outputs of OECD/G20 BEPS Project for discussion at G20 Finance Ministers’ meeting, Oct. 5, 2015; OECD, BEPS 2015 Final Reports, Oct. 5, 2015, <https://www.oecd.org/ctp/beps-2015-final-reports.htm>.

⁴ See, e.g., OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, 9, OECD PUBLISHING (Oct. 14, 2020).

⁵ Chancellor of the Exchequer Philip Hammond, Budget 2018: Philip Hammond’s speech (Oct. 29, 2018), (transcript available at <https://www.gov.uk/government/speeches/budget-2018-philip-hammonds-speech>).

⁶ HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, Gov.UK (Nov. 2018), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754975/Digital_Services_Tax_-_Consultation_Document_FINAL_PDF.pdf.

⁷ HM Treasury, *Digital Services Tax: response to the consultation*, ¶ 2.6, Gov.UK (Jul. 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816389/DST_response_document_web.pdf (hereinafter “Digital Services Tax: Response to the Consultations”).

⁸ Digital Services Tax: Response to the Consultations, ¶ 3.3.

⁹ *Id.* at ¶ 3.3.

¹⁰ Finance (Digital Services Tax) Bill 2020, HC Bill [114], <https://publications.parliament.uk/pa/bills/cbill/58-01/0114/20114.pdf> (UK).

agreement.”¹¹ The bill received Royal Assent and was adopted as the Finance Act 2020 on July 22, 2020.¹²

In 2018, an OECD report stated that “[t]here is no consensus on either the merit or need for interim measures[.]”¹³ In 2020, an OECD report noted that “it is expected that any consensus-based agreement must include a commitment by members . . . to withdraw relevant unilateral actions, and not adopt such unilateral actions in the future.”¹⁴ Despite the United Kingdom’s approval of this OECD report,¹⁵ the UK adopted a DST without a sunset clause.¹⁶ The UK government asserts that “[t]he DST is intended to be an interim measure, pending a long-term global solution to the tax challenges arising from digitalization” and that it “believes this [review clause] achieves the same objectives as a sunset clause.”¹⁷ However, the UK’s own policy papers admit that in order to repeal the DST “Parliament would then need to take separate action, through a Finance Bill, to give effect to any decisions on the DST arising from the review[.]”¹⁸

Unilateral laws, like the United Kingdom’s DST, undermine progress in the OECD by making an agreement on a multilateral approach to digital taxation less likely.¹⁹ If unilateral measures proliferate while negotiations are ongoing, countries lose the incentive to engage seriously in the negotiations.²⁰ For this reason, among others, the United States has discouraged governments from adopting country-specific DSTs. Nonetheless, the United Kingdom has chosen to create and implement its own unilateral tax on digital services.

¹¹ *Written evidence submitted by the Chartered Institute of Taxation (FB12)*, PARLIAMENT.UK (Jun. 15, 2020), <https://publications.parliament.uk/pa/cm5801/cmpublic/Finance/memo/FB12.pdf> (hereinafter “Chartered Institute of Taxation DST Written Evidence”).

¹² HL (22 Jul. 2020) (804), <https://hansard.parliament.uk/lords/2020-07-22/debates/4819BE33-24A9-48F8-BE5A-BB0FA4D69EB5/RoyalAssent>.

¹³ Org. for Economic Co-operation and Development, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, at 178 (OECD Publishing 2018), https://read.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-interim-report_9789264293083-en#page180.

¹⁴ Org. for Economic Co-operation and Development, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, at 211 (OECD Publishing 2018), https://read.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint_beba0634-en#page213.

¹⁵ *Id* at 4.

¹⁶ *See* Finance Act (2020) § 71, c. 14 (Eng.), <https://www.legislation.gov.uk/ukpga/2020/14/part/2/enacted>.

¹⁷ HM Treasury, *Digital Service Tax: response to the consultation*, § 7.7-7.8, Gov.UK (Jul. 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816389/DST_response_document_web.pdf.

¹⁸ HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, § 9.9, Gov.UK (Nov. 2018).

¹⁹ *See, e.g.*, Chartered Institute of Taxation DST Written Evidence at 1.

²⁰ *See, e.g.*, Silicon Valley Tax Directors Group, Comment Letter Re: Written Submission in Response to Initiation of Section 301 Investigations of Digital Services Taxes (USTR-2020-0022), 75 (Jul. 15, 2020) (“In recent Parliamentary debates, the [UK] Government was challenged to include a review of the UK DST in 12 months from its effective date, but it declined to do so. In light of this, we are not confident the UK would withdraw its DST if a global consensus is reached.”).

B. BACKGROUND OF THE INVESTIGATION

On June 2, 2020, the U.S. Trade Representative initiated an investigation of the UK DST under section 302(b)(1)(A) of the Trade Act.²¹ On the same date, the Trade Representative requested consultations with the government of the United Kingdom.²² The United Kingdom’s Chancellor of the Exchequer accepted the request for consultations in a letter dated August 18, 2020.²³ Consultations were held on December 4, 2020.

As set out in the Notice of Initiation, the investigation involves determinations of whether the act, policy, or practice at issue—i.e., the UK’s DST—is actionable under section 301 of the Trade Act, and if so, what action, if any, to take under Section 301. This report provides analysis relevant to a determination of actionability under Section 301.

1. Relevant Elements of Section 301

Section 301 sets out three types of acts, policies, or practices of a foreign country that are actionable: (i) trade agreement violations; (ii) acts, policies or practices that are unjustifiable (defined as those that are inconsistent with U.S. international legal rights) and burden or restrict U.S. commerce; and (iii) acts, policies or practices that are unreasonable or discriminatory and burden or restrict U.S. commerce.²⁴ Section 301 defines “discriminatory” to “include . . . any act, policy, and practice which denies national or most-favored nation treatment to United States goods, service, or investment.”²⁵ “[U]nreasonable” refers to an act, policy, or practice that “while not necessarily in violation of, or inconsistent with, the international legal rights of the United States is otherwise unfair and inequitable.”²⁶ The statute further provides that, in determining if a foreign country’s practices are unreasonable, reciprocal opportunities to those denied U.S. firms “shall be taken into account, to the extent appropriate.”²⁷

If the Trade Representative determines that the Section 301 investigation “involves a trade agreement,” and if that trade agreement includes formal dispute settlement procedures, USTR may pursue the investigation through consultations and dispute settlement under the trade agreement.²⁸ Otherwise, USTR will conduct the investigation without recourse to formal dispute settlement.

If the Trade Representative determines that the act, policy, or practice falls within any of the three categories of actionable conduct under Section 301, the USTR must also determine

²¹ Initiation of Section 301 Investigations of Digital Services Taxes, 85 Fed. Reg. 34,709, 34,710 (Jun. 5, 2020).

²² See Letter from Ambassador Robert Lighthizer to Rt Hon Elizabeth Truss MP, June 2, 2020 (Annex 1).

²³ See Letter from Sec’y of State for Int’l Trade Rt Hon Elizabeth Truss MP & Chancellor of the Exchequer Rt Hon Rishi Sunak MP to Ambassador Robert Lighthizer, Aug. 18, 2020 (on file with USTR).

²⁴ 19 U.S.C. § 2411(a)-(b).

²⁵ 19 U.S.C. § 2411(d)(5).

²⁶ 19 U.S.C. § 2411(d)(3)(A).

²⁷ 19 U.S.C. § 2411(d)(3)(D).

²⁸ 19 U.S.C. § 2413(a).

what action, if any, to take. If the Trade Representative determines that an act, policy or practice is unreasonable or discriminatory and that it burdens or restricts U.S. commerce:

The Trade Representative shall take all appropriate and feasible action authorized under [section 301(c)], subject to the specific direction, if any, of the President regarding any such action, and all other appropriate and feasible action within the power of the President that the President may direct the Trade Representative to take under this subsection, to obtain the elimination of that act, policy, or practice.²⁹

Actions authorized under Section 301(c) include: (i) suspending, withdrawing, or preventing the application of benefits of trade agreement concessions; (ii) imposing duties, fees, or other import restrictions on the goods or services of the foreign country; (iii) entering into binding agreements that commit the foreign country to eliminate or phase out the offending conduct or to provide compensatory trade benefits; or (iv) restricting or denying the issuance of service sector authorizations, which are federal permits or other authorizations needed to supply services in some sectors in the United States.³⁰

2. Focus of the Investigation

The initial focus of the investigation was: “[d]iscrimination against U.S. companies; retroactivity; and possibly unreasonable tax policy. With respect to tax policy, the DSTs may diverge from norms reflected in the U.S. tax system and the international tax system in several respects. These departures may include: [e]xtraterritoriality; taxing revenue not income; and a purpose of penalizing particular technology companies for their commercial success.”³¹

Additionally, USTR invited comments as to the extent to which the DST burdens or restricts U.S. commerce as well as other aspects that may warrant a finding that the UK DST is actionable under Section 301.³²

3. Input from the Public

USTR provided the public and other interested persons with opportunities to present their views and perspectives on the United Kingdom’s DST. The Initiation Notice invited written comments by July 15, 2020.³³ More than 380 public comments were filed in response to the Initiation Notice.³⁴ USTR received comments from businesses, industry associations, and other groups that supported the section 301 investigation and provided information and arguments in support of the bases identified in the Initiation Notice.³⁵

²⁹ 19 U.S.C. § 2411(b).

³⁰ In cases in which USTR determines that import restrictions are the appropriate action, preference must be given to the imposition of duties over other forms of action. 19 U.S.C. § 2411(c).

³¹ *Initiation of Section 301 Investigations of Digital Services Taxes*, 85 Fed. Reg. 34,709, 34,710 (June 5, 2020).

³² *Id.*

³³ *Id.* at 34,709.

³⁴ *See Initiation of Section 301 Investigations of Digital Services Taxes*, Docket USTR-2020-0022, REGULATIONS.GOV.

³⁵ *See, e.g.*, Silicon Valley Tax Directors Group, Comment Letter Re: Written Submission in Response to Initiation of Section 301 Investigations of Digital Services Taxes (USTR-2020-0022), 14-25 (Jul. 15, 2020).

II. THE UNITED KINGDOM DIGITAL SERVICES TAX

This section describes the structure and expected operation of the United Kingdom’s DST. Subsection A describes the content of the United Kingdom’s digital services tax, focusing on several major elements: the definition of taxable services, the revenue thresholds for covered companies, the scope of revenues covered, how the tax is paid, and its relationship to other taxes. Subsection B discusses the companies that United Kingdom politicians and independent commentators have suggested will be covered by the DST.

A. FEATURES OF THE UNITED KINGDOM’S DIGITAL SERVICES TAX

Taxable Services

The UK describes its DST as “a tax on the gross revenues that a group receives from providing a digital services activity to UK users.”³⁶ The UK digital services tax applies to certain business models. Specifically, the UK digital services tax applies to businesses that provide a social media service, an internet search engine or an online marketplace.³⁷ The UK law defines a “[s]ocial media service” as:

an online service that meets the following conditions—

(a) the main purpose, or one of the main purposes, of the service is to promote interaction between users (including interaction between users and user-generated content), and

(b) making content generated by users available to other users is a significant feature of the service.^[38]

Under the DST’s enacting law, an internet search engine “does not include a facility on a website that merely enables a person to search—the material on that website, or the material on that website and on closely related websites.”³⁹

The UK law defines an “[o]nline marketplace” as:

an online service that meets the following conditions—

(a) the main purpose, or one of the main purposes, of the service is to facilitate the sale by users of particular things, and

³⁶ HM Revenue & Customs, *Overview of Revenues*, DIGITAL SERVICES TAX MANUAL, DST21000 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst21000>.

³⁷ Finance Act (2020) § 43(2), c. 14 (U.K.), <https://www.legislation.gov.uk/ukpga/2020/14/part/2/enacted>.

³⁸ *Id.* at § 43(3).

³⁹ *Id.* at § 43(4).

(b) the service enables users to sell particular things to other users, or to advertise or otherwise offer particular things for sale to other users.⁴⁰

Certain services, such as financial services, are excluded from the DST.⁴¹ However, HM Revenue & Customs guidance indicates that “[i]t is possible some non-financial marketplaces may receive some revenues from financial or payment services. As these marketplaces will not qualify for the exemption, these revenues will remain taxable where they arise in connection with the marketplace.”⁴²

Revenue Thresholds

Under the UK law, companies are liable for the DST when the total amount of a business group’s worldwide “digital services revenues” exceeds £500 million, and the total amount of “UK digital services revenues” arising in that period to members of the group exceeds £25 million.⁴³ The UK “DST operates by reference to accounting periods[.]”⁴⁴ HM Revenue & Customs guidance notes that “[t]he DST rules restrict the maximum length of the DST accounting period to 12 months.”⁴⁵

Scope of Revenues

The first revenue threshold pertains to “digital services revenues.” These revenues are defined as “the total amount of revenues arising to members of the group in that period in connection with any digital services activity of any member of the group.”⁴⁶ As described by HM Revenue & Customs:

⁴⁰ *Id.* at § 43(5). HM Revenue & Customs guidance provides the following description:

There are two parts to the online marketplace definition which must both be satisfied for an online service to fall in scope:

- the service enables users to sell particular things to other users, or to advertise or otherwise offer to other users particular things for sale, and
- the main purpose, or one of the main purposes, of the service is to facilitate the sale by users of particular things.

