National Audit Office

REPORT

# Investigation into the Digital Services Tax

HM Revenue & Customs

SESSION 2022-23
23 NOVEMBER 2022
HC 905

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National Audit Office

# Investigation into the Digital Services Tax

## HM Revenue & Customs

**Report by the Comptroller and Auditor General**

Ordered by the House of Commons
to be printed on 21 November 2022

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

**Gareth Davies**
**Comptroller and Auditor General**
**National Audit Office**

**17 November 2022**

HC 905 | £10.00

## Investigations

**We conduct investigations to establish the underlying facts in circumstances where concerns have been raised with us, or in response to intelligence that we have gathered through our wider work.**

**We undertook this investigation to report on how HMRC implemented, and is administering, the Digital Services Tax following its introduction in April 2020.**




**010805 11/22 NAO**

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# What this investigation is about

**1** This investigation examines HM Revenue & Customs' (HMRC's) implementation of the Digital Services Tax (DST). The government introduced DST in April 2020 because it was concerned that the existing international tax system did not recognise the value being generated for digital companies through UK online users. DST is designed to tax business groups that derive large revenues from UK users of search engines, social media platforms and online marketplaces. It taxes the revenues (rather than profits) derived from these activities at a rate of 2%. The DST is levied on business groups (groups of companies with the same controlling interest) rather than each individual company. Groups are liable to pay DST if their worldwide revenues from in-scope activities are more than £500 million and more than £25 million are derived from UK users. A group's first £25 million of UK revenues are exempt from DST.

**2** Historically taxes on corporations have been levied based on the location of the profit-making activity of a company, but the internet enables companies to generate revenues without being physically located in the UK. The UK is among many other countries seeking a multilateral solution to concerns about how the international tax system operates for multinational companies. The Organisation for Economic Co-operation and Development (OECD) and G20 are leading work with around 140 countries and tax jurisdictions under an 'Inclusive Framework on Base Erosion and Profit Shifting' project to reform international tax rules.

**3** The UK government intends to retire DST once 'Pillar One' of the OECD reforms is introduced in the UK. Pillar One is expected to re-allocate some taxing rights over the largest and most profitable multinational business groups from their home countries to the tax jurisdictions where their customers and users are located. In July 2022 the OECD announced that the multilateral convention which will implement Pillar One globally will be open for jurisdictions to sign in mid-2023, with the aim of the Pillar One reforms coming into force in 2024. Separately, 'Pillar Two' will introduce a global minimum corporate tax rate.

**4** This investigation reports on how DST is operating following the first year of its implementation. This report sets out:

- what are DST and the OECD reforms and why they are happening;
- the impact of DST in its first year; and
- how HMRC has managed the risks of non-compliance with the tax by companies within its scope, and what lessons it has learned.

**5** The report does not provide details about the tax paid by individual business groups, since this would violate taxpayer confidentiality. The report does not seek to examine and report on the value for money of HMRC's administration of DST at this early stage in its operation, but it does make recommendations to support its implementation.

# Summary

## Key findings

### Revenues generated by Digital Services Tax (DST)

6 **HM Revenue & Customs (HMRC) received £358 million in DST receipts for the 2020-21 tax year, which was 30% more than forecast. HMRC's initial forecast, in July 2019, expected DST receipts of £275 million for 2020-21.** HMRC and the Office for Budget Responsibility forecast in March 2022 that cumulative revenue from DST will exceed £3 billion by 2024-25. HMRC told us there were two main reasons for the higher-than-expected receipts:

- The initial forecast assumed that business groups would seek to minimise their DST liability, but it had not observed such behaviour.
- Fourteen of the 18 groups that paid DST paid more than expected. One group paid almost five times the amount initially forecast. HMRC had not identified six of the payers in its initial assessment (paragraphs 2.2 to 2.4 and 2.11, and Figure 6).

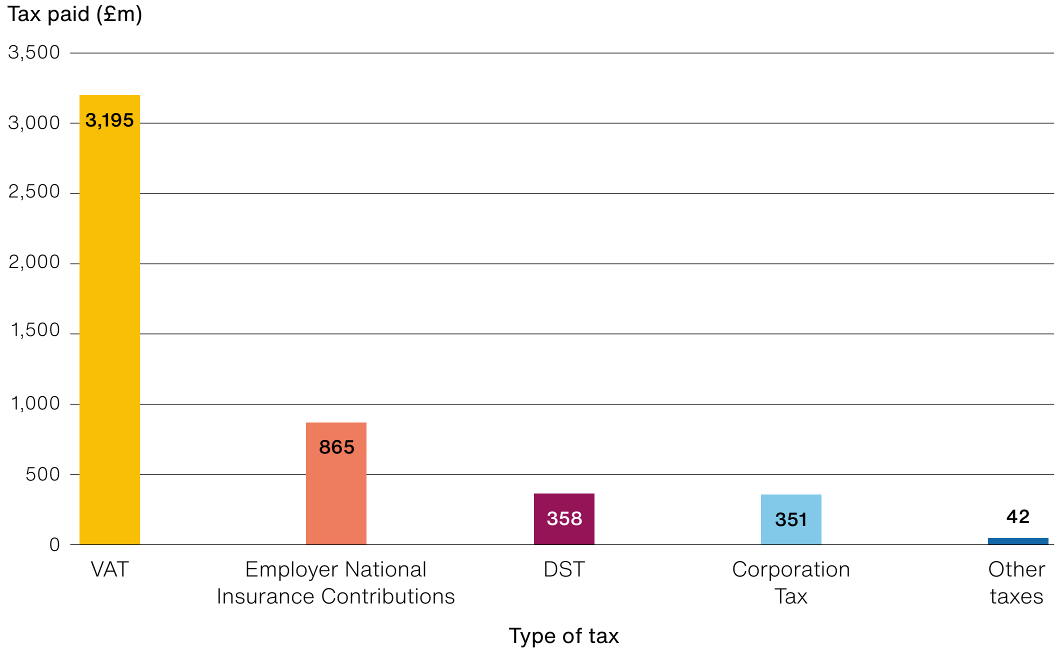
7 **Around 90% of DST revenues for 2020-21 were provided by five business groups.** In total 18 business groups paid DST. Of the £358 million in DST receipts, £324 million (90%) was paid by five groups. Eleven of the 20 business groups that HMRC initially expected to make a payment determined they did not owe any DST (paragraphs 2.2 to 2.4 and Figure 5 and Figure 6).

8 **DST accounted for 7% of tax paid by in-scope business groups in 2021-22.** The 18 business groups that paid DST for the 2020-21 tax year paid around £4.8 billion across all taxes in 2021-22 (excluding employee income tax and national insurance). This included £358 million in DST for the 2020-21 tax year, representing 7% of the UK tax take from those business groups (see **Figure 1**). These groups have paid considerably more tax in total since the beginning of the COVID-19 pandemic as revenues have increased. Their total tax paid increased by 36% between 2019-20 and 2020-21 and by 34% between 2020-21 and 2021-22 (excluding DST). Around two-thirds of tax paid was VAT and around one-fifth was employer contributions to National Insurance. Their taxable profits increased by 16% during the pandemic, while VAT revenues doubled. It is unclear how much of this was due to increased sales or new VAT rules on imported goods (paragraphs 2.8 and 2.9 and Figure 8).

## Figure 1

Tax paid broken down by tax type for the 18 business groups that paid Digital Services Tax (DST) in 2021-22

**The DST was roughly equal to the amount of Corporation Tax paid by business groups liable for DST**




**Notes**

1 VAT includes both VAT and Import VAT.

2 Other taxes are Import Duty and Stamp Duty Land Tax.

3 This Figure does not include Employee National Insurance Contributions and Employee Income Tax. These taxes were collectively worth £2,466 million in 2021-22.

4 Business groups paid DST incurred in 2020-21 during 2021-22.

Source: National Audit Office analysis of HM Revenue & Customs data

9 **Most digital business groups who are paying the tax now pay more in DST than they do in Corporation Tax.** The introduction of the Digital Services Tax has meant that most groups affected are paying significantly more tax as a result. Of the 18 groups paying DST, 13 paid more DST than Corporation Tax in 2020-21. Of these, nine paid more than twice as much DST as Corporation Tax. A further three groups paid no Corporation Tax. At the other end of the spectrum, three groups paid mostly Corporation Tax, with DST representing less than 10% of their Corporation Tax bill (paragraph 2.10 and Figure 9).

## The implementation of DST

**10 HMRC implemented DST for £6.3 million, around £1.5 million under budget.** HMRC's review of its implementation of DST concluded that it had successfully delivered its key criteria. It recorded underspends against both staff costs (spending £3.5 million of a £4.1 million budget) and Information Technology (IT) costs (£2.8 million of a £3.7 million budget), which it attributed to setting a conservative budget (paragraphs 3.2 and 3.3).

**11 Digital services taxpayers and their representatives were broadly positive about HMRC's implementation of Digital Services Tax.** They appreciated being able to return a single submission for the whole business group (rather than separate submissions for each company) and only needing to submit a return annually. Most noted that HMRC tended to be helpful when contacted, provided clear guidance and took a flexible and proportionate approach regarding how groups calculated their DST liability in order to reduce the administrative burden (paragraph 3.6).

## Managing the risk that business groups do not meet their DST obligations

**12 HMRC's compliance work for DST in the 2020-21 tax year is ongoing and it has not yet identified any tax losses.** HMRC has identified eight categories of behaviour that could lead to non-payment of tax, ranging from tax evasion (deliberate illegal activity) to errors in completing tax returns. HMRC has not yet identified any tax losses in any category (although its compliance work is ongoing). HMRC considers the risk of evasion as low because the reputational risk to companies would likely outweigh any financial gains. HMRC also told us it had not observed business groups attempting to avoid the tax by reducing or removing their requirement to pay DST within the law, as originally expected. HMRC worked with groups to understand how they calculated their DST liability. HMRC told us it has not audited the data underlying DST returns for any group so far, but that it has the resource to do so if needed. Its current focus is on supporting groups to calculate their liability accurately (paragraphs 3.9 and 3.10).

**13 HMRC has identified more groups potentially in scope for DST than it initially expected.** In July 2019, HMRC initially identified 31 business groups as being potentially in scope for DST. In September 2022 it had reviewed, or was assessing, 101 groups, and had undertaken, or was undertaking, a more detailed risk assessment of 30 of these groups following their submission of a return. HMRC told us that any group identified as being potentially liable for DST in the 2021-22 tax year will also be retrospectively assessed for the 2020-21 tax year (paragraphs 3.8 and 3.11 and Figure 13).

