Digital Services Tax

Navigating the Winds of Change

The destination challenge

The digitalisation of the economy has brought significant benefits to business but poses significant challenges to the international corporate tax system; in particular, because many companies have a substantial economic presence in certain jurisdictions without being taxable there.

The G20/OECD Inclusive Framework of nearly 140 countries is committed to delivering a multilateral solution to deal with these challenges and shift more taxable income to where the users/consumers are located.

> These changes could represent the biggest shake up of international corporate tax since the '50s.

While the discussions on the OECD recommended measures are ongoing, one key area of change already happening is the introduction of Digital Services Taxes (DSTs).

DSTs seek to tax gross revenues where users of digitalised supplies are located, including e.g., revenues from online advertising, intermediation, and sales/streams of digital content, at rates of 2% – 7.5%.

These taxes will affect a business's effective tax rate (ETR), present a difficult accounting challenge and come with a significant compliance burden, potentially requiring the use of data sources not touched by tax departments before.

Over 13 countries in the EU alone have implemented or announced a DST. Whilst certain attributes of these regimes are shared, there is a lack of harmonisation at this stage. This means that a strategy to manage DSTs will have to be both global and local in nature - ensuring the requirements can be met in as standardised a way as possible and seeking to avoid the potential for double taxation.

The initial challenges will be to:

- ➔ Identify which rules apply to which elements of the business, understand the impact on the organisation as a whole and influence the debate where possible;
- ➔ Identify the data needed and assess and agree the calculations to be performed. Then design and embed operating procedures to deal with the compliance and accounting needs raised by the tax on deemed revenues attributable to interactions with “users”.

A strategy to manage DSTs will have to be both global and local in nature.

PwC Support

PwC is helping various organisations manage these changes.

We are closely monitoring the technical and political developments to provide insights and updates and we are innovating to help clients deal with the regulatory and operational challenges these new taxes are imposing.

Our support can be provided in a number of areas including:

- ➔ **Understanding the changes** - Supporting the business in knowledge transfer, providing insight into the new and proposed DST’s, setting the new taxes in the wider context of changes in direct and indirect taxation, political constraints and trade disputes.
- ➔ **Modelling and Calculating the impact** - Reviewing the location of various functions, assets and services; analysing where the new rules apply already and where they are likely to apply in the future; modelling the impact of these rules on the business model, understanding the data and how to calculate the tax due, highlighting immediate compliance needs and assessing the options available to the business going forward.
- ➔ **Getting the accounting right** - Each DST is different and needs to be assessed as to whether it is a 'tax on profits' accrued in the tax line or a 'tax on gross income' accrued as an expense above the tax line. Complexity arises when a regime incorporates a 'margin' test, such as the UK, as to whether that taints the gross income tax calculation to become a profits based income tax or not. We can support companies with the latest tax accounting thinking to design an appropriate accounting policy.
- ➔ **Setting and socialising the strategy** - Assist management with the strategic approach it will adopt with internal and external stakeholders, covering changes to the operating model, compliance and accounting.
- ➔ **Delivering the strategy** - Planning, resourcing and executing the strategy; performing the calculations and operationalising the compliance and accounting required to meet all the relevant global and local requirements, ensuring the effective use of technology to improve data quality and to minimise the administrative burden on the business.

Case Study:

UK Digital Services Tax

In this example, we will look at a group that currently has a substantial economic presence in a number of countries, has set out its global approach and is now specifically looking at the new UK DST rules and regulations effective from 1 April 2020.

In the UK DST applies to groups with significant global revenues and UK revenues derived from in-scope activities.

The UK DST will be applied on revenue earned in connection with the UK from **search engines**, **online marketplaces** and **social media services** including, in relation to each, **online advertising**.

There are safe harbour rates for businesses with low margins or losses on these activities and the first DST payment is due nine months after the end of the group's financial year.

The business has a June year end. It is very worried it will only have 90 days from 1 July 2020 to register if affected. The business will also need to consider whether to start accruing for the tax in the accounts.

The business operates on thin margins and is also concerned that the UK rules differ from its general roll-out strategy in two main areas that could affect them:

- Many DSTs are focused on deemed revenues attributable directly or indirectly to certain sources but the UK DST concentrates on the underlying activities.
- The activities caught under UK DST are drawn more widely than in other countries, looking more broadly at all revenues earned from specific services/platform types (being marketplaces, search engines, and social media platforms).

The approach to be taken by the group

Analysis:

- Run sessions to understand the new rules and regulations in detail.
- Establish a common understanding of the business model and analyse the different ways of monetising the in-scope online services, the identification of users/customers, etc.
- Prepare a memorandum on where the business activities may fall within the scope of the UK DST.

Clearance:

- Assess whether to apply to the UK tax authorities (HMRC) for a formal clearance to determine whether the business has in-scope activities for the UK DST, analysing the pros and cons.
- Prepare documentation and attend discussions with HMRC on 'grey' areas to seek guidance and formal clearance on in-scope activities.

Calculations:

- Identify requisite accounting periods and data needed for the calculations.
- Determine data sourcing procedures, data hierarchy requirements and analyse any data quality issues - across accounts and right up to user level activity information.
- Assess the methods of calculation, including segmentation and whether it is worth applying for the alternative basis of charge and/or cross-border relief claims.
- Perform the calculations (where necessary including operating margins).
- Decide on the most appropriate calculation methodology to apply for UK DST.

Compliance:

- Set out the scope and procedures for its accruals, compliance and accounting practices on UK DST.
- Design and embed key controls, technologies and monitoring activities to ensure processes will be efficient and effective - standardised to global practices wherever possible.
- Define and embed data archiving and change management policies, including GDPR, across the tax sensitive data requirements - standardised to global practices wherever possible.

To discuss any aspect of the digital taxation changes, DST or OECD options, and to see how we can support you, please contact any of the following or your usual PwC advisor:

Charlotte Richardson

M: +44 (0)7775 606317

E: charlotte.d.richardson@pwc.com

Giorgia Maffini

M: +44 (0)7483 378124

E: giorgia.maffini@pwc.com

Phil Greenfield

M: +44 (0)7973 414521

E: philip.greenfield@pwc.com

Tom Birch

M: +44 (0)7703 563631

E: tom.birch@pwc.com

pwc