The first condition is a factual test which considers whether the features of the online service enable third party users to sell things to other users. The second then considers whether the facilitation of such transactions is a main purpose of the service.

HM Revenue & Customs, *Online Marketplace - Overview*, DIGITAL SERVICES TAX MANUAL, DST18100 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst18100>.

⁴¹ Finance Act (2020) § 45, c. 14 (U.K.).

⁴² HM Revenue & Customs, *Financial Services*, DIGITAL SERVICES TAX MANUAL, DST18700 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst18700>.

⁴³ Finance Act (2020) § 46, c. 14 (U.K.); HM Revenue & Customs, *Policy paper – Digital Services Tax* (March 11, 2020), <https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax>.

⁴⁴ HM Revenue & Customs, *DST Accounting Periods*, DIGITAL SERVICES TAX MANUAL, DST42000 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst42000>.

⁴⁵ *Id.*

⁴⁶ Finance Act (2020) § 40, c. 14 (U.K.).

This is a very broad concept. There only has to be a connection or link between the revenues received and the underlying activity for the revenues to be included. It does not matter how the group generates these revenues or how they are described. This means revenues from ancillary activities to the DST activity will be included as Digital Services revenues. . . . The breadth of this definition means that revenues may arise in connection with both a digital service activity and another online service. In these circumstances, the revenues should be attributed to the digital services activity on a just and reasonable basis.⁴⁷

The second revenue threshold pertains to “UK digital services revenues.” UK digital services revenues are defined as “so much of its digital services revenues for that period as are attributable to UK users.”⁴⁸ The Finance Act outlines five circumstances in which revenues are considered to be attributable to UK users:

Case 1 is where—

- (a) the revenues are online marketplace revenues,
- (b) they arise in connection with a marketplace transaction, and
- (c) a UK user is a party to the transaction.

Case 2 is where—

- (a) the revenues are online marketplace revenues, and
- (b) they arise in connection with particular accommodation or land in the United Kingdom (see section 42).

Case 3 is where—

- (a) the revenues are online marketplace revenues,
- (b) they arise in connection with online advertising for particular services, goods or other property, and
- (c) the advertising is paid for by a UK user.

Case 4 is where—

- (a) the revenues are online advertising revenues,
- (b) they are not within any of Cases 1 to 3, and
- (c) the advertising is viewed or otherwise consumed by UK users.

Case 5 is where—

- (a) the revenues are not within any of Cases 1 to 4, and
- (b) they arise in connection with UK users.⁴⁹

Alternatively stated, HM Revenue and Customs guidance identifies that:

Social media services will often receive revenues from:

⁴⁷ HM Revenue & Customs, *Digital Services Revenues*, DIGITAL SERVICES TAX MANUAL, DST23000 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst23000>.

⁴⁸ Finance Act (2020) § 41, c. 14 (U.K.).

⁴⁹ Finance Act (2020) § 41, c. 14 (U.K.).

- displaying advertising to users of the service
- subscription or other access fees from users of the service
- charging users to access specific content on the platform
- other direct fees from users of the service
- sale or licencing of user data

Internet search engines will typically receive revenues from:

- Search advertising on the group’s search engine results
- Search advertising shown by the search engine on third-party websites
- Other search advertising revenues
- sale/licencing of user data [and]

Online marketplaces will often receive revenues from:

- Commission fees received for facilitating transactions between users
- Delivery fees
- Fees to access or otherwise buy and sell products, services or other property on the platform
- Fees from advertising products to users of the marketplace, either by preferential search listings or display advertising
- General advertising on the marketplace
- Subscription fees to access marketplace services[.]⁵⁰

However, the law exempts certain online marketplace revenues from the scope of UK digital services revenues when “they arise in connection with particular accommodation or land outside the United Kingdom . . . and . . . the only UK user who is a party to the transaction is a provider or seller of the thing to which the transaction relates;” or “they arise in connection with particular accommodation or land outside the United Kingdom[.]”⁵¹

Rate

The UK digital service tax applies a 2% tax on covered revenues when a business group’s revenues exceed the DST thresholds.⁵² The UK DST provides for an allowance of £25 million, which means that companies will not be charged for the first £25 million of covered revenues.⁵³

⁵⁰ HM Revenue & Customs, *Common Sources of Revenue from Digital Services Activities*, DIGITAL SERVICES TAX MANUAL, DST24000 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst24000>.

⁵¹ Finance Act (2020) § 41 c. 14 (U.K.) (emphasis added).

⁵² See, e.g., HM Revenue & Customs, *Policy Paper: Introduction of the new Digital Services Tax*, GOV.UK (Jul. 11, 2019), <https://www.gov.uk/government/publications/introduction-of-the-new-digital-services-tax/introduction-of-the-new-digital-services-tax>; *Digital Technology: Taxation*, PQ61662, UK PARLIAMENT (June 24, 2020) <https://questions-statements.parliament.uk/written-questions/detail/2020-09-29/96879>.

⁵³ Finance Act (2020) § 46, 47, c. 14 (U.K.); see also HM Revenue & Customs, *Policy paper: Digital Services Tax*, GOV.UK (Mar. 11, 2020), <https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax>.

The UK also provides for an alternative basis of charge for its DST.⁵⁴ A company may voluntarily elect to calculate its DST liability under this method.⁵⁵ Pursuant to HM Revenue & Customs guidance, a separate election may apply to each category of digital services activities, *i.e.*, one for social media services, another for internet search engines and a third for its online marketplaces.⁵⁶ This alternative calculation method involves seven steps:

Steps 1 & 2

The first step is therefore to divide the group's total UK digital services revenues between each category of digital services activity.

Step 3

The next step involves apportioning the £25m annual allowance between the group's categories of digital services activities. The apportionment is done by multiplying the £25m allowance by the ratio of each category's UK digital services revenues over the group's total UK digital services revenues.

Step 4

Step 4 involves calculating the operating margin of each category of revenues the group has made an election to calculate its liability under the alternative charge. This step does not need to be followed for any other category.

The operating margin is calculated by deducting any relevant operating expenses (E) from the UK digital services revenues of that category (R). The result is then divided by the UK digital services revenues of the category (R).

The margin will be nil if E exceeds R.

Step 5

The total liability of the group for the specified category of revenues ('taxable amount') is calculated as $0.8 \times \text{the operating margin} \times \text{the net revenues}$.

The operating margin is the margin found in Step 4.

The net revenues are found by deducting the category's share of the allowance (Step 3) from the UK digital services revenue of that category.

For any category of revenues that is not being calculated under the alternative charge calculation, the taxable amount is 2% of the net revenues.

Step 6

The taxable amounts are then added together to come to the 'group amount' (*i.e.* the total DST liability of the members of the group).

⁵⁴ Finance Act (2020) § 48, c. 14 (U.K.).

⁵⁵ HM Revenue & Customs, *Alternative Charge Election*, DIGITAL SERVICES TAX MANUAL, DST43400 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst43400>.

⁵⁶ HM Revenue & Customs, *Alternative Charge Calculation*, DIGITAL SERVICES TAX MANUAL, DST43410 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst43410>.

Step 7

The relevant person's liability to digital services tax in respect of the accounting period is the appropriate proportion of the group amount. There is further guidance on this in DST44000.⁵⁷

The UK notes that such an "election is only of benefit in cases where there is a very low operating margin on the digital services activity."⁵⁸

Retroactive Liability & Payment of DST

The United Kingdom adopted the DST on July 22, 2020.⁵⁹ However, DST tax liability obligates as of April 1, 2020.⁶⁰ Payment for the UK DST is due on the day following the end of nine months from the end of the accounting period.⁶¹ The first accounting period begins on April 1, 2020 and ends on March 31, 2021, subject to certain conditions.⁶²

Relationship to Other Taxes

In a policy document, HM Revenue & Customs identified that "[t]he DST will be deductible as a normal business expense but not creditable against UK Corporation Tax".⁶³ HM Revenue & Customs guidance following the DST's adoption confirmed that "[t]here are no specific rules determining the deductibility or otherwise of DST against any other tax liability. For UK Corporation Tax the normal rules concerning whether expenditure is an allowable deduction should be considered in respect of each DST liability."⁶⁴ One comment noted that per HM Revenue & Customs guidance, "the DST will be deductible against UK Corporation Tax under existing principles, but it will not be creditable."⁶⁵ This suggests that the UK DST is an additive tax.

⁵⁷ *Id.*

⁵⁸ HM Revenue & Customs, *Alternative Charge Election*, DIGITAL SERVICES TAX MANUAL, DST43400 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst43400>.

⁵⁹ *Royal Assent*, House of Lords Hansard v. 804 (Jul. 22, 2020), <https://hansard.parliament.uk/lords/2020-07-22/debates/4819BE33-24A9-48F8-BE5A-BB0FA4D69EB5/RoyalAssent>.

⁶⁰ Finance Act (2020) § 61 c. 14 (U.K.); HM Revenue & Customs, *Policy paper – Digital Services Tax* (March 11, 2020) ("The Digital Services Tax will apply to revenue earned from 1 April 2020.").

⁶¹ Finance Act (2020) § 51, c. 14 (U.K.).

⁶² *Id.* at § 61.

⁶³ HM Treasury, *Digital Service Tax: response to the consultation, Intended approach*, Gov.UK (Jul. 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816389/DST_response_document_web.pdf.

⁶⁴ HM Revenue & Customs, *UK CT Deductibility of DST*, DIGITAL SERVICES TAX MANUAL, DST47100 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst47100>.

⁶⁵ Silicon Valley Tax Directors Group, Comment Letter Re: Written Submission in Response to Initiation of Section 301 Investigations of Digital Services Taxes (USTR-2020-0022), 75 (Jul. 15, 2020).

Revenues arising from certain cross-border transactions subject to a non-UK digital service tax may receive limited tax relief.⁶⁶ In order to receive relief, the corporate group subject to the UK DST must make a claim for relief in its DST return.⁶⁷ If the UK determines that a valid claim for relief has been made, then UK digital services revenues from the qualifying cross-border transactions may be reduced by 50%.⁶⁸ As of August 5, 2020, HM Revenue & Customs considered only four countries, France, Italy, Malaysia, and Turkey, as sufficiently similar to the UK DST for the purposes of cross-border relief.⁶⁹

Expected Tax Revenues

In March, 2020, HM Revenue & Customs reported estimated annual revenues for the DST as follows:

Exchequer impact (£ million) ^[70]					
2019 to 2020	2020 to 2021	2021 to 2022	2022 to 2023	2023 to 2024	2024 to 2025
+70	+280	+390	+425	+465	+515

Under this assessment, the UK anticipated raising a total of £2.145 billion from the DST from 2019 through 2025. As of November, 2020, the UK Office of Budget Responsibility forecast receipts for the digital services tax as follows:

Outturn	Forecast [in £ billion] ^[71]					
2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
0.0	0.2	0.3	0.4	0.5	0.5	0.6

Under this assessment, the UK forecasts raising a total of approximately £1.9 billion from the DST from 2019 through 2025.

B. COVERED COMPANIES

The UK digital services tax applies to certain business models. This creates a challenge in assessing whether a business is in scope, as business models are rapidly evolving for businesses engaged in providing services through the use of dynamic, cutting-edge technology. Accordingly, it is difficult to predict with certainty what companies will be covered by the DST.

As described in this report, the DST applies only to companies employing specified business models (involving a social media service, an internet search engine or an online

⁶⁶ Finance Act (2020) § 50, c. 14 (U.K.).

⁶⁷ HM Revenue & Customs, *Cross Border Relief Claim*, DIGITAL SERVICES TAX MANUAL, DST43200 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst43200>.

⁶⁸ *Id.*

⁶⁹ HM Revenue & Customs, *Similar DSTs*, DIGITAL SERVICES TAX MANUAL, DST43300 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst43300>.

⁷⁰ HM Revenue & Customs, *Policy paper: Digital Services Tax* GOV.UK (Mar. 11, 2020).

⁷¹ Office for Budget Responsibility, *Economic and fiscal outlook*, Nov. 2020, CP318, Table 3.3 (UK).

marketplace) with, during the previous accounting period (of up to 12 months), digital services revenues exceeding £500 million and UK digital services revenues exceeding £25 million.⁷² Revenue thresholds are determined at the company group level.⁷³ Previously, companies have not been required to publish (or even to collect) data on whether they meet these revenue thresholds.⁷⁴

United Kingdom policy papers identify that the UK DST will be borne by “a small number of large multinational groups.”⁷⁵ In a 2018 review of the DST, the UK Office for Budget Responsibility reported that “[i]n total around 30 groups were identified[.]”⁷⁶ Those groups were “identified using the United Nations Conference on Trade and Development *World Investment Report* and the commercial ORBIS database.”⁷⁷

While that UK report did not identify which companies were among the 30 company groups that may be subject to the DST, the report concluded that “[m]ost of the forecast revenue is expected to come from a handful of large businesses. This mostly relates to advertising revenue and the commissions charged by online marketplaces.”⁷⁸

The UK report’s conclusion is consistent with the few companies identified in this investigation to have publicly addressed how they will handle the UK DST, which is an indicator that those companies may incur UK DST liability. Notably, all of these companies were U.S. companies. These include:

- Amazon, a U.S.-headquartered company, addressed how it would handle the UK DST charge;⁷⁹

⁷² HM Revenue & Customs, *DST Thresholds, Rates and Allowances*, DIGITAL SERVICES TAX MANUAL, DST41000 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst41000>.