14 **Future compliance work may be more challenging, as HMRC identifies more business groups potentially liable for DST.** New groups may have different characteristics and attitudes to paying DST. The challenges HMRC may face include:

- managing groups that misunderstand, or seek to misrepresent, whether their revenues are in scope for DST. Relatively subtle distinctions in the business model used by a group can move revenues in or out of scope for DST;
- communicating with groups that do not have a physical presence in the UK, but may be liable to pay DST; and
- taking enforcement action against groups that do not have a physical presence in the UK and refuse to pay DST they owe. HMRC has not yet faced this situation, so the enforcement options available to it are untested (paragraphs 3.11 to 3.17 and Figure 14).

## Preparing for the OECD reforms

15 **Uncertainty over the details of the Organisation for Economic Co-operation and Development (OECD) 'Pillar One' reforms means that HMRC has not yet estimated the impact on total tax receipts.** DST is intended to be a temporary tax, until it is replaced by the OECD's Pillar One reforms to international corporate tax rules. HMRC told us it is not yet able to estimate how much tax revenue it might collect, as key elements of the Pillar One rules have yet to be finalised. These reforms will affect future tax receipts in three ways:

- DST will no longer apply, so revenues from it will cease.
- Corporation Tax payments from some groups will change under Pillar One rules.
- Some groups will be able to reduce their Corporation Tax payments by the amount that their DST payments exceeded what they would have paid under Pillar One during the 'transition' years of 2022 and 2023.

Although the Pillar One reforms will effectively replace DST, HMRC considers that differences mean that there is little in the design, legislation and administration of DST that can be meaningfully applied to its future work. Decisions relating to legislation, implementation and the compliance regime will need to be agreed between all participating nations (paragraphs 1.12 to 1.14 and 3.19 to 3.21).

## Concluding remarks

**16** Big digital companies are paying more UK tax, and the Digital Services Tax (DST) is part of this. HMRC collected 30% more revenue through DST than originally forecast for its first year, around 90% of which was paid by five business groups. DST accounted for 7% of the total amount of tax paid by business groups within scope for the tax. Other taxes paid by these business groups grew by 34% between 2020-21 and 2021-22, due to increased sales during the COVID-19 pandemic and new VAT rules on imported goods.

**17** HMRC has yet to identify any non-compliance and it is not yet clear if HMRC has captured all groups that should be within scope for the tax. HMRC could still face challenges ahead with enforcing compliance, especially among groups without a physical presence in the UK. It will need to manage a larger population of business groups across a wider range of business activities than it initially expected. HMRC will need to ensure good levels of compliance to maintain DST as a credible alternative until the OECD Pillar One reforms come into effect.

## Recommendations

**18** To help it prepare for the potentially larger population of business groups liable for the Digital Services Tax, HMRC should:

a **set out criteria to ensure its teams are able to consistently identify all business groups, companies and sources of revenue that are in scope for the Digital Services Tax.** This could include updating guidance to DST Compliance teams to specify when, or in what circumstances, they should:

- escalate a case to additional levels of scrutiny; and
- triangulate data supporting an individual group's tax return with other information, including the group's contracts with other companies, management information and (where necessary) the group's data on UK internet traffic to help understand completeness, and potentially identify additional revenue streams within groups;

b **estimate the potential tax gap for DST (the difference between total theoretical tax liabilities and the amount that has been paid) separate from any HMRC calculation of the overall tax gap.** For example, by comparing total revenue with macro-economic data since the COVID-19 pandemic began and data on business sectors not initially expected to be in scope for DST;

c **develop and implement a plan to identify, and raise awareness among, business groups that are unaware they may be liable for the UK DST,** particularly those without a physical presence in the UK; and

d **develop a contingency plan for enforcement against business groups that do not have a physical presence in the UK and fail to engage with HMRC,** after exploring the available options. This could include discussions with tax authorities in other countries that operate a digital services tax and have similar interests, to ensure there is a clear pathway for enforcement.

# Part One

## The Digital Services Tax

**1.1** This part of the report explains why government introduced the Digital Services Tax (DST), what is covered by DST, why it will be replaced by internationally agreed tax reforms and when this might happen.

**1.2** Parliament, the government and the wider public have expressed concerns about the amount of UK tax that large digital companies pay, which can be very low compared to the revenues they generate from their operations in this country. The Committee of Public Accounts has raised concerns about tax avoidance by large multinational business groups, including digital businesses. Over the past decade it has repeatedly recommended government improves its work to prevent tax avoidance including leading international cooperation and has taken evidence from digital business groups (Google LLC and Amazon.com Inc.).[1]

### The challenges posed by existing international tax rules

**1.3** The UK government was concerned that tax rules had not kept pace with changing business models, making it difficult to ensure multinational business groups pay a fair share of tax. It introduced the DST in 2020. While it recognised these issues as not unique to digital services, it felt that digital businesses are particularly well placed to create profit from service users in the UK, without paying UK Corporation Tax. It noted that public dissatisfaction over digital businesses not paying a fair amount of tax was growing. It therefore felt that it was necessary to take unilateral action (until multilateral reforms could be put in place) and that a tax on the revenues of digital services provided to the UK market was the best way of doing this.

**1.4** Other countries share the UK's concerns over taxing multinational business groups. Since 2013, the Organisation for Economic Co-operation and Development (OECD) and the G20 group have worked together under the 'Base Erosion and Profit Shifting' project and subsequently with around 140 countries and tax jurisdictions under the 'Inclusive Framework on Base Erosion and Profit Shifting' to reform international tax rules (the OECD reforms). **Figure 2** on pages 12 and 13 provides a timeline of key actions and publications.[2]

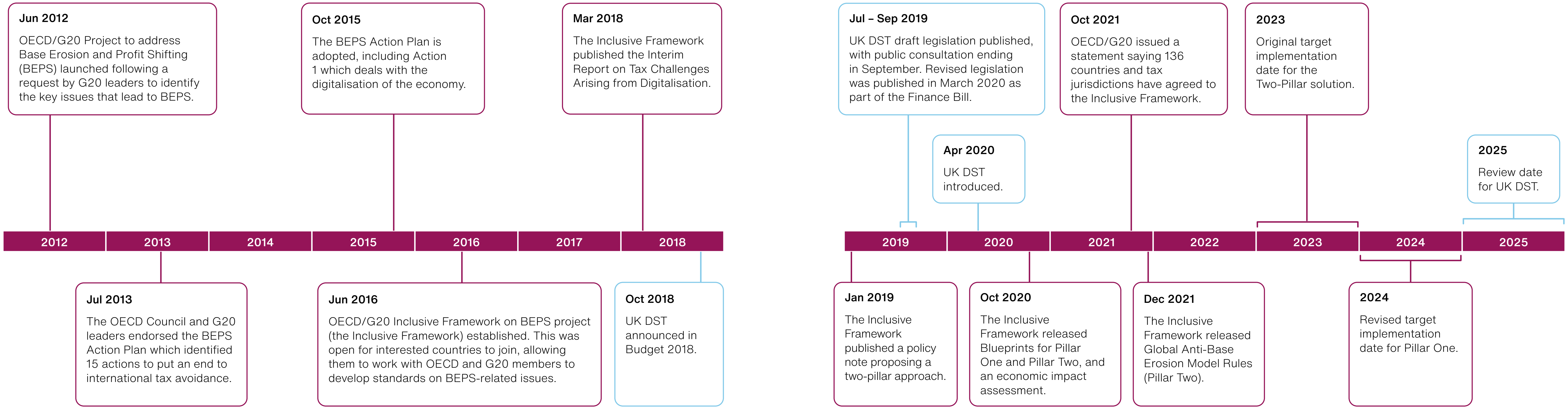
1 See: HC Committee of Public Accounts, *HM Revenue & Customs: Annual report and accounts 2011-12,* Nineteenth Report of Session 2012-13, HC 716, December 2012. HC Committee of Public Accounts, *Tax Avoidance-Google*, Ninth Report of Session 2013-14, HC 112, June 2013. HC Committee of Public Accounts, *Improving tax collection*, Fiftieth Report of Session 2014-15, HC 974, March 2015. HC Committee of Public Accounts, *Corporate tax settlements*, Twenty-fifth Report of Session 2015-16, HC 788, February 2016.

2 The G20 group is an intergovernmental forum comprising 19 countries and the European Union (EU) which works to address major issues related to the global economy.

## Figure 2

Timeline of the development of the UK Digital Services Tax (DST) and Organisation for Economic Co-operation and Development (OECD) and G20 tax reforms, between 2012 and 2025

**The UK government introduced DST, despite being closely involved in the OECD/G20 reforms, because it remained concerned that digital business groups were not paying the right amount of tax. It has committed to withdrawing DST when the OECD/G20 reforms are in place**




- Action or publication relating to OECD/G20 work on Base Erosion and Profit Shifting (BEPS)
- Action or publication relating to the UK DST

**Notes**

1 Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax.

2 The OECD, G20 and member countries and jurisdictions are working together under the 'Inclusive Framework on BEPS' project (the Inclusive Framework) to reform international tax rules.

3 The G20 is an intergovernmental forum comprising 19 countries and the European Union (EU) which works to address major issues related to the global economy.

Source: National Audit Office analysis of HM Revenues & Customs, HM Treasury and Organisation for Economic Co-operation and Development information

**1.5** In 2015, the OECD estimated corporate tax avoidance costs from base erosion and profit shifting were between $100 billion and $240 billion annually (4%–10% of annual global corporate income tax revenues). Its reforms identified two main problems with the existing international tax rules:

- The rules work on the principle that profits should only be taxed in a country in which it creates value through a physical presence, such as a factory or warehouse. Digitalisation now means multinational groups can conduct business with little or no physical presence in a country.
- Most countries that are home to multinational business groups only taxed domestic business income, but those business groups have used the growth of intangibles, such as brands, copyright and patents, to shift business profits to tax jurisdictions that imposed little or no tax. This is exacerbated by competition between tax jurisdictions to attract foreign investment.

## Unilateral responses to these challenges in the UK and other countries

**1.6** These issues affect all types of business, not just digital services. However, the UK government chose to implement DST because, despite being closely involved in the OECD reforms and believing an international agreement to be the best long-term solution, it remained concerned that digital business groups were not paying tax at a level that was commensurate with the value generated from UK users of their services. It also felt progress towards an international agreement was too slow. HM Treasury published a position paper in November 2017 setting out its concerns, and introduced DST in April 2020.[3] **Figure 3** shows some examples of how revenue could be generated from UK users of digital services.

