Taxing the digital economy: United Kingdom

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A bit of history

- ‘In the UK, we take the view that
  - a website of itself is not a permanent establishment
  - a server is insufficient itself to constitute a permanent establishment of a business that is conducting e-commerce through a website on the server…
  - regardless of whether the server is owned, rented or otherwise at the disposal of the business.’ Inland Revenue press release 11 April 2000

OECD Commentary on art. 5

- UK observation:
  - the United Kingdom takes the view that a server used by an e-tailer, either alone or together with web sites, could not as such constitute a permanent establishment (para176).

Diverted ProfitsTax

Autumn Budget Statement 2014

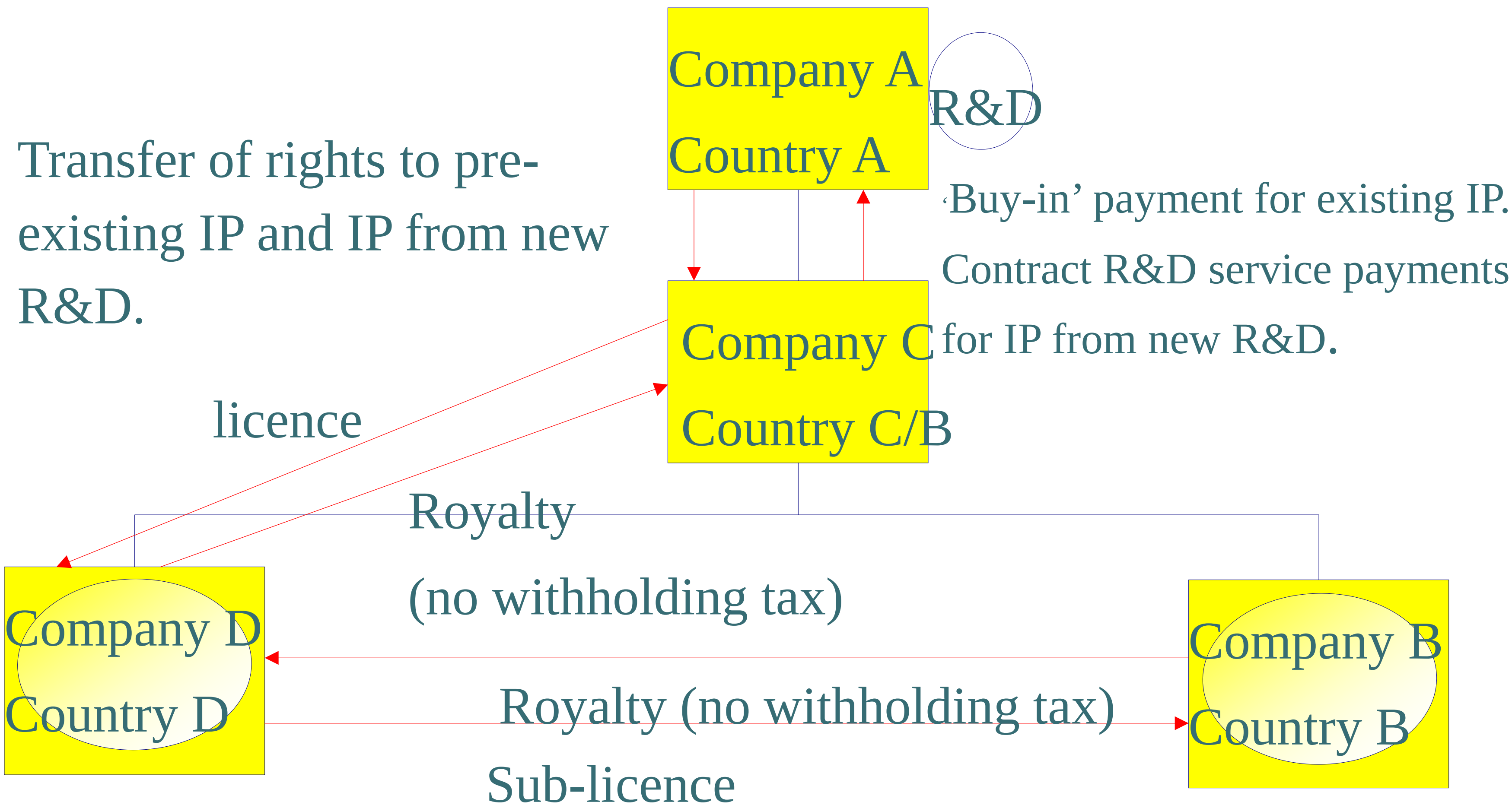
- Our new Diverted Profits Tax, designed to counter the use of aggressive tax planning techniques used by multinational enterprises to divert profits from the UK.