⁷³ *Id.*; Finance Act (2020) § 57, c. 14 (U.K.); HM Revenue & Customs, *Definition of a Group for DST*, DIGITAL SERVICES TAX MANUAL, DST12600 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst12600>.

⁷⁴ Finance Act (2020) § 54, c. 14 (U.K.) (addressing the “[d]uty to notify HMRC when threshold conditions are met”).

⁷⁵ HM Revenue & Customs, *Policy paper – Digital Services Tax* (March 11, 2020); HM Revenue & Customs, *Policy paper - Introduction of the new Digital Services Tax*, Gov.UK (July 11, 2019), <https://www.gov.uk/government/publications/introduction-of-the-new-digital-services-tax/introduction-of-the-new-digital-services-tax>.

⁷⁶ Office for Budget Responsibility, *Economic and fiscal outlook*, 2018, Cm 9713, A.9-14 (UK).

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Upcoming fee changes in the UK following introduction of Digital Services Tax*, AMAZON SERVICES (Aug 4, 2020), <https://sellercentral-europe.amazon.com/forums/t/upcoming-fee-changes-in-the-uk-following-introduction-of-digital-services-tax/322163>.

- Apple, a U.S.-headquartered company, addressed how it would handle the UK DST charge;⁸⁰
- eBay, a U.S.-headquartered company, reported that “eBay is one of the marketplaces which will have to pay the new tax[;]”⁸¹
- Facebook, a U.S.-headquartered company, addressed how it would handle the UK DST charge;⁸² and,
- Google, a U.S.-headquartered company, addressed how it would handle the UK DST charge.⁸³

Media reports corroborate the assessment that digital services companies impacted by the UK DST are mainly U.S. companies.⁸⁴

III. USTR’S FINDINGS REGARDING THE UNITED KINGDOM’S DIGITAL SERVICES TAX

A. THE UNITED KINGDOM’S DIGITAL SERVICES TAX DISCRIMINATES AGAINST U.S. COMPANIES

Analysis of “large multinational groups” subject to the UK DST identifies mainly U.S. companies, indicating that the UK DST discriminates against and unfairly targets U.S. companies.

1. Statements by UK Officials Show that the Digital Services Tax Is Intended to Unfairly Target U.S. Companies

UK officials, including the UK Prime Minister, Chancellor of the Exchequer, and members of Parliament have indicated that the DST is targeted towards U.S. companies. These UK officials, who proposed and enacted the UK DST, have indicated the intention to target

⁸⁰ *Upcoming tax and price changes for apps and in-app purchases*, DEVELOPER.APPLE.COM (Sept. 1, 2020), <https://developer.apple.com/news/?id=oyy56t2r>.

⁸¹ UK News Team, *Protecting your business from Digital Services Tax costs*, COMMUNITY.EBAY.CO.UK (Oct. 8, 2020, 2:52 pm), <https://community.ebay.co.uk/t5/Announcements/Protecting-your-business-from-Digital-Services-Tax-costs/ba-p/6701162>.

⁸² *Facebook Won’t Hit UK Advertisers With Digital Tax Costs*, LAW360 (Sept. 4, 2020, 4:09pm), <https://www.law360.com/articles/1307667/facebook-won-t-hit-uk-advertisers-with-digital-tax-costs>.

⁸³ See Alex Barker, *Google to pass cost of digital services taxes on to advertisers*, FIN. TIMES (Sept. 1, 2020), <https://www.ft.com/content/fda648aa-bb52-4ab2-aa18-46b5023cb893>.

⁸⁴ See, e.g., Alexander J. Martin, *UK announces 2% digital services tax on Facebook, Google and Amazon*, SKY NEWS (Mar. 11, 2020), <https://news.sky.com/story/uk-announces-2-digital-services-tax-on-facebook-google-and-amazon-11955381> (“The department explained the tax was likely to affect ‘large multi-national enterprises with revenue derived from the provision of a social media service, a search engine or an online marketplace to UK users’. Key among these will be Facebook, Google and Amazon.”); Hadas Gold, *U.S Tech companies will be hit with new UK tax in just three weeks*, CNN BUSINESS (Mar. 11, 2020), <https://www.cnn.com/2020/03/11/tech/uk-digital-tech-tax/index.html> (“The measure is designed to ensure that large tech companies — many of them American — pay more tax. . . .”).

U.S. companies by reference to “established tech giants[.]” This, and similar phrases, allude to successful U.S. companies, which are frequently identified in conjunction with these statements of intention. For example:

- On November 14, 2019, John McDonnell, a UK Member of Parliament, tweeted that “[w]e will pay for this through . . . a new tax on multinationals – *so the tech giants like Facebook and Google will pay a bit more.* . . .”⁸⁵
- On December 3, 2019, UK Prime Minister Boris Johnson said that “[o]n the digital services tax, I do think we need to look at the operation of the big digital companies and the huge revenues they have in this country and the amount of tax that they pay. . . . We need to sort that out. They need to make a fairer contribution.”⁸⁶
- On February 3, 2020, Margaret Hodge, a UK Member of Parliament, wrote that: “[I]ast year we learnt once again how *Google, Facebook, and Amazon* all made billions of pounds in the UK but only paid corporate tax bills worth tens of millions of pounds. This is a fraction of what they should be paying! These *US companies* . . . are not paying their fair share back.”⁸⁷
- On November 16, 2019, Jeremy Corbyn, a UK Member of Parliament and then-Leader of the Labour Party, tweeted that “[w]hen companies like *Google* paid just £28 million in tax - despite making £1.6 billion in UK sales - that suggests they can afford to contribute a bit more.”⁸⁸

These statements address how much U.S. companies pay in taxes to the UK but do not address whether similarly situated UK digital services companies should pay a greater share of taxes. Such statements strongly point to an intention to target U.S. companies with special, unfavorable tax treatment.⁸⁹

⁸⁵ John McDonnell (@johnmcdonnellMP), TWITTER (Nov. 14, 2019, 5:12 PM), <https://twitter.com/johnmcdonnellMP/status/1195102227620384769> (emphasis added).

⁸⁶ *Johnson backs tech tax despite Trump’s threats*, BBC (Dec. 4, 2019), <https://www.bbc.com/news/business-50656106>.

⁸⁷ Margaret Hodge, MP, *Netflix must pay its fair share of tax*, Politicshome.com (Feb. 3, 2020), <https://www.politicshome.com/thehouse/article/netflix-must-pay-its-fair-share-of-tax> (emphasis added).

⁸⁸ Jeremy Corbyn (@jeremycorbyn), TWITTER (Nov. 16, 2019, 8:19 AM), <https://twitter.com/jeremycorbyn/status/1195692857400725504> (emphasis added).

⁸⁹ See also Information Technology Industry Council, Comment Letter on Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 10-12 (July 15, 2020), <https://beta.regulations.gov/comment/USTR-2020-0022-0345>.

2. The Selection of Covered Services Under the UK DST Discriminates Against U.S. Companies

In 2018, the UK Chancellor of the Exchequer Philip Hammond introduced the Digital Service Tax by announcing that:

This will be a narrowly-targeted tax on the UK-generated revenues of specific digital platform business models.

It will be *carefully designed* to ensure it is established tech giants – *rather than our tech start-ups* - that shoulder the burden of this new tax.⁹⁰

Carefully designed is an apt description—the UK DST targets three categories of services where U.S. companies are market leaders: internet search engines, social media services and online marketplaces. It appears unlikely that the DST will cover certain digital services where similar UK or European firms are successful.⁹¹

Internet Search Engines

Two analyses of the UK DST conclude that the only two search engines likely to qualify for the UK DST are Google and Microsoft’s Bing.⁹² The market share held by U.S. companies corroborates such a conclusion. According to one data analytics firm, four U.S. companies: Google, Bing, Yahoo!, and DuckDuckGo, account for over 99% of the search engine market.⁹³ Thus, inclusion of internet search engines as one of the three covered digital services provides support for the conclusion that the UK DST is narrowly defined so as to unfairly target U.S. companies.

Social Media Services

UK guidance identifies certain social media services that are within scope of the DST, which include: “social or professional networks[,], blogging or discussion platforms[,], video or

⁹⁰ Chancellor of the Exchequer Philip Hammond, Budget 2018: Philip Hammond’s speech (Oct. 29, 2018) (emphasis added).

⁹¹ See, e.g., Alex Hern, *UK to impose digital sales tax despite risk of souring US trade talks*, THE GUARDIAN (Mar. 11, 2020), <https://www.theguardian.com/media/2020/mar/11/uk-to-impose-digital-sales-tax-despite-risk-of-souring-us-trade-talks> (“European digital successes such as Spotify and Monzo are excluded because they do not operate “search engines, social media services and online marketplaces”).

⁹² Rory Cellan-Jones, *Budget 2018: Who will pay the Digital Services Tax?*, BBC NEWS (Oct. 30, 2018), <https://www.bbc.com/news/technology-46028715>; Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION (May 13, 2019), <https://itif.org/publications/2019/05/13/digital-services-taxes-bad-idea-whose-time-should-never-come>.

⁹³ Joseph Johnson, *Search engines ranked by market share in the United Kingdom (UK) as of June 2020*, Statista (Jul. 28, 2020), <https://www.statista.com/statistics/280269/market-share-held-by-search-engines-in-the-united-kingdom/>.

image sharing platforms[,] dating platforms[,] [and] review platforms.”⁹⁴ This investigation identified at least one U.S. headquartered company, which operates a social media service, subject to the UK DST.⁹⁵ However, this investigation has not positively identified any UK company that will be subject to the UK DST.

Online Marketplaces

This investigation identified at least two U.S. headquartered companies that operate online marketplaces and are likely to be subject to the UK DST.⁹⁶ However, this investigation has not positively identified any UK companies that will be subject to the UK DST.

UK guidance suggests that the UK DST will be interpreted in a manner so as to shield UK companies from DST liability. Specifically, the UK government has stated that it “will continue to give consideration to how the legislation applies to marketplace delivery fees and whether that application is consistent with the policy rationale of the DST.”⁹⁷ If the UK applies the DST in a manner excluding “marketplace delivery fees”, this would result in the exclusion of companies such as Just Eat or Deliveroo, which are the few—if any—UK companies that might otherwise be subject to the UK DST.⁹⁸

Because the UK DST targets select digital service activities where U.S. companies are market leaders, the UK DST is structured to discriminate against U.S. companies and target U.S. companies with special, unfavorable tax treatment.

3. The UK DST Revenue Thresholds Discriminate Against U.S. Companies

As described in Section II, the UK DST applies only to companies with annual digital services revenues over £500 million and “UK digital services revenues” over £25 million.⁹⁹ Statements by UK officials responsible for creation of the DST and UK policy documents indicate that the DST revenue thresholds were designed to target U.S. companies.

In 2018, the UK Chancellor of the Exchequer Philip Hammond stated that the DST “will be a narrowly-targeted tax on the UK-generated revenues of specific digital platform business

⁹⁴ HM Revenue & Customs, *Guidance: Check if you need to register for Digital Services Tax*, GOV.UK (Apr. 1, 2020), <https://www.gov.uk/guidance/check-if-you-need-to-register-for-digital-services-tax>.

⁹⁵ *Facebook Won't Hit UK Advertisers With Digital Tax Costs*, LAW360 (Sept. 4, 2020, 4:09pm), <https://www.law360.com/articles/1307667/facebook-won-t-hit-uk-advertisers-with-digital-tax-costs> (Facebook, a U.S.-headquartered company, addressed how it would handle the UK DST charge.).

⁹⁶ UK News Team, *Protecting your business from Digital Services Tax costs*, COMMUNITY.EBAY.CO.UK (Oct. 8, 2020, 2:52 pm), <https://community.ebay.co.uk/t5/Announcements/Protecting-your-business-from-Digital-Services-Tax-costs/ba-p/6701162> (eBay, a U.S.-headquartered company, reported that “eBay is one of the marketplaces which will have to pay the new tax[.]”).

⁹⁷ *Budget 2020*, HC 121, March 2020, ¶ 2.205.

⁹⁸ Tim Bradshaw, *UK aims to raise £500m a year through digital services tax*, FIN. TIMES (Mar. 11, 2020), <https://www.ft.com/content/a2ccbba8-5f0e-11ea-b0ab-339c2307bcd4>.