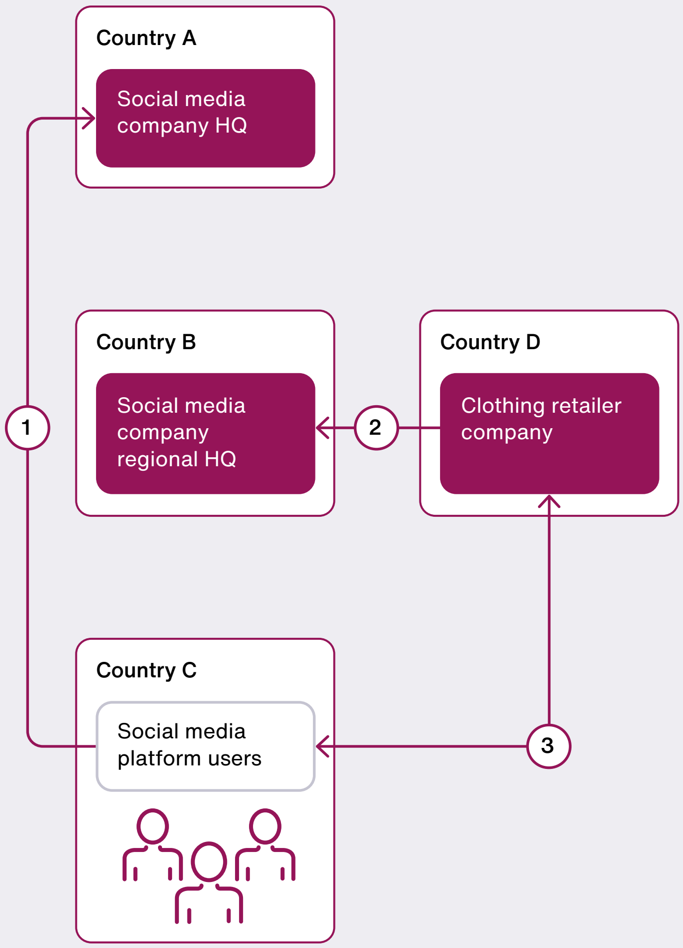
**1.7** The UK is not the only country which has implemented a tax of this kind. HM Revenue & Customs (HMRC) has identified four countries with a tax which it considered similar to the UK version (France, Italy, Spain and Turkey) and is continuing to monitor activity in various other countries. None of these taxes were exactly the same as the UK, with varying scopes and tax rates. More countries are planning to introduce a DST if a multilateral agreement is not reached.

3 HM Treasury, *Corporate tax and the digital economy: position paper*, November 2017.

## Figure 3
HM Treasury's illustrative examples of how digital business models can generate value from users

**HM Treasury examples show how multinational business groups could create value from UK users and explain why the Digital Services Tax was necessary**

Diagram 1: Social media business model



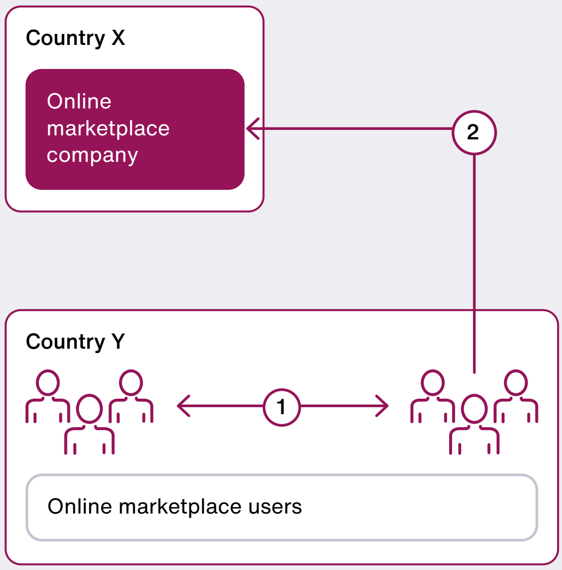

1 Social media platform collects user data and targets adverts.

2 Business purchases advertising space on platform.

3 Business generates brand awareness and sales to users as a result of advertising.

A social media business platform gives rise to a number of overlapping relationships. Overall in this model users have an important role in generating value for the social media company, by providing data and content which allows it to better target advertising and increase revenues.

Diagram 2: Online marketplace business model




1 Users agree a transaction on an online marketplace.

2 Online marketplace takes commission on the sale.

In this example an online marketplace facilitates interactions between two different sets of consumers e.g. consumers looking to temporarily lease or rent property. There is no requirement for the marketplace to have a business entity or physical presence in the country where the transactions between consumers take place. However, the marketplace is reliant on having a large and engaged network of users in that country. It does not have a physical limit on its capacity to provide this marketplace function and may be able to intelligently monitor and respond to market outcomes by analysing aggregate trading activity and user data.

Source: National Audit Office analysis of HM Treasury documents

## The Digital Services Tax

**1.8** The UK's DST applies to business groups (a group of companies with the same controlling interest) that provide search engines, social media platforms or online marketplaces to UK users. The government's intent is to levy tax where value is created, rather than where the business is physically located. Revenue generated from the interaction of UK users with these services is taxed in the UK.

**1.9** HMRC administers DST at the level of business group (rather than individual company). Groups are liable to pay DST if their worldwide revenues from these digital activities are more than £500 million, and if more than £25 million of revenue is derived from UK users. If the groups exceed these thresholds, their revenues (not profits) derived from UK users are taxed at a rate of 2%. A group's first £25 million of revenues are exempt from DST. DST is intended to be a temporary tax, pending multilateral reform of the international corporate tax rules.[4]

**1.10** DST is not a tax on the online sale of goods. Nor is it a tax on the provision of online content, such as TV or music subscription services. The provision of financial or payment services are also outside scope for the tax. Services within scope for the UK's DST are those which monetise users' engagement with online platforms such as:

- search engines, which allow users to view webpages beyond the platform;
- social media platforms, which allow users to interact with, and share user-generated content with, other users; and
- online marketplaces, which allow users to advertise or sell goods and services to other users.

**1.11** In practice, DST can fall on business groups providing a wide range of online services. HMRC's statutory requirement to protect taxpayer confidentiality prevents them from naming the payers of DST. However, Amazon.com Inc., eBay Inc., Google LLC and Apple Inc. have publicly acknowledged that they have paid, or expect to pay, DST. Amazon.com Inc., Google LLC and Apple Inc. have said they will pass on the cost of the tax to their customers. **Figure 4** on pages 17 and 18 shows some of the types of business that could be covered by DST legislation and Appendix Two provides more detail about activities that are in and out of scope for DST.

4 Business groups with a very low operating margin on in-scope activity, or which are at risk of being taxed twice on the same revenue through an overseas DST-equivalent, will pay a lower rate.

## Figure 4

Examples of business activity that may be in scope for the Digital Services Tax (DST)

**DST legislation does not specify exactly which types of business are liable for DST, but potential examples are shown below**

| Type of platform | Potential examples of business in scope | Potential examples of business out of scope |
|---|---|---|
| Search engine | Any platform that meets the widely understood definition of a search engine, i.e. an online service whose core purpose is to allow users to search for webpages or information across the internet | Internal website search engines |
| | | Websites that have 'search boxes' which display search results from external or unrelated websites |
| Social media | Social networking sites | |
| | Professional networking sites | |
| | Micro-blogging platforms | |
| | Video or image sharing platforms, where users upload or share content | The direct sale of online content (for example TV or music subscription services, online newspapers, etc) where the business either owns the content or has acquired the right to distribute the content |
| | Online dating websites | |
| | Platforms that primarily exist to share user reviews | |
| | Website recommendation platforms | |
| | Some online games | Online games that do not rely on online play with/against other users and do not involve user-created content |
| Online marketplace | Facilitating sales of goods and services between businesses and consumers | A sale of goods or services directly from a business to a consumer |
| | Facilitating sales of goods between two businesses | A sale of goods or services directly from a business to another business |
| | Facilitating sales of goods between two consumers | |
| | Online auction | In person auction that is streamed online |
| | Jobs marketplace | |
| | Insurance marketplace | |
| | Vehicle or vehicle parts marketplace | |
| | Hotel or accommodation marketplace | |
| | Travel agency/tourism marketplace | |
| | Travel marketplace for air, train, etc tickets | |

**Figure 4** *continued*

Examples of business activity that may be in scope for the Digital Services Tax (DST)

| Type of platform | Potential examples of business in scope | Potential examples of business out of scope |
|---|---|---|
| Online marketplace *continued* | Food delivery marketplace | |
| | Clothing or fashion marketplace | |
| | Estate agent marketplace | |
| | Live events marketplace (the sale of tickets to live events) | |
| | Services marketplace, for example, building services | |
| | The sale of online games, or add-ins to online games, between third parties | The sale of online games, or add-ins to online games, between the host platform and a user |
| | Cryptocurrency marketplace or exchange | |
| | | Online gambling |
| | | Financial services |

**Notes**

1 Whether or not a business group is liable for DST will depend on the value of its turnover from UK users global turnover and on the exact nature of its business model. This Figure provides illustrative examples and is not exhaustive.

2 There are special rules to determine DST from online marketplaces which receive revenues arising in connection with accommodation or land. The rules are designed to look at the location of the property, rather than the normal location of the user owning the property.

Source: National Audit Office analysis of HM Revenues & Customs information

## Progress in agreeing and implementing the OECD reforms

### What is proposed

**1.12** The government intended, when it introduced DST, that it would no longer apply when an international solution was in place. The international solution will be delivered through the OCED reforms. These reforms include two 'pillars':

- Pillar One: Will re-allocate some taxing rights over the largest and most profitable multinational business groups from their home countries to the tax jurisdictions where their customers and users are located, while providing increased certainty over tax to be paid.
- Pillar Two: Introduces a global minimum corporate tax rate, set at 15% of profit. It applies to groups of companies with revenue above €750 million.[5]

5 Organisation for Economic Co-operation and Development (OECD) and G20 group, *Two-pillar solution to address the tax challenges arising from the digitalisation of the economy*, October 2021.

**1.13** Pillar One's scope will differ from that of DST:

- It will be a tax on profits rather than revenues.
- It will apply to a much broader range of activities – it is not simply aimed at online business groups – and it will cover online sales.
- While the scope is wider than DST, requirements for global turnover of more than €20 billion and profits exceeding 10% of turnover will effectively limit coverage to around 100 of the world's largest and most profitable businesses.
- Legislative decisions, implementation decisions and the operation of compliance regimes will be carried out multilaterally in line with agreed conventions and frameworks.

## Progress in implementing the reforms

**1.14** In October 2021 the OECD announced that 136 countries had reached final political agreement on the framework for the two-pillar solution, with an initial intention to introduce Pillar One in 2023.[6] At the same time the UK government reached agreement with the United States and other countries on an approach to transition from DST to Pillar One. Under the agreement, groups that would be in scope for both DST and Pillar One would be able to reduce their future Corporation Tax liability by the amount that their DST payments exceed the tax that would have been due under Pillar One for the 'transition' years of 2022 and 2023. As part of the agreement, the United States agreed not to impose tariffs on the UK and other countries which had developed their own DSTs. The United States had previously announced that these taxes discriminated against US-based business groups. In July 2022 the OECD announced that the multilateral convention which will implement Pillar One globally will be open for jurisdictions to sign in mid-2023, with the aim of the Pillar One reforms coming into force in 2024. If DST is not replaced to this timescale, HM Treasury is obliged by legislation to carry out a review of the tax by the end of 2025.