UK Diverted Profits Tax: FA 2015 Pt 3

Aggressive tax planning that erodes the UK tax base through diversion of profits:

- avoidance of UK permanent establishments
- creation of intra-group expenditure or diversion of income intra-group
  - under arrangements lacking economic substance
  - to exploit tax mismatches
  - where it is reasonable to assume absent the tax benefit the expenditure would not have been incurred or the income would have been in the charge to UK CT.

Two-tiered structure and transfer of intangibles under a cost-contribution arrangement



Online advertising services

Company B
Country B

Service fee

Advertising fee

Company E

Marketing
Tech support

Country S

Avoidance of Taxable Presence

– Non-UK resident company carries on trade (the "foreign company")

– Person carrying on activity in UK in connection with supply of goods or services (the "avoided PE")

– "Reasonable to assume" activity designed to ensure that the foreign company does not carry out a trade in the UK through a PE

– Effective tax mismatch and/or tax avoidance is the main purpose or one of the main purposes

Effective Tax Mismatch

- Increase in expenses and/or
- Reduction in income
- Tax reduction exceeds corresponding overseas tax liability
- Recipient of payment pays tax at less than 80% of UK rate

DPT Features

- Separate tax charged at 25% of “diverted profits”
- Not self- assessed – notification
- Pay and then dispute
- Recovery from related companies
- Outside tax treaties
- Exemption for SMEs
- Exemption if UK sales to UK customers less than £10 million or UK expenses less than £ 1Million
- From 1 April 2015

Royalty withholding tax

Royalty withholding tax

- Income tax on royalties of a non-UK resident "only if from a source in the United Kingdom." ITTOIA 2005 s 577.
- Royalties Withholding Tax Consultation
  - December 2017
- Intended to apply from April 2019

Payments in Scope

- Royalties defined in OECD Model art 12(2) (Current ITA s 907)
- Proposed application:
  - payments for the use or exploitation of rights over intellectual property and other intangible assets in the UK. (wide definition of intangible assets)
  - Including, for example, the right to distribute specified goods or provide specified services in the UK.

Intangible asset

- Intangible asset has the meaning it has for accounting purposes (CTA 2009 s 712)
- Includes
  - internally-generated intangible assets
  - intellectual property
- UK FRS 10
  - ‘non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the entity through custody or legal rights’

International accounting standards

- IAS 38
- ‘Intangible asset’ is an identifiable non-monetary asset without physical substance.
- ‘Asset’ is a resource:
  - controlled by an entity as a result of past events; and
  - from which future economic benefits are expected to flow to the entity.