⁹⁹ Finance Act (2020) § 46, c. 14 (UK); HM Revenue & Customs, *Policy paper – Digital Services Tax* (March 11, 2020).

models. It will be carefully designed to ensure it is *established tech giants – rather than our tech start-ups* - that shoulder the burden of this new tax.”¹⁰⁰ As previously described in this report, such a reference to “established tech giants” is an allusion to leading U.S. digital service companies. A key aspect of this design is the selected revenue thresholds, which as addressed in Section II, largely include U.S. companies but exclude UK companies.

Comments submitted in this investigation reinforce the assessment that the UK DST thresholds are discriminatory against U.S. companies. As noted by one comment, “[a] host of successful U.S. technology companies meet these thresholds, while very few (if any) domestic companies meet both thresholds.”¹⁰¹ Another comment in this investigation noted that the UK DST’s “high gross revenue thresholds . . . effectively discriminate against large digital services [companies] . . . of which many are headquartered in the [U.S.]”¹⁰² A third comment added that “[t]he practical effect of the tax will be that a handful of U.S. companies will contribute the majority of the tax revenue.”¹⁰³

This is not an abstract issue, as described by a comment which noted that such thresholds place “U.S. travel technology companies at a disadvantage relative to [online travel agents] in local markets, who may command a large local market share . . . but which fall just under the current DST revenue thresholds and therefore will not pay any DST.”¹⁰⁴ Another comment noted that with respect to advertising services, “DSTs have the effect of shifting advertising spending away from larger U.S. companies with revenues that exceed the thresholds, to domestic companies with digital advertising revenues that do not meet the thresholds”¹⁰⁵—thus, unfairly advantaging domestic companies against leading U.S. companies.

Furthermore, aside from separating large U.S. companies from others, there is no particular significance to the DST threshold levels chosen by the UK.¹⁰⁶ Amplifying statements by the UK contend that “[t]he thresholds are also based on an expectation that the value derived from users will be more material for large digital businesses, which have established a large UK

¹⁰⁰ Chancellor of the Exchequer Philip Hammond, Budget 2018: Philip Hammond’s speech (Oct. 29, 2018).

¹⁰¹ Jeff Paine, Asia Internet Coalition (AIC) Comments and Recommendations to USTR’s Initiation of Section 301 Investigations of Digital Services Taxes (DST), 3 (Jul. 15, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0337>; *see also* Interactive Advertising Bureau, Re: Docket No. USTR-2020-0022 (Jul. 15, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0374> (“As a result of their success in the U.S. and globally, many U.S. companies meet or exceed the revenue thresholds established by DSTs.”).

¹⁰² Dr. Matthias Bauer, European Centre for International Political Economy (ECIPE) Comment Letter: Initiation of Section 301 Investigations of Digital Services Taxes (Jul. 14, 2020), <https://beta.regulations.gov/comment/USTR-2020-0022-0318>.

¹⁰³ Rachel Stelly, Comments of the Computer & Communications Industry Association (CCIA), 13 (Jul. 14, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0329>.

¹⁰⁴ Travel Technology Association, Comment Letter Re: Initiation of Section 301 Investigations of Digital Services Tax, 2 (Jul. 14, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0323>.

¹⁰⁵ Alex Propes, Re: Docket No. USTR-2020-0022 (Jul. 15, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0374>.

¹⁰⁶ Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION (May 13, 2019).

user-base, and generate substantial revenues from that user base[.]”¹⁰⁷ and that “the revenue thresholds provide an implicit measure of user created value. Marketplaces which generate less than £500m of annual turnover are unlikely to benefit from large scale network effects from having users on both sides of the platform.”¹⁰⁸ Such justifications are baseless. Not only has the theory of “user created value” been thoroughly refuted, but as described by one analysis, “[i]t is not clear why users suddenly create more value when a company gets beyond this size.”¹⁰⁹

Guidance pertaining to the revenue thresholds further clarifies that the thresholds are intended to unfairly target leading U.S. companies. For example, in policy papers, the UK government noted that “[t]he thresholds and allowance will apply on a group-wide basis, not on a per business activity or per company basis[.]”¹¹⁰ and that “[r]evenues will consequently be counted towards the Digital Services Tax thresholds even if they are recognised in entities which do not have a UK taxable presence for corporation tax purposes.”¹¹¹ The aim of these rules is to ensure that leading U.S. firms’ revenues are captured by the UK DST. Thus, the revenue thresholds chosen by the UK discriminate against and unfairly target U.S. companies.

B. THE UNITED KINGDOM’S DIGITAL SERVICE TAX IS UNREASONABLE BECAUSE IT IS INCONSISTENT WITH INTERNATIONAL TAX PRINCIPLES

This investigation assesses that the UK DST is inconsistent with principles of international taxation, including application to revenue rather than income, corporate income taxation unconnected to a permanent establishment, retroactivity, and prevention of double taxation.

1. The DST’s Application to Revenue Rather than Income Is Inconsistent with International Tax Principles

The architecture of the international tax system reflects that corporate income (as defined by domestic law), and not corporate gross revenue, is an appropriate basis for taxation. There are over 3,000 bilateral tax treaties in effect, the majority of which are based on the OECD Model Tax Convention on Income and on Capital and on the UN Model Double Taxation Convention between Developed and Developing Countries.¹¹² The OECD model treaty provides disciplines on the taxation of “business profits” and other types of income streams, such as dividends, interest, royalties, and capital gains. However, the OECD model treaty makes no provision for taxes on gross revenues.¹¹³ The UN model treaty likewise has disciplines on

¹⁰⁷ HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, § 6.7, Gov.UK (Nov. 2018).

¹⁰⁸ HM Revenue & Customs, *Online Marketplace - Overview*, DIGITAL SERVICES TAX MANUAL, DST18100 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst18100>.

¹⁰⁹ Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION (May 13, 2019).

¹¹⁰ HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, § 6.8, Gov.UK (Nov. 2018).

¹¹¹ HM Revenue & Customs, *Policy paper – Digital Services Tax* (March 11, 2020).

¹¹² BRIAN J. ARNOLD, AN INTRODUCTION TO TAX TREATIES 1 (2015).

¹¹³ OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD PUBLISHING, art. 7, Dec. 18, 2017 (on business profits); *see id.* arts. 6, 8-21.

business profits and numerous other types of income but has no provision for taxes on gross revenues.¹¹⁴ The U.S. model tax treaty, as well as scores of bilateral tax treaties to which the United States is a party, including the U.S.-U.K. Tax Treaty, have the same scope in this regard.¹¹⁵ Other sources confirm that prevailing tax policy principles support the taxation of corporate income but not of gross revenue, for example, one analysis noted that most European countries rejected revenue-based taxation in the 1960s.¹¹⁶

Chapter 2 of the OECD publication *Addressing the Tax Challenges of the Digital Economy*, entitled “Fundamental Principles of Taxation,” recognizes two bases for corporate taxation—income and consumption.¹¹⁷ The UK DST is neither. As described by the OECD, income taxes are “imposed on net profits, that is receipts minus expenses.”¹¹⁸ The UK DST, however, is a tax on gross revenue.¹¹⁹ The OECD notes that “[i]ncome taxes are levied at the place of source of income.¹²⁰ UK policy papers make clear that revenues are not distinguished by the place of source of income, rather, solely based on the revenues relationship to a covered business model: “taxable revenues will include any revenue earned by the group which is connected to the social media service, search engine or online marketplace, irrespective of how the business monetises the service.”¹²¹

Nor is the DST a consumption tax. Consumption taxes “find their taxable event in a transaction, the exchange of goods and services for consideration either at the last point of sale to the final end user (retail sales tax and VAT), or on intermediate transactions between businesses (VAT)[,]”¹²² and “are levied at the place of destination (i.e.[,] the importing country).”¹²³

The distinction between the UK DST and a consumption tax is most apparent in the case of online advertising. Under the UK DST, revenues are taxable when “the revenues are online advertising revenues” and “the advertising is viewed or otherwise consumed by UK users.”¹²⁴

¹¹⁴ See United Nations, *Model Double Taxation Convention Between Developed and Developing Countries*, art. 7, 2017 (setting out disciplines on taxes of business profits); *id.* arts. 6, 8-21 (covering other types of income).

¹¹⁵ See Dep’t Treasury, *United States Model Income Tax Convention*, art. 2, 2016 (setting out disciplines on “total income, or on elements of income”); *id.* art. 7 (establishing disciplines on taxes of “business profits”); *Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains, with exchange of notes, U.K.-U.S., Jul. 24, 2001, 2224 U.N.T.S. 247 (amended Jul. 19, 2002) (hereinafter “U.S.-U.K. Tax Treaty”).*

¹¹⁶ Daniel Bunn, *A Summary of Criticism of the EU Digital Tax*, Tax Foundation (Oct. 22 2018), <https://taxfoundation.org/eu-digital-tax-criticisms/>.

¹¹⁷ OECD, *Addressing the Tax Challenges of the Digital Economy*, ch. 2: “Fundamental Principles of Taxation,” at 32-47 (2014).

¹¹⁸ *Id.* at 33.

¹¹⁹ *Id.* at 32.

¹²⁰ *Id.* at 32.

¹²¹ HM Revenue & Customs, *Policy paper: Digital Services Tax* (Mar. 11, 2020), <https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax>.

¹²² OECD, *Addressing the Tax Challenges of the Digital Economy*, ch. 2: “Fundamental Principles of Taxation,” at 32 (2014).

¹²³ *Id.*

¹²⁴ Finance Act (2020) § 41, c. 14 (U.K.).

However, such viewers are not a party to the transaction between advertisement purchaser and advertiser that constitutes the transaction which generates revenue. In order to attempt to include the user or viewer in the analysis of the place of destination, the location of the advertisement purchaser and advertiser become irrelevant under the UK DST's analysis. Simply explained: “[s]ince viewers don’t pay anything to tech firms, the attribution of advertising and other revenues (perhaps paid by firms in New York or Paris) to the UK will be arbitrary.”¹²⁵

For comparison, the UK already employs a value added tax (VAT) scheme, which is charged on “most goods and services,”¹²⁶ such as: “business sales - for example when you sell goods and services[,] hiring or loaning goods to someone[,] selling business assets[,] commission. . . [and] ‘non-sales’ like bartering, part-exchange and gifts[.]”¹²⁷ However, the UK VAT is separate and distinct from the UK DST. Thus, while the UK attempts to make the DST sound like a consumption tax¹²⁸—the UK DST is not—it is a gross revenue tax inconsistent with the principles of corporate income taxation.

In conclusion, analysis of the UK DST reveals that the DST's application to revenue rather than income is inconsistent with principles of international corporate taxation. Additionally, the UK DST conflates key elements of international corporate taxation, which is unreasonably inconsistent with principles of international corporate taxation.

2. The UK DST Results in Double Taxation

The UK DST is inconsistent with the tax principle of avoiding double taxation. Avoiding double taxation, *i.e.*, preventing the same income being taxed twice, is a foundational principle of the international tax system.¹²⁹ According to the OECD, the “*harmful effects* on the exchange of goods and services and movements of capital, technology and persons” of double taxation “*are so well known* that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents[.]”¹³⁰ Both tax treaties and model tax treaties alike make

¹²⁵ Gary Clyde Hufbauer & Zhiyao (Lucy) Lu, *UK Money Grab: Proposed Digital Tax*, Peterson Institute for International Economics (Nov. 1, 2018), <https://www.piie.com/blogs/realtime-economic-issues-watch/uk-money-grab-proposed-digital-tax>.

¹²⁶ *Tax on shopping and services*, GOV.UK, <https://www.gov.uk/tax-on-shopping>.

¹²⁷ *Businesses and charging VAT*, GOV.UK, <https://www.gov.uk/vat-businesses>.

¹²⁸ See, e.g., Finance Act (2020) § 41, c. 14 (U.K.); HM Revenue & Customs, *Policy paper: Digital Services Tax* (Mar. 11, 2020) (describing the UK DST as a “2% tax on the revenues of search engines, social media services and online marketplaces which *derive* value from UK users.”) (emphasis added); HM Revenue & Customs, *Common Sources of Revenue from Digital Services Activities*, DIGITAL SERVICES TAX MANUAL, DST24000 (Aug. 5, 2020), (annotating “Commission fees received for facilitating *transactions* between users”) (emphasis added).

¹²⁹ See, e.g., OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD PUBLISHING, introduction (Dec. 18, 2017) (“International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more). States on the same taxpayer in respect of the same subject matter and for identical periods.”).

¹³⁰ OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD PUBLISHING, introduction (Dec. 18, 2017).

clear that one of their primary objectives is the elimination of double taxation between countries.¹³¹

First, because of the gross-revenue design of the UK DST, leading U.S. companies may be subject to both national taxes, such as the UK Corporation Tax, as well as the DST.¹³² The structure of the UK DST also makes it more likely that the UK DST will not be within scope of the over 3,000 bilateral tax treaties in effect, the majority of which are based on the OECD Model Tax Convention on Income and on Capital and on the UN Model Double Taxation Convention between Developed and Developing Countries.¹³³ Accordingly, it is highly likely that the UK DST will result in double taxation.