6 Organisation for Economic Co-operation and Development (OECD), *Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy – 8 October 2021*, available at: www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm

# Part Two

## Revenue raised from the Digital Services Tax

**2.1** This part of the report describes how revenues from the Digital Services Tax (DST) compare to forecasts and how it has increased the amount of tax that digital services pay.

### DST revenue collected to date, against forecast

#### Revenue from DST in its first year of operation

**2.2** The DST raised £358 million in its first year of operation (2020-21). Eighteen business groups paid DST. **Figure 5** shows that five groups contributed 90% of total revenue.

#### Performance against forecast

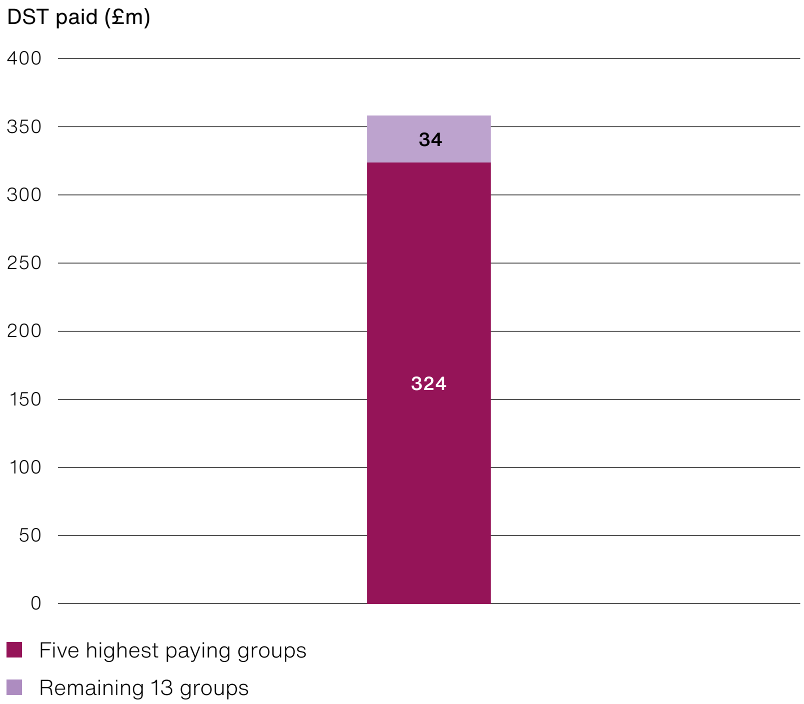
**2.3** At £358 million, revenue for the 2020-21 tax year was 30% higher than HM Revenue & Customs' (HMRC's) initial forecast of £275 million, made in July 2019. HMRC told us the main reasons for this were:

- that it reduced its initial forecast by 20% in the expectation that business groups would make efforts to reduce or remove their requirement to pay DST (although HMRC thought the scope to do this would be limited). HMRC did not observe such behaviour, and, in October 2021, it removed this assumption from its model; and
- a small number of groups had paid far more DST than expected.

## Figure 5

Digital Services Tax (DST) revenue paid for the 2020-21 tax year, by business groups

**Five of the 18 business groups paying DST paid 90% of the total revenue collected**




**Notes**

1 This Figure includes information about 18 business groups that made a DST payment for the 2020-21 tax year.

2 A business group is a group of companies with the same controlling interest.

3 Business groups are anonymised in order to preserve taxpayer confidentiality.

4 Numbers are rounded.

Source: National Audit Office analysis of HM Revenues & Customs data

**2.4** HMRC told us one of the chief reasons actual DST returns differed from forecast was the impact of the COVID-19 pandemic. This had both a positive and negative impact on DST payable by different business groups. It also found more businesses fell within scope for the tax, either through HMRC's work or through self-identification. HMRC explained that:

- 14 groups paid more than expected:
  - five business groups paid more than forecast due to increased use of online marketplaces and social media as a result of government restrictions in response to COVID-19;
  - three business groups that were forecast to pay nothing made payments; and
  - six groups it had not expected to be in scope for DST subsequently registered to pay DST.
- 15 business groups have paid less than forecast (of which 11 paid nothing). In nine cases this was due to the impact of COVID-19 on the business, for example the travel industry. Three groups were found to be out of scope. Discussions are ongoing with three groups.

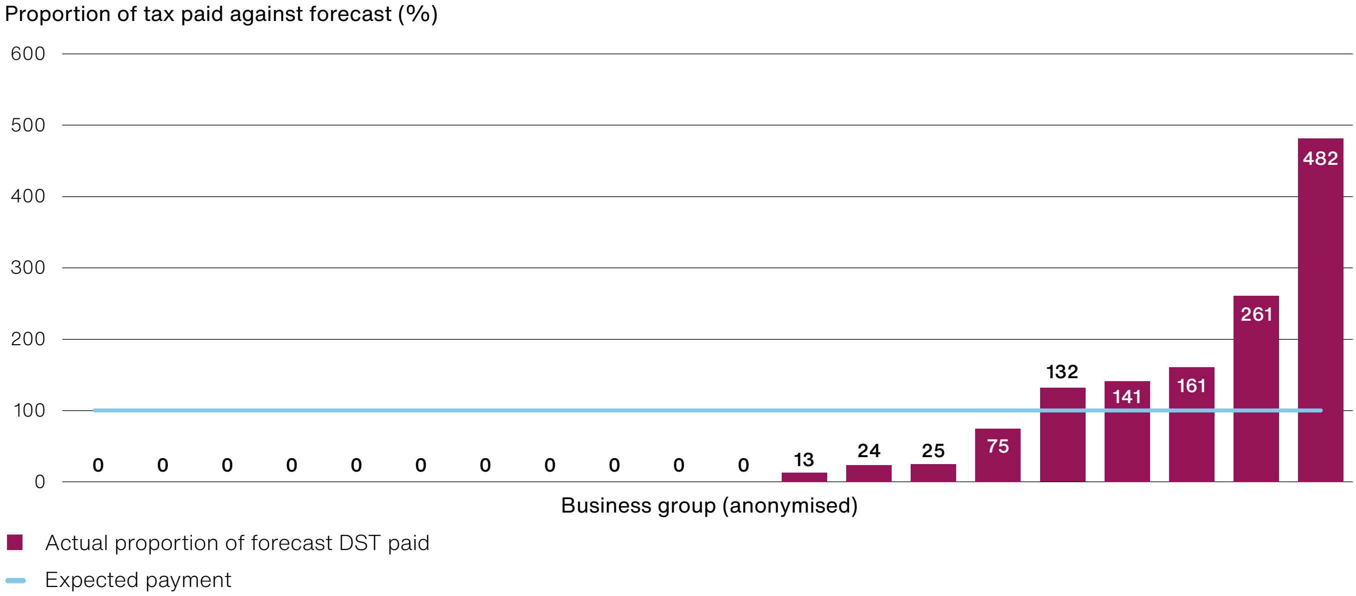
**2.5** **Figure 6** shows the difference between forecast and actual DST revenue paid by each of 20 business groups included in HMRC's original forecast. It shows that, while three-quarters paid less than initially expected, five of the groups paid more than expected, with two paying far more than forecast.

**2.6** **Figure 7** on page 24 shows that the business groups that ultimately paid the tax were a mix of those that were identified as being within scope for DST during initial development work, and those that were identified subsequently. Some of the business groups within scope were assessed by HMRC as not liable to pay DST in 2020-21 on the grounds that they did not meet the revenue or profitability criteria.

## Figure 6

The proportion of forecast Digital Services Tax (DST) for 2020-21 that was actually paid by each of the 20 business groups initially forecast to pay DST

**Eleven of the 20 groups expected to make a payment did not pay any DST and a further four paid less than expected, but five paid more than forecast**




Notes

1 HM Revenue & Customs (HMRC) initial DST forecast model included 31 business groups, of which 20 were expected to pay some DST.

2 HMRC's initial forecast for DST payments was made in July 2019.

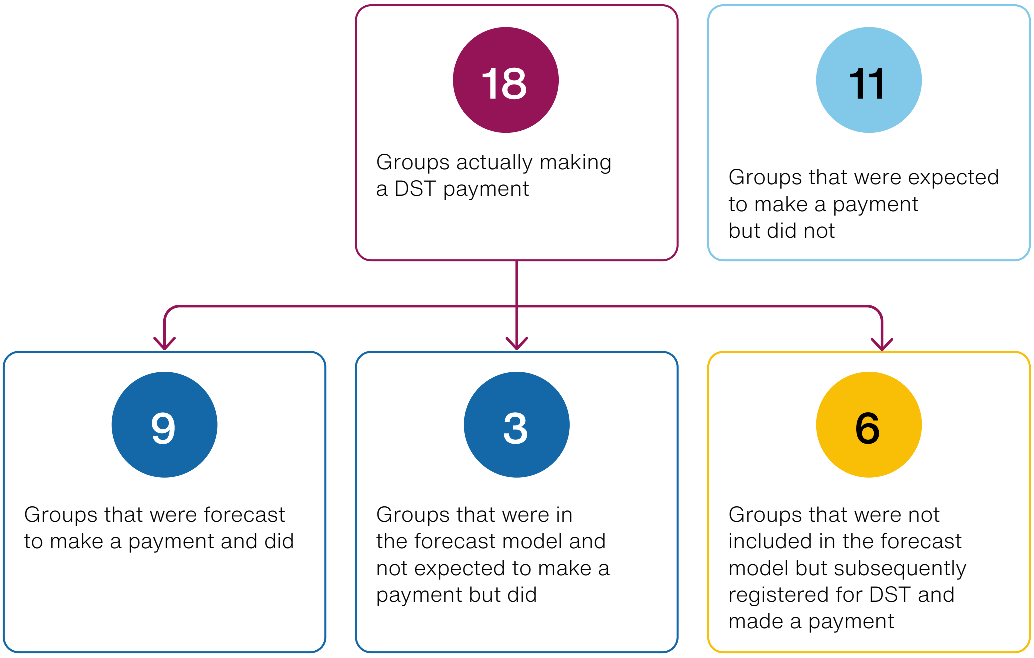
3 Six groups that made payments were not included in original forecasts and so are not included in the comparison presented here.

4 Payers are anonymised to protect taxpayer confidentiality.

Source: National Audit Office analysis of HM Revenue & Customs data

## Figure 7
Business groups that paid Digital Services Tax (DST) for the 2020-21 tax year

**Half of the 18 groups that paid DST had not been forecast to do so by HM Revenue & Customs (HMRC) in its initial model, and 11 groups that had been expected to pay DST did not**




- Total number of groups that made a payment
- Groups in model that did not make a payment but were expected to
- Groups in model that did make a payment
- Groups not included in model that did make a payment

**Notes**

1 This Figure refers to HMRC's initial forecast of groups expected to pay DST, from July 2019.

2 This Figure relates to forecast and actual payments incurred for the 2020-21 tax year. Payments were actually made to HMRC after 2020-21.