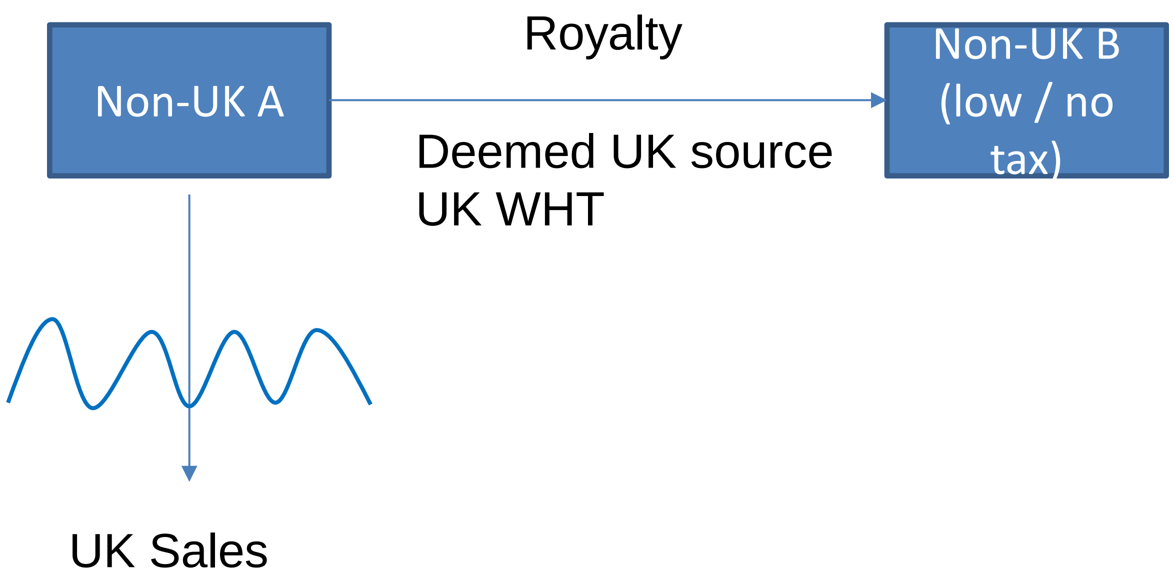
Parties to payments

- Payments between associated enterprises as per UK domestic definition TIOPA s148
- Possible application to independent enterprises
- Payee not resident in state where the UK has a treaty with OECD Model art 24 non-discrimination
- Payee resident in low or no tax state

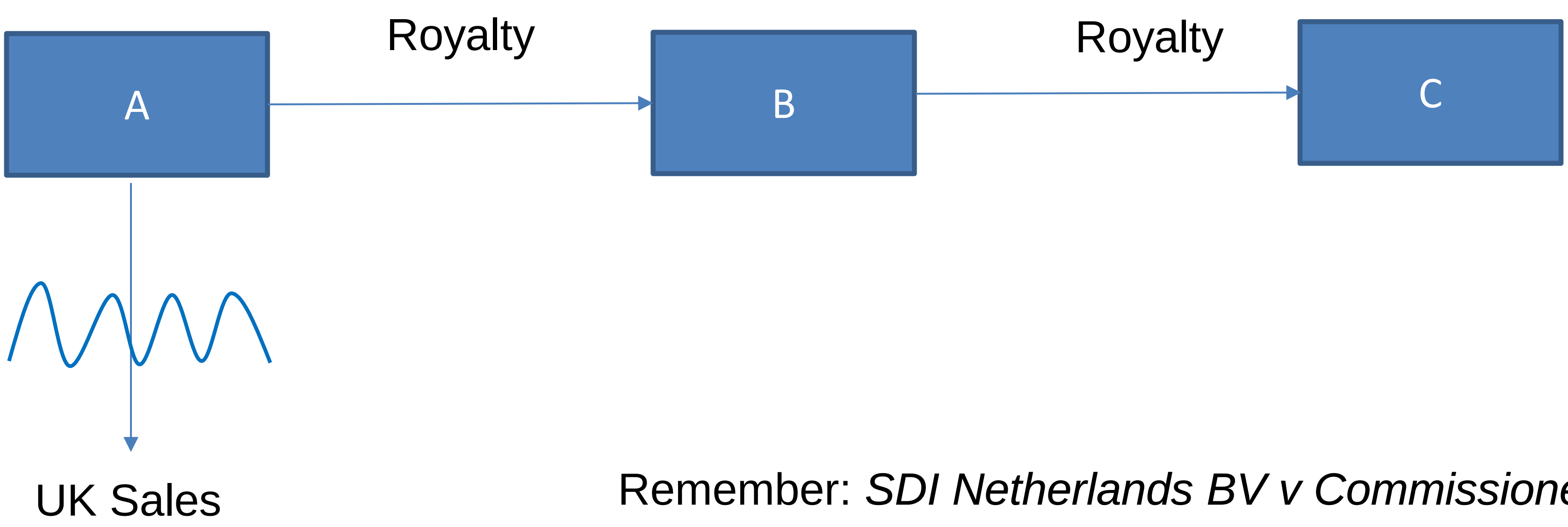
[Extra]territorial scope

- Existing: royalty not from a UK source if payer is not UK resident or not a UK PE of a non-resident.
- Proposed: liability regardless of whether the payer has a taxable presence in the UK or not.

Example


Non-UK A
Royalty
Non-UK B (low / no tax)
Deemed UK source
UK WHT
UK Sales

Sub-licencing



Remember: *SDI Netherlands BV v Commissioner ?*

Application

- Alongside existing legislation on cross-border royalties:
- ITTOIA, ITA, 20%
- Diverted Profits Tax 25%
- The tax liability will be the highest of that under existing rules in rules

Further Information

Jonathan Schwarz:

Schwarz on Tax Treaties (5th Ed)

http://bit.ly/2BCMZbr

Blog: Kluwer International Tax

http://bit.ly/1Dm2hcZ

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