Second, the UK DST's broad definition of revenues makes it likely that revenues subject to the UK DST will also be subject to digital service taxes or other taxes adopted by other taxing jurisdictions. Digital services taxes adopted or under consideration by dozens of countries and other jurisdictions take many forms, and as noted by HM Revenue & Customs: each jurisdiction's DST, or similar tax, employs a mechanism of taxation.¹³⁴ These divergent taxes and methods of taxation not only increase compliance burdens, but also make it more likely that multiple jurisdictions will partially, if not completely, overlap.

Advocates for the UK DST note that the UK DST contains a provision which authorizes tax relief when the revenues are subject to a foreign tax similar to the UK DST.¹³⁵ In practice, however, this provision provides minimal, if any, relief. As of August 5, 2020, HM Revenue & Customs believed that only four digital services taxes were sufficiently similar in order to qualify for any relief.¹³⁶ As one comment explained:

[T]he UK's attempted solution is insufficient; it actually highlights the extent of the problem. The proposed UK measure reduces the tax obligation by 50% in certain circumstances where the same revenue is subject to a DST in another jurisdiction. However, a 50% discount is arbitrary and is unlikely to eliminate the risk of multiple taxation where the two DSTs have basic differences, such as inconsistent tax rates, scope, and calculation methods. Also, the UK fix does not address multiple taxation as a result of home country corporate income taxes or

¹³¹ See, e.g., OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD PUBLISHING, preamble (Dec. 18, 2017); United Nations, *Model Double Taxation Convention Between Developed and Developing Countries*, preamble, 2017; United States Model Income Tax Convention, preamble, 2016.

¹³² See Dr. Matthias Bauer, European Centre for International Political Economy (ECIPE) Comment Letter: Initiation of Section 301 Investigations of Digital Services Taxes (Jul. 14, 2020), <https://beta.regulations.gov/comment/USTR-2020-0022-0318>.

¹³³ BRIAN J. ARNOLD, AN INTRODUCTION TO TAX TREATIES 1 (2015).

¹³⁴ HM Revenue & Customs, *Similar DSTs*, DIGITAL SERVICES TAX MANUAL, DST43300 (Aug. 5, 2020).

¹³⁵ *Id.*

¹³⁶ Cf. KPMG, *Taxation of the digitalized economy: developments summary*, KPMG.COM (Oct. 27, 2020), <https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf>.

other taxes.¹³⁷

Thus, the UK DST is likely to result in double taxation, which is unreasonable.

3. The UK DST's Retroactivity Is Inconsistent with International Tax Principles

Tax certainty is an important principle of international taxation. In 2003, the OECD Ottawa Taxation Framework identified “[c]ertainty and simplicity” as a key principle of taxation.¹³⁸ In 2014, the OECD again identified “certainty and simplicity” as one of the “fundamental principles of taxation” in its publication *Addressing the Tax Challenges of the Digital Economy*.¹³⁹ In that publication, the OECD stated that “[t]ax rules should be clear and simple to understand, so that taxpayers know where they stand.”¹⁴⁰ Additionally, the G20, of which the UK is a participant, reaffirmed their commitment to “enhanced tax certainty” in the G20 Osaka Leaders’ Declaration.¹⁴¹ The UN has also endorsed providing “legal and fiscal certainty as a framework within which international operations can confidently be carried on.”¹⁴² Other sources confirm that tax certainty is an important principle of international taxation.¹⁴³

¹³⁷ Information Technology Industry Council, Comment Letter on Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 17 (July 15, 2020).

¹³⁸ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, IMPLEMENTATION OF THE OTTAWA TAXATION FRAMEWORK CONDITIONS: THE 2003 REPORT (2003).

¹³⁹ OECD, *Addressing the Tax Challenges of the Digital Economy*, OECD/G20 Base Erosion and Profit Shifting Project, 30, OECD PUBLISHING (2014).

¹⁴⁰ *Id.* at 30.

¹⁴¹ *G20 Osaka Leaders’ Declaration*, 4, G20 (Jun. 29, 2019), <https://g20.org/en/g20/Documents/2019-Japan-G20%20Osaka%20Leaders%20Declaration.pdf> (“We reaffirm the importance of . . . enhanced tax certainty.”).

¹⁴² United Nations, Model Double Taxation Convention Between Developed and Developing Countries, at iv, 2017; see also BRIAN J. ARNOLD, AN INTRODUCTION TO TAX TREATIES, at 11 (2015) (“One of the most important effects of tax treaties is to provide certainty for taxpayers.”).

¹⁴³ See, e.g., *Implementation of the Ottawa Taxation Framework Conditions: The 2003 Report*, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (2003); Daniel Bunn, Elke Asen, Cristina Enache, *Digital Taxation Around the World*, 2, TAX FOUNDATION (May 27, 2020), <https://files.taxfoundation.org/20200610094652/Digital-Taxation-Around-the-World1.pdf> (“Taxpayers deserve consistency and predictability in the tax code. Governments should avoid enacting temporary tax laws, including tax holidays, amnesties, and retroactive changes. Many digital tax policies are designed to be temporary, with some timelines tied to international agreements on changes. Temporary tax policy creates uncertainty and challenges for both administration and compliance.”); OECD, *Mechanisms for the Effective Collection of VAT/GST When the Supplier is not Located in the Jurisdiction of Taxation*, 51, OECD PUBLISHING (2017), <https://www.oecd.org/tax/tax-policy/mechanisms-for-the-effective-collection-of-VAT-GST.pdf> (In keeping with this principle, the OECD has recommended a six-month phase in period for new extraterritorial VAT regimes. It explained that, “the provision of adequate lead time” is important to “promoting a good understanding of [the new tax] while allowing a smoother and proper operational process change” and that “[a] minimum of six months lead time is considered to be a reasonable period.”).

The UK DST was adopted on July 22, 2020.¹⁴⁴ However, DST tax liability obligates as of April 1, 2020.¹⁴⁵ While this three and a half month period may appear brief, nevertheless, the UK DST is inconsistent with the principle of tax certainty by attaching liability for the DST before the DST was adopted. Thus, the UK DST is inconsistent with the principle tax certainty, a key principle of international taxation. The UK DST’s inconsistency with this principle of international taxation is unreasonable.

4. The UK Digital Services Tax’s Extraterritoriality Is Inconsistent with International Tax Principles

As described in this report, the UK DST “is a tax on the gross revenues that a group receives from providing a digital services activity to UK users.”¹⁴⁶ As such, the UK DST is unconnected to a permanent establishment and unconnected to revenues related to such a permanent establishment. This investigation assesses that the UK DST’s application to revenues unconnected to companies’ presence in the United Kingdom is inconsistent with prevailing international tax principles, which provide that a company is subject to income-type taxation only to the extent that company has a permanent establishment in the taxing country.

The international tax system reflects the principle that companies are not subject to a country’s corporate tax regime in the absence of a territorial nexus to that country. This is reflected in international tax treaties, which typically establish that a company need not pay a country’s corporate income tax unless it has a “permanent establishment” in that country. For instance:

- The OECD model tax treaty provides that the profits of an enterprise “shall be taxable” only in the country of which the enterprise is a national “unless the enterprise carries on business in [another country] through a permanent establishment situated therein.”¹⁴⁷
- The UN Model Treaty similarly provides that the profits of an enterprise are taxable in a country only if “the enterprise carries on business in [that country] through a permanent establishment situated therein.”¹⁴⁸
- The U.S. Model Tax Treaty and the U.S.-U.K. Tax Treaty both contain similar provisions barring taxation absent a permanent establishment.¹⁴⁹

¹⁴⁴ *Royal Assent*, House of Lords Hansard v. 804 (Jul. 22, 2020), <https://hansard.parliament.uk/lords/2020-07-22/debates/4819BE33-24A9-48F8-BE5A-BB0FA4D69EB5/RoyalAssent>.

¹⁴⁵ Finance Act (2020) § 61, c. 14 (UK); HM Revenue & Customs, *Policy paper – Digital Services Tax* (March 11, 2020).

¹⁴⁶ HM Revenue & Customs, *Overview of Revenues*, DIGITAL SERVICES TAX MANUAL, DST21000 (Aug. 5, 2020).

¹⁴⁷ OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, art. 7(1).

¹⁴⁸ UN, *Model Double Taxation Convention Between Developed and Developing Countries*, art. 7(1).

¹⁴⁹ *Compare United States Model Income Tax Convention*, art. 7 (“Profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.”) with U.S.-UK Tax Treaty, art. 7 (“The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as

Each of these model treaties defines “permanent establishment” as “a fixed place of business through which the business of an enterprise is wholly or partly carried on.”¹⁵⁰ All also provide that the term includes a place of management, branch, office, factory, workshop, or “place of extraction of natural resources.”¹⁵¹ A “permanent establishment” does not include, *inter alia*, the maintenance of a fixed place of business solely for the purpose of “purchasing goods or merchandise or of collecting information for the enterprise” or of “carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.”¹⁵² Other sources confirm that this is the general rule in international tax policy.¹⁵³

The international tax system also reflects the principle that, if a foreign company has a permanent establishment in a country, it is subject to that country’s tax regime only to a circumscribed extent. The OECD model tax treaty provides that a country may tax a foreign company only on “the profits that are attributable to the permanent establishment” in that country.¹⁵⁴ The profits attributable to the permanent establishment “are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions.”¹⁵⁵ The U.S. model tax treaty and the U.S.-U.K. Tax Treaty both contain substantially the same provisions.¹⁵⁶ The UN model treaty is substantially similar: it provides that a country may tax only so much profit as is attributable to the permanent establishment in that country or to other business activities (including sales of goods) carried out in the country that are of “the same or similar kind” as those carried out by the permanent establishment.¹⁵⁷

As described by one comment: “[t]he U.S.-UK Income Tax Treaty is consistent with longstanding international norms on the taxation of income of nonresident companies, and a unilateral departure from that norm is evidence of unreasonableness.”¹⁵⁸

aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as are attributable to that permanent establishment.”). Note that the treaty in paragraph 5 of Article 5 may also deem a permanent establishment to exist notwithstanding the general rule in paragraphs 1 and 2 of Article 5 if there is a dependent agent conducting certain activities on behalf of the foreign enterprise.

¹⁵⁰ OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, art. 5(1); UN, *Model Double Taxation Convention Between Developed and Developing Countries*, art. 5(1); *United States Model Income Tax Convention*, art. 5(1); U.S.-U.K. Tax Treaty, art. 5(1).

¹⁵¹ OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, art. 5(2); UN, *Model Double Taxation Convention Between Developed and Developing Countries*, art. 5(2); *United States Model Income Tax Convention*, art. 5(2); U.S.-U.K. Tax Treaty, art. 5(2).

¹⁵² OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, art. 5(4); UN, *Model Double Taxation Convention Between Developed and Developing Countries*, art. 5(4); *United States Model Income Tax Convention*, art. 5(4); U.S.-U.K. Tax Treaty, art. 5(4)(e).

¹⁵³ See, e.g., OECD, Inclusive Framework on Base Erosion and Profit Shifting, Action 7: Permanent establishment status, OECD (2019), <https://www.oecd.org/tax/beps/beps-actions/action7/>.

¹⁵⁴ OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, art. 7(1).

¹⁵⁵ *Id.* at art. 7(2).

¹⁵⁶ *United States Model Income Tax Convention*, art. 7; U.S.-U.K. Tax Treaty, art. 7; see *supra* n. 161.

¹⁵⁷ UN, *Model Double Taxation Convention Between Developed and Developing Countries*, art. 7(1)-(3).

¹⁵⁸ United States Council for International Business (USCIB) Comments on Initiation of Section 301 Investigations of Digital Services Taxes, Docket No. USTR-2020-0022, 14 (Jul. 15, 2020).

In sum, pursuant to prevailing international tax principles: (1) a company is only subject to a country's corporate tax if it maintains a permanent establishment in that country; and (2) if such a permanent establishment exists, then a company is only subject to tax on its revenues attributable to that permanent establishment. The UK DST is inconsistent with these principles because it is not limited to companies with a permanent establishment in the United Kingdom. Rather, liability for the UK DST is based on revenue thresholds. These revenue thresholds represent a shortcut to taxing leading U.S. digital service companies without identifying a permanent establishment.¹⁵⁹

This conclusion is corroborated by a UK policy paper, which states that “[r]evenues will consequently be counted towards the Digital Services Tax thresholds even if they are recognised in *entities which do not have a UK taxable presence* for corporation tax purposes.”¹⁶⁰

This means that for companies with a physical presence in the United Kingdom, the revenues to which the DST applies are not limited to those attributable to a permanent establishment. A covered company may have an office in the UK that carries out a particular, limited function for the company. This office and its operations may be so limited that it does not meet the definition of “permanent establishment,” meaning that generally the company would not be subject to corporate taxation in the United Kingdom. Alternatively, the office may meet the definition of permanent establishment but only provide a subset of the services that the company provides. Under existing international tax principles, that would mean the country where the permanent establishment is located would be entitled to tax, not all profit the company generates in its territory, but only profit that the permanent establishment might be expected to make if it were an independent company in its (limited) line of business.¹⁶¹

This assessment comports with comments to this investigation.¹⁶² Because this analysis demonstrates that UK DST is inconsistent with existing, longstanding international norms which govern when a country may exercise taxing jurisdiction over a resident of another country, the UK DST is unreasonable.