3 HMRC told us that the most common reason that business groups paid more or less DST than expected was the impact of the COVID-19 pandemic.

Source: National Audit Office analysis of HM Revenue & Customs data

## How DST has increased the tax paid by in-scope business groups

**2.7** As stated in paragraph 1.8, DST is intended to make sure that digital business groups pay tax that reflects the value they generate from the UK. We looked at UK tax paid by business groups within scope for the tax. HMRC provided us with anonymised data on the total tax paid by the 18 business groups that had paid DST for the 2020-21 tax year.

**2.8** **Figure 8** on page 26 shows that the total tax paid by these groups increased by 36% during the first year of the COVID-19 pandemic, from £2.4 billion in 2019-20, to £3.3 billion in 2020-21. The trend continued in 2021-22 (the year in which the first year's DST was collected), with taxes excluding DST raising £4.5 billion, an increase of 34%. DST accounted for 7% of the £4.8 billion of tax paid by these groups in 2020-21.

**2.9** The highest value tax paid by these groups was VAT, which contributed around two-thirds of all revenues. Employer contributions to National Insurance raised about one-fifth of revenues. The trend in Corporation Tax shows taxable profits increased by 16% from 2019-20 to 2021-22. Corporation Tax receipts decreased in 2021-22 compared with 2020-21. VAT revenues doubled during the pandemic but it is unclear how much of this was due to increased sales or changes to VAT rules on imported goods.

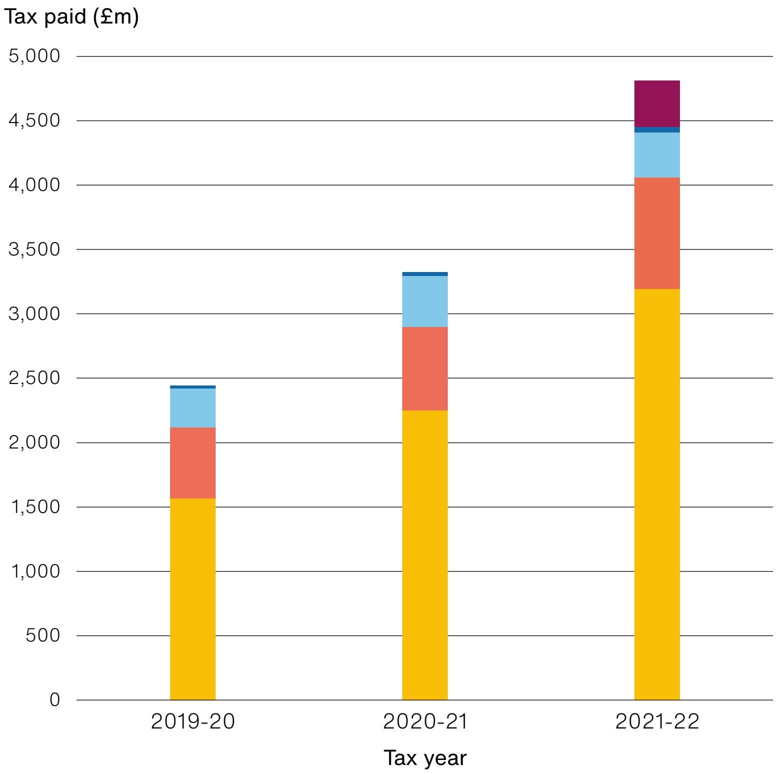
**2.10** At £358 million, the amount of DST business groups paid in 2021-22 was approximately the same as those groups paid in Corporation Tax. Stakeholders we spoke to were concerned that, because DST is tax on revenues rather than profits, it creates double taxation (that is, profitable business groups pay tax twice on the same income, once as revenue under DST, and once as profit under Corporation Tax). They also said, since it did not allow for the level of profitability, DST could disadvantage business groups with a low profit margin. HMRC acknowledged it was a feature of DST to not consider the profit margin in most cases, but told us that the alternative basis of charge (by which groups can elect to calculate their DST liability using a different methodology) mitigated the risk for business groups with the lowest profit margins.[7] **Figure 9** on page 27 shows that 13 of 18 groups paid more DST than Corporation Tax in 2021-22, although there was significant variation. Nine of these groups paid more than twice as much DST as Corporation Tax, with a further three groups paying no Corporation Tax at all. Three groups paid between 13 and 19 times more Corporation Tax than DST.

7 The methodology for the alternative basis of charge requires the group to pay tax at the rate of 80% on its operating profit, that is: DST revenues*operating margin*0.8. It is not favourable for groups with an operating margin of more than 2.5% to elect to use this methodology. If the operating margin is negative (that is, loss-making) the margin is deemed to be nil and no tax is due.

## Figure 8

Total tax paid between 2019-20 and 2021-22 by business groups that paid Digital Services Tax (DST) for the 2020-21 tax year

**The DST contributed to increased revenues to the Exchequer from the business groups liable for DST**




| | 2019-20 | 2020-21 | 2021-22 |
|---|---|---|---|
| **Total tax paid (£m)** | **2,442** | **3,322** | **4,811** |
| DST (£m) | 0 | 0 | 358 |
| Other taxes paid by business group (£m) | 20 | 28 | 42 |
| Corporation Tax (£m) | 303 | 393 | 351 |
| Employer National Insurance Contributions (£m) | 553 | 651 | 865 |
| VAT (£m) | 1,567 | 2,250 | 3,195 |

**Notes**

1 Eighteen business groups paid DST for the 2020-21 tax year.

2 VAT includes both VAT and Import VAT.

3 Other taxes are Import Duty and Stamp Duty Land Tax.

4 This Figure does not include Employee National Insurance Contributions and Employee Income Tax. These taxes were collectively worth £1,578 million in 2019-20; £1,846 million in 2020-21; and £2,466 million in 2021-22.

5 Business groups paid DST incurred in 2020-21 during 2021-22.

6 From 1 January 2021 new rules came into effect for the VAT treatment of goods from overseas. This means it is not possible to compare VAT across tax years.

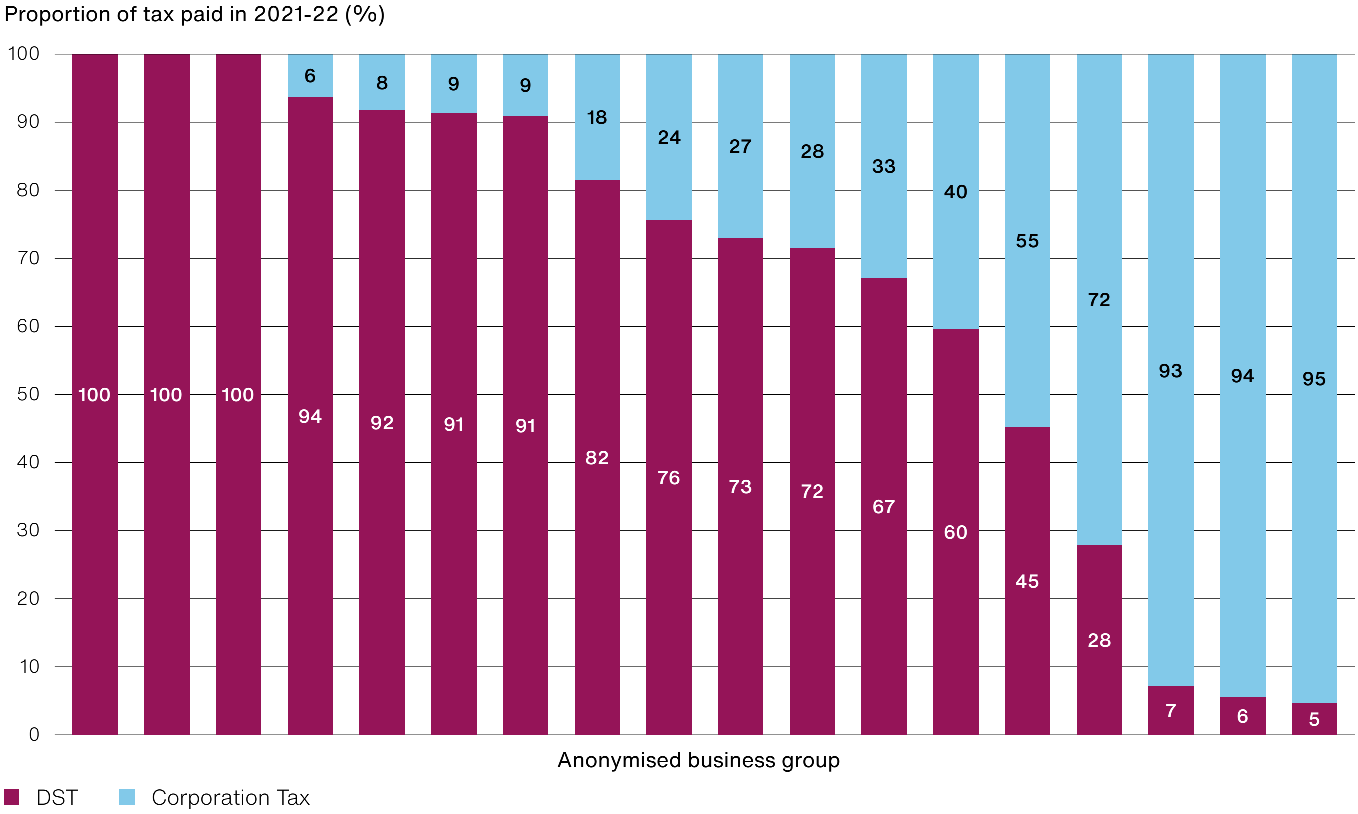
7 Numbers may not sum due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

## Figure 9

The relative proportions of Digital Service Tax (DST) and Corporation Tax paid by business groups that paid DST for the 2020-21 tax year in 2021-22