¹⁵⁹ Daniel Bunn, Elke Asen & Cristina Enache, *Digital Taxation Around the World*, TAX FOUNDATION (May 27, 2020).

¹⁶⁰ HM Revenue & Customs, *Policy paper – Digital Services Tax* (March 11, 2020) (emphasis added).

¹⁶¹ See OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, art. 7; United States Model Income Tax Convention, art. 7; U.S.-U.K. Tax Treaty, art. 7; UN, *Model Double Taxation Convention Between Developed and Developing Countries*, art. 7.

¹⁶² Silicon Valley Tax Directors Group, *Comment Letter Re: Written Submission in Response to Initiation of Section 301 Investigations of Digital Services Taxes (USTR-2020-0022)*, 19 (Jul. 15, 2020) (“All of the Covered DSTs are imposed on an extraterritorial basis, i.e. imposed on revenue streams unconnected to a permanent establishment established in the taxing state.”); United States Council for International Business (USCIB) *Comments on Initiation of Section 301 Investigations of Digital Services Taxes*, Docket No. USTR-2020-0022, 12 (Jul. 15, 2020) (“The UK DST has a safe harbor for low-profit or loss-making businesses, which is of course welcome, but is also an indication that the DST is intended to tax corporate profits that they would not be permitted to tax under an income tax treaty because these companies would not have a permanent establishment in the UK.”).

C. THE UNITED KINGDOM'S DIGITAL SERVICE TAX BURDENS OR RESTRICTS U.S. COMMERCE

This section of the report describes manners in which the UK DST burdens or restricts U.S. commerce.

1. DST Liability Is a Burden

As described in this report, the UK DST is expected to raise approximately £1.9 billion to £2.145 billion from the DST from 2019 through 2025. Because the covered companies identified in this report are mainly U.S. companies, U.S. companies are likely to incur the greatest burden under the DST.¹⁶³ Accordingly, the financial liability of the UK DST constitutes a burden.

2. The UK DST's Results in a Burdensome Effective Tax Rate for Covered U.S. Companies

UK officials argue that leading U.S. companies do not pay their “fair share” of taxes. However, the UK DST's application to revenue results in an effective tax rate more than twice the UK Corporation Tax rate. Because the UK DST is designed in a way that effectively extracts more taxes from leading U.S. companies than from UK companies subject only to the UK Corporation Tax, the UK DST burdens affected U.S. companies.

In the UK, corporations are subject to the UK Corporation Tax, which is a tax on corporate profits at the rate of 19%.¹⁶⁴ By contrast, the UK DST is a tax on specified gross revenues.¹⁶⁵ The difference between a tax on profits and a tax on gross revenues is stark—one analysis revealed that a “2 percent revenue tax applied to a business with a 4.6 percent profit margin would result in a 43.5 percent effective tax rate.”¹⁶⁶ According to this analysis, the effective tax rate is more than double the UK Corporation Tax rate and affected U.S. companies will bear the burden of a tax rate 24.5% higher than those companies would if subject to the UK Corporation Tax alone. As one comment assessed: “[t]his makes it different in substance and application than the income taxes that apply to other businesses in the UK.”¹⁶⁷

Comments to this investigation corroborate this analysis. As one comment noted: “by taxing gross revenue instead of profits, DSTs do not account for real costs of doing business, such as R&D [(research and development)] or capital expenditures. This increases the cost of

¹⁶³ See Rachel Stelly, Comments of the Computer & Communications Industry Association (CCIA), 13 (Jul. 14, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0329>.

¹⁶⁴ *Corporation Tax rates and reliefs*, GOV.UK, <https://www.gov.uk/corporation-tax-rates>.

¹⁶⁵ HM Revenue & Customs, *Overview of Revenues*, DIGITAL SERVICES TAX MANUAL, DST21000 (Aug. 5, 2020).

¹⁶⁶ Daniel Bunn, *Who will Ultimately Pay the Digital Services Tax in the UK?*, TAX FOUNDATION (Aug. 4, 2020), <https://taxfoundation.org/who-will-ultimately-pay-the-uk-digital-services-tax-amazon-passes-the-cost-along-to-sellers/>.

¹⁶⁷ Daniel Bunn & Elke Asen, Tax Foundation Comments on the Initiation of Section 301 Investigations of Digital Services Taxes, 9 (Jul. 9, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0295>.

capital and discourages investment and innovation for all companies in scope[.]”¹⁶⁸ A second comment stated that “[a] gross basis tax restricts commerce because companies will be forced to choose among unacceptable options: raise prices to cover the additional cost of the tax or cease to do business because the business is uneconomical.”¹⁶⁹ Thus, the UK DST burdens U.S. companies.

3. The UK DST Incurs High Compliance and Administrative Costs, Burdening Leading U.S. Companies

The UK DST incurs high compliance and administrative costs, which burdens leading U.S. digital companies in comparison to UK competitors that are not subject to the DST. As described by the UK:

The government envisages that, based on the broad design, businesses will need to take the following steps when determining whether they have to pay the DST:

- assess whether any of the activities performed by a group are within the meaning of one or more of the in-scope activities: the provision of a search engine, social media platform or online marketplace[;]
- determine the global revenues that are generated in connection with those in scope activities [;]
- determine how much of that revenue is attributable UK users[;]
- compare the revenues attributable to UK users (relevant revenues) with the revenue thresholds[;] [and]
- if they are above these thresholds the business will pay DST on its relevant UK revenues after the deduction of the allowance and any relevant safe harbour adjustments[.]¹⁷⁰

Each of these steps involves significant administrative and cost burdens to covered U.S. companies. Two examples are illustrative. First, the UK DST covers revenues from facilitating or providing online advertising when the advertising is viewed by a UK user.¹⁷¹ Just to determine a fundamental calculation for step three above, the DST and UK guidance requires covered companies to “allocate the revenues to UK users on a just and reasonable basis”.¹⁷² This, in turn, requires companies to:

. . . determine the revenues that are directly attributable to showing advertising to UK users. For example, some advertising contracts will be priced on a revenue

¹⁶⁸ Internet Association, *Comments of Internet Association*, 2 (Jul. 15, 2020), <https://beta.regulations.gov/comment/USTR-2020-0022-0326>.

¹⁶⁹ United States Council for International Business (USCIB) Comments on Initiation of Section 301 Investigations of Digital Services Taxes, Docket No. USTR-2020-0022 (Jul. 15, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0364>.

¹⁷⁰ Digital Services Tax: Response to the Consultation, 4.

¹⁷¹ HM Revenue & Customs, *Allocating Case 4 and Case 5 Revenues Between UK Users and Non-UK Users*, DIGITAL SERVICES TAX MANUAL, DST29000 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst29000>.

¹⁷² *Id.*

per click or revenue per impression basis. The group may consequently have the data to show the proportion of the revenues generated from a campaign which relate to UK users. Where it is possible to directly identify the revenues attributable to UK users, the group is required to do so.¹⁷³

In practical terms, this means that “[q]uantifying revenues attributable to UK users in this way is likely to be very complicated - . . . it is now not unimaginable that from April 2020 a business will be taxed on revenues from business activities because someone in the UK has ‘clicked’ on a page for 10 seconds before exiting[.]”¹⁷⁴

When such data is unavailable, HM Revenue & Customs guidance requires that the “group will need to apportion the total revenue (e.g. from that contract or campaign) between UK users and non-UK users on a just and reasonable basis[.]”¹⁷⁵ considering a list of factors that include:

- The intended commercial outcome of the transaction[;]
- The contractual requirements[;]
- The relative volume of users in each jurisdiction[;]
- The revenue per user in each jurisdiction[;]
- The relative engagement of users in each jurisdiction[;]
- The size and maturity of the online service in each jurisdiction[;] [and]
- The average profitability or revenue performance in each jurisdiction (or in comparable jurisdictions)[.]¹⁷⁶

Not only are these highly subjective criteria, which are likely to be the subject of complex audits,¹⁷⁷ but compliance requires, in essence, an individualized and detailed review of every sale, contract, or other source of revenue for every covered company. Such requirements will incur high costs and are an additional burden on affected U.S. companies.

Second, the UK DST’s retroactivity results in burdens for covered U.S. companies, which will also affect the companies and individuals that purchase their services. As a substantively new tax, the UK DST requires companies to implement complex new business and financial reporting systems to capture new transaction data. While the UK DST is only retroactive for a relatively short period of time, the UK DST provides no grace period for implementation.¹⁷⁸

¹⁷³ *Id.*

¹⁷⁴ Eloise Walker & Jason Collins, *UK’s new digital services tax will be ‘compliance nightmare’*, PINSENT MASONS (Nov. 7, 2018, 2:36pm), <https://www.pinsentmasons.com/out-law/news/uk-new-digital-service-tax-compliance-nightmare>.

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ See Digital Services Tax: Returns, Enquiries, Assessments and Appeals, Finance Act (2020) Schedule 8, c. 14 (UK).

¹⁷⁸ In this context, any period of retroactivity absent a grace period may raise these and similar issues. Cf. OECD, *Mechanisms for the Effective Collection of VAT/GST When the Supplier is not Located in the Jurisdiction of Taxation*, 51, OECD PUBLISHING (2017) (In keeping with this principle, the OECD has recommended a six-month phase in period for new extraterritorial VAT regimes. It explained that, “the provision of adequate lead time” is important to “promoting a good understanding of [the new tax] while allowing a smoother and proper operational process change” and that “[a] minimum of six months lead time is considered to be a reasonable period.”).

This means that companies were presented with two costly choices: undergoing a costly system re-design in advance of the DST's adoption or incurring costly audit risk attempting to apply and capture data for the prior three months.

Complying with the UK DST increases the costs of setting up such systems on affected U.S. companies. As one comment noted:

[T]he introduction of DSTs requires new tools and metrics to track and calculate the taxes payable based on the user location, which may run afoul of data protection standards and requirements. In addition, the need to collect data, translate and interpret legislation, calculate DSTs, often on multiple business models, and make filings and payments for each group company significantly increases the compliance costs [of companies][.]”¹⁷⁹

Further, as companies may not have been able to collect essential data prior to the UK DST's adoption, the UK DST adds to already high audit risk and uncertainty, which will lead to additional costs. As described in a comment to the investigation: “[m]any affected companies were likely not tracking the revenues to calculate their new tax burden prior to implementation, and all businesses will have to determine which revenue falls within the scope of the tax. This is further complicated by the tax's retroactivity.”¹⁸⁰ The UK DST's retroactivity also means that companies had already incurred DST liability for over three months at the time of adoption. This burdensome treatment impacts covered companies' ability to budget for this additional tax obligation, as described in a comment: “[r]etroactivity presents a huge administrative and compliance burden, and limits the ability of affected companies to effectively plan and prepare for a levy.”¹⁸¹ Thus, the UK DST's retroactivity results in burdens for covered U.S. companies.

Third, while UK DST permits limited cross-border relief claims, UK guidance imposes several conditions: first, it must be “a marketplace transaction where: . . . a foreign user is a party to the marketplace transaction [and] all or part of the revenues arising in connection with the transaction are or would be subject to a foreign DST charge[.]”¹⁸² The company seeking the relief must also collect and maintain sufficient information to establish for HM Revenue & Customs that the “mechanics” of the foreign DST charge are sufficiently similar to the UK DST, taking into account aspects such as “whether the tax is levied on gross revenues[.] whether the tax is calculated on the revenues that are derived from users in that territory [and] whether the tax applies to broadly similar services based on a similar policy rationale[.]”¹⁸³ HM Revenue & Customs guidance provides two examples of cross-border tax relief.¹⁸⁴ However, these

¹⁷⁹ Travel Technology Association, Comment Letter Re: Initiation of Section 301 Investigations of Digital Services Tax, 2 (Jul. 14, 2020), <https://www.regulations.gov/document?D=USTR-2020-0022-0323>.

¹⁸⁰ Engine Advocacy, Comments of Engine Advocacy, at 5 (July 15, 2020), <https://beta.regulations.gov/comment/USTR-2020-0022-0381>.

¹⁸¹ *Id.* at 5.

¹⁸² HM Revenue & Customs, *Cross-Border Relief Claim*, DIGITAL SERVICES TAX MANUAL, DST43300 (Aug. 5, 2020), <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst43300>.

¹⁸³ HM Revenue & Customs, *Similar DSTs*, DIGITAL SERVICES TAX MANUAL, DST43200 (Aug. 5, 2020).

¹⁸⁴ For instance, UK guidance provides the following example:

examples make it apparent that detailed information must be maintained and segregated for all revenue. Because the DST reduces liability by only 50% for covered revenues, even if sufficient information can be collected and maintained to establish qualifying claims, the cost and administrative burden of attempting to submit a qualifying claim is likely too high to justify attempts to seek claims under this provision.

Comments to this investigation corroborate this analysis. As noted by one comment:

[T]here are also substantial administrative burdens in terms of compliance costs and greater uncertainty. Companies will need to engage in significant reengineering of their internal business and financial reporting systems to ensure that they can accurately capture required information and comply with the DSTs. Companies will also need to include new filing and audit components on accounts in these jurisdictions, which creates legal and financial risks. For example, the data retention mechanisms necessary to support the calculations of ads shown in each country and taxable under their DSTs may not comply with the EU's General Data Protection Regulation (GDPR). To the extent that these taxes differ in scope and thresholds, those compliance costs increase. We estimate associated costs to be in the millions in each jurisdiction for those companies that are in scope. Further, there will be very high audit uncertainty, which will lead to additional disputes and subsequent costs.¹⁸⁵

A UK user buys a table on an online marketplace from a user based in Avalon. The user pays the online marketplace provider, Business O, an annual £100 subscription fee. As a result of the transaction the Avalonian user pays a £30 commission fee to Business O in addition to its £200 annual membership fee.

Business O's revenues from the marketplace transaction are the £30 commission. All of the revenues from the marketplace transaction will be UK digital services revenues.

The subscription and membership fees do not arise in connection with an individual transaction, online advertising or from listing particular items so do not fall within cases 1 to 4. They will consequently fall under the general rule in Case 5. The £100 subscription fee arises in connection with a UK user so the £100 will be UK digital services revenues. The £200 membership fee does not arise in connection with a UK user so is not taxable.

Avalon has a Digital Services Tax which is similar to the UK DST. The revenues from the transaction arise from a relevant cross border transaction.

Business O can make a claim for cross border transaction relief. If it makes the claim the UK digital services revenue from this transaction will be reduced to £15, being half of the £30 commission.

The £100 subscription fee paid by the UK user does not qualify for relief because it is not revenue relating to a marketplace transaction.

Id.

¹⁸⁵ Information Technology Industry Council, Comment Letter on Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 17 (July 15, 2020).

Another comment noted that: “[m]any affected companies were likely not tracking the revenues to calculate their new tax burden prior to implementation, and all businesses will have to determine which revenue falls within the scope of the tax. This is further complicated by the tax’s retroactivity.”¹⁸⁶

In sum, the UK DST requires significant data collection, maintenance, and calculation. Because the information required is different than what was previously required for tax compliance, the UK DST incurs high compliance and administrative costs. These costs place an additional burden on covered U.S. companies.

4. The UK DST’s Relationship to the UK Corporation Tax Burdens Covered U.S. Companies

In a policy document, HM Revenue & Customs identified that “[t]he DST will be deductible as a normal business expense but not creditable against UK Corporation Tax”.¹⁸⁷ This application is significant, as the UK government “acknowledges that if the DST is not creditable *this will have the effect of increasing some businesses’ global tax burden[.]*”¹⁸⁸

This provision increases the tax burden on U.S. companies, while limiting or eliminating the same tax burden on UK companies. As explained by one comment, this effect occurs because “a domestic company that pays a DST will generally be able to deduct the payment against its domestic corporate income taxes. This will increase the cost advantage for domestic firms, as foreign companies will not be able to offset their tax payments: [*i.e.*] they will not have a domestic income tax bill from which to deduct DST payments, and they will not be able to deduct the DST payments from their home country income taxes.”¹⁸⁹ This modality demonstrates that the UK DST’s relationship to national taxes is structured in a manner so as to burden covered U.S. companies.

5. The UK DST Burdens on Small- and Medium-Sized U.S. Companies

Additionally, the UK DST burdens U.S. small businesses and consumers as covered companies adjust pricing policies in response to the UK DST.¹⁹⁰ As noted by one comment: “[g]iven the design of these . . . measures [including the UK DST], there is also a high likelihood that costs will be passed down the supply chain, and in that respect hurt other U.S. companies,

¹⁸⁶ Engine Advocacy, Comments of Engine Advocacy, at 5 (July 15, 2020), <https://beta.regulations.gov/comment/USTR-2020-0022-0381>.

¹⁸⁷ HM Treasury, *Digital Service Tax: response to the consultation, Intended approach*, Gov.UK (Jul. 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816389/DST_response_document_web.pdf.

¹⁸⁸ *Id.* at § 6.42 (emphasis added).

¹⁸⁹ Information Technology Industry Council, Comment Letter on Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 15 (July 15, 2020), <https://beta.regulations.gov/comment/USTR-2020-0022-0345>.

¹⁹⁰ Isobel Asher Hamilton, *Apple, Amazon, and Google hike their developer and ad client fees to pass on the costs of paying new digital taxes in Europe*, Business Insider (Sept. 2, 2020), <https://www.businessinsider.com/apple-amazon-google-pass-costs-digital-services-taxes-2020-9>; Daniel Bunn, *Who will Ultimately Pay the Digital Services Tax in the UK?* TAX FOUNDATION (Aug. 4, 2020).

including small- and medium-sized companies.”¹⁹¹ UK officials do not dispute this: when asked what steps are being taken “to ensure that the Digital Services Tax does not result in cost increases for the customers and selling partners of large technology corporations[,]” UK Member of Parliament Jesse Norman stated that “[i]t is for businesses to decide their own pricing strategies.”¹⁹² As a result, while some U.S. companies initially attempted to absorb these costs, the decision of some firms to increase the price of the targeted activities shows that unilateral DSTs, such as the UK DST, may increase costs to consumers.¹⁹³ This indicates that the UK DST may also result in higher prices and costs for small- and medium-sized U.S. companies.

D. THE UNITED KINGDOM’S PUBLIC RATIONALES FOR THE DIGITAL SERVICES TAX ARE UNPERSUASIVE

1. Covered Companies Do Not Have Lower Tax Rates than Non-Covered Companies

While the UK DST was being debated and discussed, UK officials and political parties argued that leading U.S. digital companies should pay higher amounts of tax, for example:

- The UK Labour Party stated that “[t]he UK is losing £1.3bn in corporation tax to five of the biggest US tech firms each year because the Tories won’t hold them to account.”¹⁹⁴ In an accompanying video, the Labour Party stated “[f]ive of the biggest US tech firms paid just £237m in UK corporation in 2018, despite making more than £8billion in profits between them. Apple paid £71m UK tax for its three UK businesses[,] Microsoft paid £24.7m[,] Facebook £30m[,] Google £73m[,] Cisco £40m[.] The Government must hold multinationals to account to ensure they’re paying their fair share.”¹⁹⁵
- Jeremy Corbyn, a UK Member of Parliament, stated that “[w]hen companies like Google paid just £28 million in tax - despite making £1.6 billion in UK sales - that suggests they can afford to contribute a bit more.”¹⁹⁶
- Boris Johnson, while a candidate to become the UK Prime Minister, said that “I think it’s deeply unfair that high street businesses are paying tax through the nose... whereas the internet giants, the FAANGs -- Facebook, Amazon, Netflix and Google -- are paying

¹⁹¹ Information Technology Industry Council, Comment Letter on Docket No. USTR-2020-0022: Initiation of Section 301 Investigations of Digital Services Taxes, 16 (July 15, 2020).

¹⁹² *Digital Technology: Taxation, Question for Treasury*, PQ96879 (Oct. 7 2020), <https://questions-statements.parliament.uk/written-questions/detail/2020-09-29/96879>.

¹⁹³ See, e.g., *Upcoming tax and price changes for apps and in-app purchases*, DEVELOPER.APPLE.COM (Sept. 1, 2020), <https://developer.apple.com/news/?id=oyy56t2r>; *Upcoming fee changes in the UK following introduction of Digital Services Tax*, AMAZON SERVICES (Aug 4. 2020), <https://sellercentral-europe.amazon.com/forums/t/upcoming-fee-changes-in-the-uk-following-introduction-of-digital-services-tax/322163>.

¹⁹⁴ @UKLabour, TWITTER (Feb. 25, 2020, 8:20 AM), <https://twitter.com/UKLabour/status/1232294303147405312>.

¹⁹⁵ *Id.*

¹⁹⁶ @jeremycorbyn, TWITTER (Nov. 16, 2019, 8:19 AM), <https://twitter.com/jeremycorbyn/status/1195692857400725504>.

virtually nothing[.]”¹⁹⁷

These statements confuse key issues and fundamental principles that underpin the existing system of international corporate taxation.

First, statements, such as the Labour Party’s February 25, 2020 statement on Twitter, do not distinguish between worldwide profits and profits in the United Kingdom, i.e., profits attributable to a company’s permanent establishment in a country. As previously described in this report, taxation based on such permanent establishments is a recognized principle of international corporate taxation. This principle is reflected in, among others, model treaties, multilateral documents and the U.S.-U.K. Tax Treaty.

Second, statements, such as Jeremy Corbyn’s November 16, 2019 statement on Twitter, conflate sales with profit. As described in this report, gross revenue taxes are generally considered to be inconsistent with principles of international corporate taxation. Further, revenue-based taxes have been criticized on the grounds that they “are inefficient, create barriers to economic growth, and generally considered to be unfair tax policy.”¹⁹⁸ For these reasons, most European countries rejected revenue-based taxation in the 1960s.¹⁹⁹ Additionally, sales and corporate profits are not comparable bases for taxes. In the UK, sales are generally covered by the UK’s VAT tax scheme, whereas profits are covered by the UK’s Corporation Tax. Notably, because UK’s DST is a gross revenue tax, it does not address any possible issues with the appropriate taxes for those statistics, such as the UK’s VAT and the UK’s Corporation Tax.²⁰⁰

Third, Prime Minister Boris Johnson’s statement comparing ‘brick and mortar’ businesses to digital businesses implies that companies covered by the DST have a lower rate of taxation than non-covered companies. This is not supported by studies. Recent studies have shown that digital companies pay an average effective tax rate that is comparable or even higher than the average tax rate for traditional companies. A study by Copenhagen Economics found that “studies document that digital firms targeted by unilateral digital services taxation proposals pay as much tax as traditional firms.”²⁰¹ In two studies, the European Centre for International

¹⁹⁷ Reuters Staff, *UK PM candidate Johnson urges tax on global tech giants*, REUTERS (Jul. 4, 2019, 3:16 pm), <https://www.reuters.com/article/us-britain-eu-johnson-tech/uk-pm-candidate-johnson-urges-tax-on-global-tech-giants-idUSKCN1TZ1Z1>.

¹⁹⁸ Daniel Bunn, *A Summary of Criticism of the EU Digital Tax*, Tax Foundation (Oct. 22 2018), <https://taxfoundation.org/eu-digital-tax-criticisms/>

¹⁹⁹ *Id.*

²⁰⁰ See Daniel Bunn & Elke Asen, Tax Foundation Comments on the Initiation of Section 301 Investigations of Digital Services Taxes, 2 (Jul. 9, 2020) (“Unlike corporate income taxes, DSTs are levied on revenues rather than profits, not taking into account profitability. Seemingly low tax rates of such turnover taxes can translate into high tax burdens.1 For instance, a business with \$100 in revenue and \$85 in costs has a profit margin of \$15—or 15 percent. A DST rate of 3 percent means the business is required to pay \$3 in revenue tax (3 percent of \$100 revenue), corresponding to a profit tax of 20 percent (\$3 tax divided by \$15 profit). This implies that the corresponding effective profit tax rates vary by profitability, disproportionately harming businesses with lower profit margins.”).

²⁰¹ Helge Sigurd Næss-Schmidt, et al., *The Proposed EU Digital Services Tax: Effects on Welfare, Growth and Revenues*, COPENHAGEN ECONOMICS (Sep. 2018), <https://www.copenhageneconomics.com/dyn/resources/>

Political Economy (ECIPE) found that real industry data indicates that average effective tax rates of digital companies are at least as high as those of traditional companies. In particular, ECIPE concluded that “[a] great number of digital companies, including large [U.S.]-based Internet companies (e.g. Amazon, Facebook, Google), actually show much higher effective corporate tax rates than a myriad of traditional, less or non-digital companies headquartered in the EU[.]”²⁰² Thus, the UK statement does not raise a defensible rationale that that covered companies have lower rates of taxation than non-covered companies. Rather, covered companies may have higher overall rates of taxation.

2. UK Users Do Not Create Value for the Covered Companies in a Unique, Significant Way

The UK government and UK officials have promoted the rationale that leading U.S. digital service companies somehow uniquely benefit from user interaction, user content creation, or data provided by or concerning their users, for example:

- The 2020 UK budget report stated that the DST “will ensure the amount of tax paid in the UK reflects the value these businesses derive from their interactions with, and the contributions of, an active user base.”²⁰³
- UK Member of Parliament Jesse Norman stated that “[t]he Digital Services Tax is designed to ensure that digital businesses pay UK tax reflecting the value they derive from UK users.”²⁰⁴
- UK Member of Parliament Mel Stride stated that: “[t]he digital services tax is about certain types of digital businesses that generate substantial value in the United Kingdom as a direct consequence of the interaction of UK users and those digital platforms; this would be the likes of search engines, social media platforms and certain online marketplaces.”²⁰⁵

Publication/publicationPDF/7/457/1537162175/copenhageneconomics-study-on-the-eu-dst-proposal-13-september.pdf.