**Most groups (13 of 18) paid more DST than Corporation Tax**




**Notes**

1 Business groups are anonymised to protect taxpayer confidentiality.

2 Tax collected in 2021-22 was incurred in 2020-21, i.e. the first year of DST.

Source: National Audit Office analysis of HM Revenue & Customs data

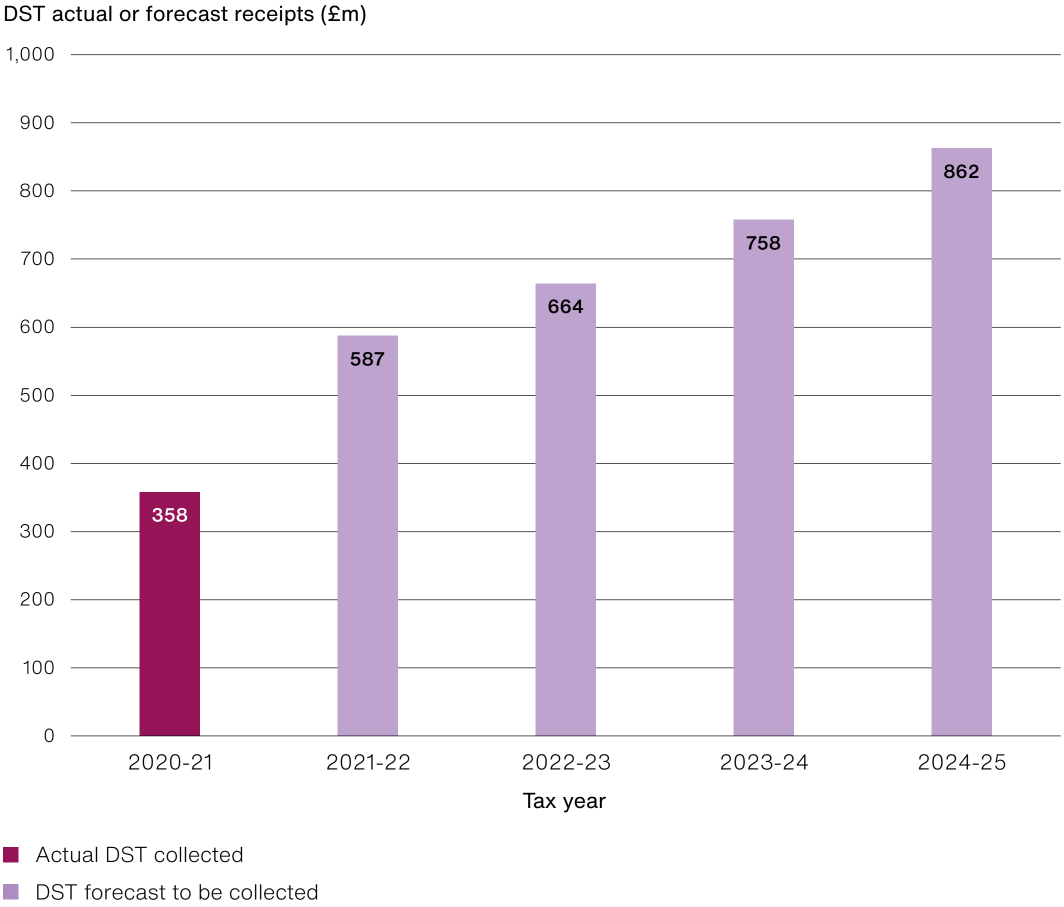
## Future receipts from the Digital Services Tax

**2.11** HMRC and the Office for Budget Responsibility regularly revise their long-term forecasts for DST revenue. Their initial forecast for cumulative revenues to be collected between 2020-21 and 2024-25 was £1.5 billion (published by HMRC in July 2019); the most recent (March 2022) forecast was for more than £3 billion. Part of the reason for this increase was the removal of the adjustment for groups seeking to minimise their DST liability (see paragraph 2.3). HMRC also told us it had a better understanding of the population of groups now, including how they had been affected by the COVID-19 pandemic. **Figure 10** overleaf shows forecast revenue from DST is expected to increase each year until 2024-25. The impact of the COVID-19 pandemic on businesses, both positive and negative, means that the first year of payments may not be typical of later years.

## Figure 10

Actual and forecast receipts from the Digital Services Tax (DST), for the 2020-21 to 2024-25 tax years

**The receipts from DST are expected to increase from the 2020-21 tax year, and to total £3,230 million by 2024-25**




**Notes**

1 This Figure shows data on actual DST receipts for 2020-21 provided by HM Revenue & Customs (HMRC).

2 This Figure shows forecast DST receipts between 2021-22 and 2024-25 on a National Accounts Basis, produced by the Office for Budget Responsibility in March 2022.

Source: National Audit Office analysis of HM Revenue & Customs and Office for Budget Responsibility data

# Part Three

## Managing risks to, and learning lessons from, the Digital Services Tax

**3.1** This part of the report describes how HM Revenue & Customs (HMRC) implemented the Digital Services Tax (DST), including how it identified and managed risks and ensured that business groups paid the correct amount of DST. It also considers whether HMRC has learned lessons from this work that will help it as the population for DST expands and when implementing the Organisation for Economic Co-operation and Development (OECD) and G20 Pillar One reforms.

### Implementation

**3.2** HMRC began work to implement DST in 2018-19, ahead of the tax coming into effect from April 2020. It assigned a project team from its Policy Driven Change directorate to implement the DST project, although this team worked with other teams within HMRC and was overseen within a wider governance framework (**Figure 11** overleaf). The project's objectives were to deliver an information technology (IT) solution for payers to transact effectively with HMRC, within the budget set, and to provide assurance that businesses are able to pay the right amount at the right time. In May 2022 HMRC's internal review of the DST project delivery concluded that the project had successfully delivered the required criteria. We report below on the cost of implementation, the implementation risks and stakeholder views of HMRC's implementation and administration of DST.

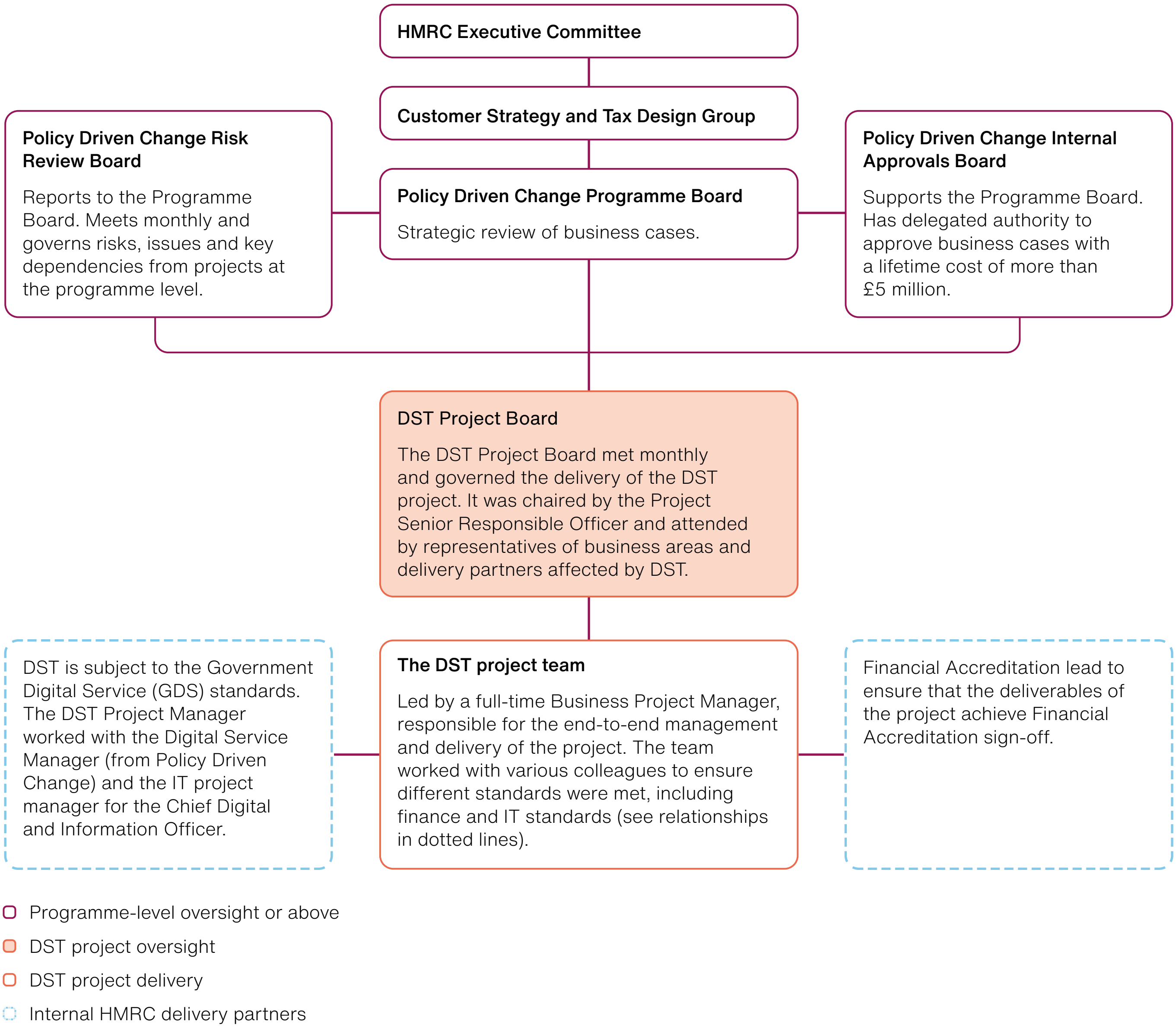
#### The cost of implementing Digital Services Tax

**3.3** HMRC implemented DST for £6.3 million, which was £1.5 million less than its £7.8 million budget. It recorded underspends against both staff costs (spending £3.5 million of a £4.1 million budget) and IT costs (£2.8 million of a £3.7 million budget). HMRC attributed the underspend to a conservative approach to budget-setting early in the life of the project.

**3.4** HMRC assigned an average of 8.4 full-time equivalent staff per year to its DST project between 2019-20 and 2021-22. It told us that, while the level of staff resourcing was tailored to the DST project, the overarching approach to determining the staff level required was consistent with similar tax projects.

## Figure 11
HM Revenue & Customs (HMRC) governance of the Digital Services Tax (DST) project

**HMRC oversaw the implementation of the DST project within its existing governance structure**




Source: National Audit Office analysis of HM Revenue & Customs information

## Implementation risks

**3.5** As part of the project delivery and oversight, HMRC identified numerous risks. Some of the risks related to project management issues, such as ensuring the necessary staff were available, and managing uncertainty until the final policy and legislation were in place. Other risks centred on identifying the best IT system to deliver DST. HMRC particularly focused on five key risks, shown in **Figure 12**. At the conclusion of the implementation stage, the project team closed risks or handed ownership to the compliance team.

### Figure 12

Key risks identified by HM Revenue & Customs (HMRC) during its implementation of the Digital Services Tax (DST) in April 2020, and how it managed them

**HMRC needed to manage risks relating to legislation, taxpayers and Information Technology (IT) systems**

| Risk identified | How HMRC managed the risk |
| --- | --- |
| Incomplete data limiting HMRC's ability to assess business groups' liability for DST. | HMRC assigned compliance staff to undertake assessments of business groups likely to be in scope. |
| Complexity in the legislation, and among the groups, limit HMRC's ability to determine groups' liability for DST. | HMRC's DST policy team provided training to compliance colleagues on the legislation. HMRC also arranged for joint working between its compliance team and its Customer Compliance Managers, who had established relationships with relevant business groups. |
| Being unable to identify, communicate with or take enforcement action against business groups that do not have a physical presence in the UK. | HMRC explored options with colleagues that had experience managing similar issues, for example with VAT. Managing compliance among groups without a UK presence is discussed further below. |
| HMRC may need to change or stop work on DST at short notice, depending on policy decisions taken regarding the Organisation for Economic Co-operation and Development (OECD) and G20 reforms on future tax revenues. | HMRC policy teams were assigned to manage any risk emerging from this. As part of an international agreement, the UK government subsequently agreed that business groups could offset DST paid in 2022 and 2023 against their future Corporation Tax bill (see paragraph 1.14). |
| IT systems would not be ready to allow HMRC to administer DST on time. | HMRC identified two potential IT solutions and undertook an internal review to select the better option. |

Source: National Audit Office analysis of HM Revenue & Customs information

### Stakeholder views

**3.6** Stakeholders who submitted DST returns (or worked with, or represented, groups submitting DST returns) were broadly positive about their engagement with HMRC. In particular, they noted that HMRC tended to be helpful when contacted, provided clear guidance (even though the scope of the legislation was not necessarily clear) and took a flexible and proportionate approach regarding how groups calculated their DST liability in order to reduce the administrative burden (collecting the data required to calculate the liability was a significant challenge for some groups). Some also compared the experience of paying the UK DST favourably with the experience in other countries, citing being able to return a single submission for the whole business group (rather than separate submissions for each company) and only needing to submit a return annually among the positive features. However, some stakeholders also reported less favourable experiences, with one citing long waits and a lack of information when contacting HMRC's helpline.

## Compliance risks

### How HMRC manages DST compliance risks

**3.7** HMRC's Customer Compliance Group directorate manages its relationships with taxpayers and ensures they pay the tax they owe. HMRC set up a team within this directorate to manage compliance risks associated with DST. The main features of its approach were:

- desk-based research, liaison with Customer Compliance Managers for large businesses, and drawing on existing HMRC knowledge, to identify business groups likely to be liable for DST;
- assigning a tax specialist to each group identified as potentially liable; and
- making an initial assessment before returns were due to determine whether to contact a group, contacting groups identified as potentially liable to DST before their returns were due for further discussion. It carried out more detailed assessments once returns were due, including discussions with groups, if needed.

**3.8** HMRC identified and reviewed 101 business groups initially. Of these, it determined 56 required further risk assessment. **Figure 13** shows the progress made with compliance work as at September 2022. HMRC had completed its risk assessments for 10 of the 56 groups. It was still engaged with 46 groups regarding their DST liability for 2020-21. Twenty of these have submitted a DST return and 26 have not submitted a return. HMRC told us that any further groups it identifies as potentially liable for DST for the 2021-22 tax year will also be retrospectively assessed for the 2020-21 tax year.

## Figure 13

HM Revenue & Customs (HMRC's) management of compliance risks for the Digital Services Tax (DST) for the 2020-21 tax year

**HMRC undertook an initial review of 101 business groups, further risk assessment of 56 groups and was still engaged with 46 groups at September 2022**

By September 2022, HMRC had commenced **pre-return** reviews with **101 groups** for the 2020-21 tax year.

It reviewed **216 online services** of which **134 were potentially relevant** for DST and **82 were found not to be in scope**.

**30 groups** submitted a return, covering **93 online services**.

**71 groups** did not submit a return, covering **123 online services**.

HMRC was still engaged with **20 groups**, covering **63 online services**.

HMRC had completed its post-return risk assessment for **10 groups**, covering **30 online services**.

HMRC was still engaged with **26 groups**, covering **41 services**.

HMRC was satisfied **45 of these groups**, covering **82 services**, were not in scope for DST in 2020-21.

In total, HMRC was still engaged with **46 groups** covering **104 online services** at September 2022.

Source: National Audit Office analysis of HM Revenue & Customs information

## Detection of non-compliance

**3.9** HMRC has not yet identified any tax losses relating to DST in the 2020-21 tax year (compliance work is ongoing). HMRC has identified eight behaviours that could lead to non-payment of DST, ranging from tax evasion (deliberate illegal activity to omit, conceal or misrepresent information) to errors in completing tax returns. HMRC told us that it has not identified any attempted tax avoidance or evasion by groups liable to pay DST, and it regarded the risk of evasion as low since the risk of reputational damage would likely outweigh any financial gains for groups large enough to meet the UK and global DST thresholds. At September 2022 HMRC had issued £100 penalties against two groups for late submission of their DST return, and both groups had paid.

**3.10** As noted in paragraph 2.3, HMRC's original estimate of DST revenue was adjusted downwards by 20% in the expectation that some business groups would take legal measures to reduce or remove their requirement to pay DST, and the Office for Budget Responsibility reported that allowance for this would need to be increased over time. However, HMRC did not observe groups seeking to reduce their 2020-21 DST liability and therefore removed the adjustment in making their autumn 2021 revenue forecast. During its post-return assessments HMRC has worked with groups to understand and agree how they calculated their DST liability. HMRC told us it has not audited the data underlying the DST return for any business group so far, but that it has the resource to do so if necessary. However, it is currently focused on supporting groups to calculate their liability, rather than auditing existing returns.

## Future compliance work

**3.11** HMRC initially expected that only a small number of very large business groups would meet criteria and thresholds requiring them to pay DST. Its first assessment identified 31 groups. Since then, HMRC has identified more groups that may be liable to pay DST, both through its compliance work and from businesses approaching HMRC directly. It has carried out pre-return risk assessments with 101 groups for the 2020-21 tax year. Groups identified more recently may have different characteristics. For example, they may be smaller, lack a physical presence in the UK, not have an established relationship with HMRC, or be less concerned about their reputation.

**3.12** There are a number of emerging compliance challenges HMRC may need to manage, with regard to DST:

- Communicating with overseas groups that do not have a physical presence in the UK.
- Enforcement against groups without a physical presence in the UK.
- Understanding which revenues are in scope for DST.

**Communicating with overseas groups that do not have a physical presence in the UK**

**3.13** HMRC told us that it did not need to undertake much work to raise awareness of DST prior to its implementation, since government's announcement that DST would be introduced was well publicised in the press and the small number of groups expected to pay DST were largely already aware of it. Some support for this view was provided by our survey of the groups that had submitted a DST return for the 2020-21 tax year. Eight of the groups completed the survey, and of these, five reported that they found out about DST from sources other than HMRC. However, as HMRC risk assesses and engages with more groups, it may identify groups that are unaware of DST because they do not have a physical presence in the UK or have an existing relationship with HMRC but who nonetheless meet the thresholds and criteria to pay UK DST.

**Enforcement against groups without a physical presence in the UK**

**3.14** HMRC may need to manage groups without a physical presence in the UK that are aware they owe DST but refuse to pay. In this situation, HMRC has a number of options it can pursue to obtain the payment it is owed (including interest and penalties for late payment):

- It can issue a payment notice to a member of any company that was part of the business group that owes DST in the accounting period the liability arose. While recovery of the debt will be easier if the company is UK-resident, they do not have to be UK-based.
- If the business group does not have a physical presence in the UK, HMRC can pursue other options, such as working with tax authorities in other countries to recover the debt. The UK is part of multiple bilateral agreements and multi-lateral arrangements that would facilitate this approach, although these would require the other government(s) to agree the UK DST was consistent with the relevant convention or generally agreed taxation principles. It is not certain they would agree (see paragraph 1.14).

**3.15** In practice, HMRC has not needed to test any of these processes, since it has not yet identified any group that has not paid DST it owes. The majority of the groups it has assessed so far do have a UK presence. Of the 101 groups on which HMRC has commenced risk assessment, 86 have some form of UK presence. Of the remaining 15 with no presence in the UK, it found nine to be out of scope, one had submitted a DST return, and it was still assessing the remaining five (as at September 2022).

**3.16** Nonetheless, as HMRC engages with a greater number of groups, it may identify more without a physical presence in the UK. HMRC told us that, before DST legislation and policy had been finalised, government officials discussed various options for managing groups that would not engage with HMRC. These included 'blocking' certain websites or requiring overseas business groups to pay a deposit before accessing UK users, which could then be retained if they failed to comply with their tax obligations. They subsequently decided these options were not necessary.

### Managing groups that fail to identify their revenues are in scope for DST

**3.17** Another potential challenge HMRC may need to manage is groups that misunderstand, or seek to misrepresent, whether their revenues are in scope for DST. Some stakeholders told us that the legislation is not clear in some areas. Since relatively subtle distinctions in business models can affect whether or not DST is owed, HMRC may find it challenging to determine whether some revenues are within or outside scope. **Figure 14** provides a hypothetical example.

## Figure 14

A hypothetical example of how variations in a business model effect whether or not revenue is liable for Digital Services Tax (DST)

**Relatively subtle variations in business models can move revenue in or out of scope for DST**

Online gaming provides one example of how the business model used can affect whether a revenue source is in scope for DST. For example:

- Group A provides an online gaming option as part of its social media platform.
- Company B (who are independent of Group A) produce a game for this platform.
- Group A could buy the game from Company B and then sell it to its users, in which case this would constitute a direct sale (i.e. it is selling something it owns), which is outside the scope for DST.
- Alternatively, Group A could act as an online marketplace by allowing its customers to buy the game directly from Company B. Under this scenario the revenue would be in scope for DST.
- Additionally, there may be 'in-app purchases' whereby, additions to the online game can be sold to users via a direct sale or online marketplace.

Source: National Audit Office analysis of HM Revenue & Customs information

**3.18** It is also possible that groups may choose to change their business model to avoid DST. For example, an online marketplace may move from facilitating the sale of goods between two third parties to buying goods from the seller and immediately reselling them to the buyer. HMRC has considered this, and believes the risk to be low since, if the online marketplace bought and resold the goods, it would become liable for the quality of those goods, fundamentally changing the risk profile of its business. In the event a group changes its business model, HMRC can consider whether to apply its 'targeted anti-avoidance rule' set out in legislation, which is designed to counteract arrangements designed to achieve a DST tax advantage for the group.[8]

## Preparations for replacing Digital Services Tax with 'Pillar One' reforms

**3.19** As noted in Part One, the UK government is committed to withdrawing DST once the OECD Pillar One reforms are in place.

**3.20** HMRC told us that proposals within the Pillar One reforms are different in nature from DST, being a reform of Corporation Tax, which means that there is very little in the design, legislation and administration of DST that can be meaningfully applied to its work on Pillar One. It also told us that it expects most of the compliance work on Pillar One to be undertaken in partnership with the tax authorities of other countries. Furthermore, it expects the number of business groups currently paying DST that will go on to pay what is introduced as a result of Pillar One will be very small.