²⁰² Matthias Bauer, *Corporate Tax Out of Control: EU Tax Protectionism and the Digital Services Tax*, EUROPEAN CENTRE FOR INT’L POLITICAL ECONOMY (Feb. 2019), <https://ecipe.org/wp-content/uploads/2019/02/Corporate-Tax-Out-of-Control.pdf>.

²⁰³ *Budget 2020*, HC 121, March 2020 ¶ 2.205, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871799/Budget_2020_Web_Accessible_Complete.pdf#page=94.

²⁰⁴ *Digital Taxation: Taxation, Question for Treasury*, PQ61662, UK PARLIAMENT (June 24, 2020) <https://questions-statements.parliament.uk/written-questions/detail/2020-09-29/96879>.

²⁰⁵ Housing, Communities & Local Government Committee and Treasury Committee, *Oral evidence: High Streets and Town Centres in 2030*, HC 1010, Qs 494-5 (Dec. 19, 2018), <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/housing-communities-and-local-government-committee/high-streets-and-town-centres-in-2030/oral/94442.html>.

- In a position paper, the United Kingdom argued that users create value through the generation of content, depth of engagement, network effects and externalities, and contribution to brands.²⁰⁶

None of these rationales validate the UK’s unilateral DST. Contrary to the UK’s assertions: value lies in innovative digital services, not user-contributed content; there are no significantly distinguishing characteristics between covered digital services companies and their users as compared to “the more traditional relationship between a business and its customers”²⁰⁷; and user interaction does not create value in any unique manner.

First, user-contributed content does not create value in and of itself, rather it is innovative systems and technologies that generate value. As argued by the UK: “while the technology and branding of the platform will be an important driver of value, a core part of the business offering remains the content generated by users.”²⁰⁸ This argument: “overlooks the fact that users create this value mostly for themselves and, to some extent, for friends and others in their network. In doing so, they largely fulfill their own desires. People want to post pictures of what they eat, descriptions of where they go, and their thoughts. Platforms let them do that for free on sophisticated, ever-evolving networks [to which] the companies add value[.]”²⁰⁹ Moreover, as described by one analysis: the value in the digital service “lies in the technology, customer service, and business model of the social networking site, not the user content.”²¹⁰ Thus, it is employees and innovative systems and services that generate value, not the users.²¹¹

Second, the aspects of user involvement that supposedly generate value for the covered companies are not unique to the services covered by the UK DST. Rather, these the interactions between users and companies “increasingly characterize many traditional industries” and so do not support differential tax treatment for leading U.S. companies covered under the UK DST.²¹²

As described by an OECD report, advances in information and communication technology has enabled companies in all sectors to connect users, provide services remotely, and benefit from user participation and data, stating:

For example, *retailers* allow customers to place online orders and are able to gather and analyse customer data to provide personalised service and advertising; the *logistics* sector has been transformed by the ability to track vehicles and cargo

²⁰⁶ HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, §2.6, Gov.UK (Nov. 2018).

²⁰⁷ *Id.* at §2.7.

²⁰⁸ HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, §2.6, Gov.UK (Nov. 2018).

²⁰⁹ Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION (May 13, 2019).

²¹⁰ *Id.*

²¹¹ *See id.* (“It is much more likely the particular business offering, which may include software, sales strategy, user support, or pricing models, creates a service that distinguishes the firm from its rivals, and its users value. . . the technology, service, and business model—not users—account for the value added.”).

²¹² Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION (May 13, 2019).

across continents; *financial services* providers increasingly enable customers to manage their finances, conduct transactions and access new products on line; in manufacturing, the digital economy has enhanced the ability to remotely monitor production processes and to control and use robots; in the *education* sector, universities, tutoring services and other education service providers are able to provide courses remotely, which enables them to tap into global demand; in the *healthcare* sector, the digital economy is enabling remote diagnosis and the use of health records to enhance system efficiencies and patient experience. The *broadcasting and media industry* have been revolutionised, expanding the role in news media of non-traditional news sources, and expanding user participation in media through user-generated content and social networking.²¹³

Another OECD report also agreed that these digital features “will become common features of an even wider number of businesses as digitalization continues.”²¹⁴ Indeed, the prevalence of user data and user interactions as a basis for transactions throughout the economy was one of the factors that led the OECD to conclude that “[b]ecause the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes.”²¹⁵

However, that is precisely what the UK DST attempts to do. Underlying the DST is a belief that “the nature of the relationship between certain businesses and their users is different to the more traditional relationship between a business and its customers.”²¹⁶ This statement appears to reference a discussion of user participation in digital businesses published in a UK government position paper.²¹⁷ That position paper assessed that digital services companies were somehow different because “the success of the businesses . . . is much more reliant on the activities, decisions and participation of users with whom the business forms a more sophisticated and sustained relationship.”²¹⁸ As illustrated by the OECD’s example above, this is a distinction without difference.²¹⁹ As the UK’s own position paper admits: “[t]he desire to maintain an engaged customer base and use information from that customer base to improve products and offerings *is not new*.”²²⁰ Accordingly, user interactions do not create value in any unique, significant way, and do not justify the UK’s adoption of its unilateral DST.

²¹³ OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, at 142.

²¹⁴ OECD, *Tax Challenges Arising from Digitalisation—Interim Report 2018: Inclusive Framework on BEPS*, at 24.

²¹⁵ OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, at 142.

²¹⁶ HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, §2.7, Gov.UK (Nov. 2018).

²¹⁷ See generally HM Treasury, *Corporate Tax and the digital economy: position paper* (Nov. 2017), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661458/corporate_tax_and_the_digital_economy_position_paper.pdf.

²¹⁸ HM Treasury, *Corporate Tax and the digital economy: position paper*, ¶ 3.19 (Nov. 2017), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661458/corporate_tax_and_the_digital_economy_position_paper.pdf.

²¹⁹ See National Foreign Trade Council Comments in Response to USTR’s Initiation, 5 (Jul. 15, 2020) <https://beta.regulations.gov/comment/USTR-2020-0022-0372> (“All businesses derive some value from their users or customers.”).

²²⁰ HM Treasury, *Corporate tax and the digital economy: position paper*, § 3.19 (Nov. 2017).

Third, data provided by or concerning users does not create value in any unique manner. As one analysis noted:

Companies collect data for many reasons, such as to improve the services they offer. [For example,] [a] search engine’s ability to see what users are searching for and the sites they select from the search results allows companies to not only place ads they think are the most relevant, but also improve their algorithms.²²¹

Rather:

It is more accurate to view . . . users’ supply of data as another input into the firm’s supply chain, similar to its purchases of data storage and broadband access, but wherein the purchase price is the free use of the platform or service. Firms do not pay corporate income taxes on the income others derive from selling them inputs, only on profits from the value they themselves add. Moreover . . . countries rarely capture barter agreements when there is no cash payment on either side of the transaction.²²²

Stated differently: “[T]his is not value added. . . . Data is being provided in exchange for receiving the ‘free’ service. There is no reason to think the data is worth any more than the value of the service [for which] it is being exchanged[.]”²²³ As addressed by one comment: “many DSTs [such as the UK DST] focus on user participation which results in taxation of activity that does not generate any actual realized or recognized income.”²²⁴ Thus, the UK’s user-value rationale relies on incorrect or unproven assertions, and results in an unfair and burdensome tax.

3. The UK DST Was Not Created as an “Interim Measure” or “Temporary Tax” and Undermines Development of a Multilateral Approach

The UK attempts to minimize the impact of the UK DST by describing it as an “interim measure”²²⁵ or a “temporary tax”.²²⁶ However, the UK DST neither contains an end date for collection of the tax nor does it provide for a sunset clause, “mean[ing] that absent positive

²²¹ Joe Kennedy, *Digital Services Taxes: A Bad Idea Whose Time Should Never Come*, INFORMATION TECHNOLOGY & INNOVATION FOUNDATION (May 13, 2019), <https://itif.org/publications/2019/05/13/digital-services-taxes-bad-idea-whose-time-should-never-come>.

²²² *Id.*

²²³ *Id.*

²²⁴ Internet Association, *Comments of Internet Association* (Jul. 15, 2020), <https://beta.regulations.gov/comment/USTR-2020-0022-0326>

²²⁵ See, e.g., HOUSE OF COMMONS TREASURY COMM., GOVERNMENT RESPONSE TO THE COMMITTEE’S TWENTY-SIXTH REPORT: BUDGET 2018, 8 (Apr. 3, 2019), <https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/2111/2111.pdf>.

²²⁶ See, e.g., HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, Gov.UK, 2 (Nov. 2018), (“The DST . . . is intended to ultimately be a temporary tax.”); *Budget 2020*, HC 121, March 2020 para 2.205. See also, PQ61662, 24 June 2020; HC Deb 15 September 2020 cc179-180; PQ96879, 7 October 2020.

action by Parliament the DST would cease to apply from a certain year.”²²⁷ Instead, Section 71 of the UK DST only provides that “[t]he Treasury must, before the end of 2025, conduct a review of digital services tax and prepare a report of the review[,]” and “[t]he Treasury must lay a copy of the report before Parliament.”²²⁸ The UK government admits that in order to repeal the DST “Parliament would then need to take separate action, through a Finance Bill, to give effect to any decisions on the DST arising from the review[.]”²²⁹ Because the UK DST does not contain a sunset clause and affirmative parliamentary action would be required to repeal the DST, the UK DST does not appear to be an interim or temporary measure.

Furthermore, unilateral measures, such as the UK’s DST, undermine progress in the OECD and undermine development of a multilateral approach to digital taxation. An 2018 OECD report, to which both the United Kingdom and the United States agreed, stated that “[t]here is no consensus on either the merit or need for interim measures[.]”²³⁰ Likewise, a 2020 OECD report noted that “it is expected that any consensus-based agreement must include a commitment by members . . . to withdraw relevant unilateral actions, and not adopt such unilateral actions in the future.”²³¹ Adoption of a unilateral measure without a sunset clause may make it more difficult for the UK to remove the tax. Thus, the UK’s adoption of a unilateral DST only adds to the challenges in developing a multilateral approach to digital taxation.

²²⁷ HM Treasury, *Digital Service Tax: response to the consultation*, § 7.4, Gov.UK (Jul. 2019); see also *UK: Digital Services tax, effective date set for 1 April 2020*, KPMG (Mar. 21, 2020), <https://home.kpmg/us/en/home/insights/2020/03/tnf-uk-digital-services-tax-effective-1-april-2020.html>.

²²⁸ Finance Act (2020) § 71, c. 14 (UK).

²²⁹ HM Treasury, HM Revenue & Customs, *Digital Service Tax: Consultation*, § 9.9, Gov.UK (Nov. 2018), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754975/Digital_Services_Tax_-_Consultation_Document_FINAL_PDF.pdf.

²³⁰ Org. for Economic Co-operation and Development, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, at 178 (OECD Publishing 2018), https://read.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-interim-report_9789264293083-en#page180.

²³¹ Org. for Economic Co-operation and Development, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, at 211 (OECD Publishing 2018), https://read.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint_beba0634-en#page213.

IV. CONCLUSIONS

The results of this investigation indicate that:

- (1) The United Kingdom's DST, by its structure and operation, discriminates against U.S. digital companies, including due to the selection of covered services and the revenue thresholds.
- (2) The United Kingdom's DST is unreasonable because it is inconsistent with principles of international taxation, including due to application to revenue rather than income, extraterritoriality, and retroactivity.
- (3) The United Kingdom's DST burdens or restricts U.S. commerce.

Additionally, as addressed in the last section of this report, the United Kingdom's public rationales for the digital services tax are unpersuasive.

ANNEX 1: LETTER FROM AMBASSADOR ROBERT LIGHTHIZER TO THE GOVERNMENT OF THE UNITED KINGDOM



THE UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON

June 2, 2020

The Rt. Hon. Elizabeth Truss MP
Secretary of State for International Trade and
President of the Board of Trade
Minister for Women and Equalities
London, UK

Dear Secretary of State Truss:

I am writing to inform you that, in accordance with Chapter 1 of Title III of the Trade Act of 1974 (known as Section 301), I have determined to initiate a Section 301 investigation of the digital services tax (DST) under consideration by the United Kingdom. In particular, the investigation addresses a proposed 2% tax on revenues of internet search engines, social media and online marketplaces.

The investigation will initially consider several problematic aspects of DSTs: (1) whether the tax would amount to *de facto* discrimination against U.S. companies; (2) whether the tax would have retroactive elements; and (3) whether the tax diverges from norms reflected in the U.S. tax system and the international tax system due to, *e.g.*, possible extraterritorial application, or a purpose of penalizing certain technology companies for their commercial success. Depending on the course of the investigation, other aspects and features of the measure might also be included.

In accordance with Section 303 of the Trade Act of 1974, I hereby request consultations with the Government of the United Kingdom regarding this matter. These issues are of great concern to the Government of the United States. I look forward to working with you or another appropriate official in a cooperative manner to resolve this matter.

Sincerely yours,

Robert E. Lighthizer

cc: The Rt. Hon. Rishi Sunak MP, Chancellor of the Exchequer