**3.21** HMRC also told us that key elements of the Pillar One rules have yet to be finalised, which means it is not possible for HMRC to undertake detailed work on how it will implement, and ensure compliance with, Pillar One. For the same reason HMRC has not estimated how much tax revenue it might collect under the Pillar One reforms when they replace DST. Until this becomes clear it cannot assess the value of the credit that business groups may claim back for DST payments (see paragraph 1.14).

8 The operation of the rule is explained in HMRC's DST manual.

# Appendix One

## Our investigative approach

### Scope

**1** This investigation examined HM Revenue & Customs' (HMRC's) implementation of the Digital Services Tax (DST). It covered the following:

- What DST is and why it was introduced, including an explanation of why it is intended to be a temporary tax and an introduction of the Organisation for Economic Co-operation and Development (OECD) reforms that are expected to replace it.
- The impact of DST in its first year, covering the tax revenue collected from DST and the impact on HMRC's total tax take.
- How HMRC has managed the risks of non-compliance with the tax by business groups within its scope, and what lessons it has learned.

### Methods

**2** In examining these issues, we drew on a variety of evidence sources outlined below, undertaking our fieldwork between March and September 2022. Our work included: interviewing HMRC and a range of other stakeholders; reviewing documentation and data held by HMRC; reviewing publicly available information; gathering information from other countries supreme audit institutions about whether their country had a digital services tax, and if so the form it took; and conducting a survey of business groups that submitted a DST return for the 2020-21 tax year.

#### Interviews

**3** **We interviewed officials from HMRC** to understand how they implemented and administered DST, how they identified and managed implementation risks and how they manage risks of groups not complying with their obligations under DST, how they forecast the revenue they would collect from DST, how they are preparing for the OECD reforms and whether there are any lessons from DST that they expect to apply to the OECD reforms. We undertook seven in-depth interviews to cover specific issues.

4 **We interviewed officials from HM Treasury** to understand why government chose to implement DST, why they designed it as they did and why they implemented it when they did. We undertook one in-depth interview and supplemented it with informal meetings and email correspondence.

5 **We spoke with other stakeholders, including representatives from the OECD, tax specialists and representatives of business.** Specifically, from the following organisations: the Chartered Institute of Taxation (CIOT), the Confederation of British Industry (CBI), Deloitte, PriceWaterhouseCoopers (PwC) and Ernst & Young.

6 We also spoke to independent experts at Tax Centres:

- Kimberley Scharf, Professor of Economics and Public Policy and Head of the School of Economics at the University of Nottingham, Fellow of the Academy of Social Sciences, Member of Council at the Economic and Social Research Council and an editor of the journal *Fiscal Studies*.
- Michael Devereux, Director of the Oxford University Centre for Business Taxation, Professor of Business Taxation at Saïd Business School, and a Professorial Fellow at Oriel College.

## Review and analysis of HMRC data

7 HMRC has a statutory duty to protect taxpayer confidentiality. Given the small number of businesses paying DST, we relied on HMRC to provide us with information about, and analysis of, the population of DST payers in a way that preserved their anonymity.

8 We reviewed and analysed HMRC data to help us understand how many business groups paid DST and how much they paid, how much HMRC expected to collect, and how HMRC resourced the implementation and administration of DST. Data included:

- anonymised data about the proportion of forecast DST actually paid by business groups;
- anonymised data about DST as a proportion of the total tax paid by business groups;
- aggregated data on the value of DST paid and the total tax paid by groups that submitted a DST return;
- HMRC's model for forecasting DST revenue, how it changed over time and the outputs from the model; and
- data on staff numbers and costs.

9 We also reviewed the Office for Budget Responsibility's published forecasts of DST receipts.

## Review of documents and other information

**10** We reviewed published and unpublished documents from HMRC and other stakeholders to help us understand the rationale behind DST and planned OECD and G20 reforms, and to understand how HMRC implemented and administered DST. Key documents included: the government's policy papers and consultation on DST; governance, planning and project management documents and data used by HMRC to implement and administer DST; documents used by HMRC's DST compliance team to manage the risk of non-compliance by groups; and OECD and G20 papers showing the development of their planned reforms.

## International comparison

**11** We engaged with our national audit counterparts in other countries to understand whether they had, or were considering, implementing a digital services tax. And, if they had, how similar it was to the UK DST.

## Survey of business groups

**12** We conducted an online survey of 28 business groups that had submitted a DST return for the 2020-21 tax year by June 2022 (including nil returns). We asked them their views of how HMRC had implemented DST, including:

- how and when they first heard about DST;
- whether they had sufficient time and information to understand if they were in scope to pay DST, and if so how much they would need to pay;
- how HMRC and wider government responded to any questions or issues they raised; and
- how easy or difficult they found it to calculate their DST liability and the resource cost of doing so.

**13** The survey was designed to be short and simple, and to take around 10 to 12 minutes to complete, but respondents were able to complete it in multiple sittings if they chose to. Most questions were multiple choice, although there were some open text questions, inviting respondents to expand on their answers and to provide other information.

**14** HMRC provided us with the contact details of the person within each group that submitted a DST return and we sent the survey link directly to that person. We did not specify who should answer the survey within the group, assuming that the contact person from HMRC would know who was best placed to answer. HMRC provided details for 28 business groups that had submitted a DST return by June 2022. Eight of these groups (29%) completed our survey.

**15** We undertook descriptive analysis of the responses. Owing to the small population of groups and the relatively low response rate, we have not sought to generalise the findings to other groups, but simply reported the number of respondents providing particular answers where relevant in our report.

**16** Our survey offered all groups the opportunity to speak to us in addition to or instead of completing the survey. Two groups took up this option to speak with us.

# Appendix Two

## Activities in scope for Digital Services Tax (DST)

1 **Figure 15** on pages 42 to 44 summarises the activities and revenue streams in scope for DST.

### Figure 15

Activities in, and outside, scope for Digital Services Tax (DST)

**Legislation and HM Revenue & Customs (HMRC) guidance provide indicative, rather than exhaustive, definitions of the activities and revenue streams in scope for DST**

| | In scope | Out of scope |
|---|---|---|
| **Search engine** | **Definition:** The legislation does not define an internet search engine. Instead, its meaning is taken as being the 'ordinary understanding' of a search engine, broadly described as an "online service whose core purpose is to allow users to search for webpages or information across the internet. The search engine will allow users to enter a search query, for instance key terms, which the search engine will then use to find webpages or information which is related to that input". Furthermore, the search results will usually be presented as a list of links or other information ordered by relevance to the original query.<br>**Potential revenues**<br>Will typically receive revenues from:<br>• Search advertising on the group's search engine results.<br>• Search advertising shown by the search engine on third-party websites.<br>• Other search advertising revenues.<br>• Sale/licencing of user data. | **Internal website search engines:** A facility on a website that enables users to search the material on that website or closely related websites.<br>**Websites that have 'search boxes' which display search results from external or unrelated websites:** These websites may be out of scope where the search technology is provided by a third party (depending on the exact arrangements). If the host website is passive and not actively contributing to the search activity, it is likely to be out of scope. |

**Figure 15** *continued*

Activities in, and outside, scope for Digital Services Tax (DST)

| | In scope | Out of scope |
|---|---|---|
| **Social Media** | **Definition:** Business models that rely on an active and engaged user base to create value. A service will meet the definition when:<br>● 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).<br>● Making content generated by users available to other users is a significant feature of the service.<br>Examples include, but are not limited to:<br>● Social networking sites.<br>● Professional networking sites.<br>● Micro-blogging platforms.<br>● Video or image sharing platforms.<br>● Online dating websites.<br>● Platforms that primarily exist to share user reviews.<br>● Some online games – see detail below.<br>Online games may be in scope. Specifically, games where the ability to play against other users is a central part of the gaming experience and where the presence of other users significantly enhances the game. And games that rely on users to create network effects in similar ways to social networks. These games may include some of the following features:<br>● Users play primarily against other users rather than an artificial intelligence.<br>● Users are able to build virtual worlds and environments in which all users operate.<br>● Users are able to create challenges and missions.<br>● Users are able to exchange things with other users within the game.<br>● Users are able to communicate with other users (for example by text or audio).<br>● The interaction with other users facilitates the user's progress or competitive standing in the game.<br>**Potential revenues**<br>The HMRC guidance does not specify how the online service generates its revenue or monetises its services. But social media services will often receive revenues from:<br>● displaying advertising to users of the service;<br>● subscription or other access fees from users of the service;<br>● charging users to access specific content on the platform;<br>● other direct fees from users of the service; and<br>● sale or licencing of user data. | **Online games that do not meet the criteria in the left hand column,** i.e. they do not rely on online play with/against other users and do not involve user-created content. |

**Figure 15** *continued*

Activities in, and outside, scope for Digital Services Tax (DST)

| | In scope | Out of scope |
|---|---|---|
| **Online marketplace** | **Definition:** Online services which provide an online market for goods, services and other property by connecting users seeking something with other users who are willing to provide it. A service will meet the definition when:<br>• 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<br>• the main purpose, or one of the main purposes, of the service is to facilitate the sale by users of particular things.<br>The definition is intended to be broad and include all forms and types of online marketplace, so it does not matter:<br>• whether the online service facilitates business to consumer (B2C), business to business (B2B) or consumer to consumer (C2C) transactions;<br>• which goods, services or property are exchanged;<br>• whether the online service provides the facility for transactions to be concluded on the platform or not;<br>• whether the provider plays an active role in regulating the quality of goods, services or properties offered through the online service;<br>• how active or passive the online service is; and<br>• whether the provider adds significant value to the goods, services or other property available on the marketplace by adding additional services such as delivery or other logistical functions.<br>**Potential revenues**<br>Will often receive revenues from:<br>• Commission fees received for facilitating transactions between users.<br>• Delivery fees.<br>• Fees to access or otherwise buy and sell products, services or other property on the platform.<br>• Fees from advertising products to users of the marketplace, either by preferential search listings or display advertising.<br>• General advertising on the marketplace.<br>• Subscription fees to access marketplace services. | **The sale of own goods online.**<br>**The provision of online content:** the government does not intend to apply DST to revenues generated from the direct sale of online content (for example, TV or music subscription services, online newspapers, etc) where the business either owns the content or has acquired the right to distribute the content.<br>**The provision of radio and television broadcasting services.**<br>**Financial Services:** There is an exemption for online financial marketplaces.<br>**Land and accommodation:** There are special rules to determine DST from online marketplaces which receive revenues arising in connection with accommodation or land. The rules are designed to look at the location of the property rather than the normal location of the user owning the property. |

Source: National Audit Office analysis of HM Revenue & Customs documents

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National Audit Office

£10.00

ISBN 978-1-78604-454-9

9 781786 044549

Design and Production by NAO Communications Team
DP Ref: 010805-001