Client Alert

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The Growing Trend of Digital Services Taxes in Europe, and Why They Matter to US Companies

First France; now the United Kingdom. Both nations join the growing number of European countries that have, in recent months, announced they are considering a new form of tax specifically directed at "digital" businesses. The new form of digital services tax is based on the premise that traditional methods of profit allocation between different countries are no longer fit for their purpose and that, in the context of "digital businesses", a fresh approach needs to be adopted that takes into account the value added by the business's user base.

France and the UK are planning to "go it alone". This follows the breakdown of discussions among the Member States of the European Union aimed at agreeing on a harmonised approach throughout Europe.

This client alert focuses on the digital services tax proposals recently announced by the UK Government and their potential implications for US businesses.

What is the UK's Digital Services Tax (DST)?

On July 11, the UK Government confirmed its proposal to introduce a DST with an effective date of April 1, 2020.

It is a time-limited 2 percent tax on revenues (e.g. commissions, subscription fees, advertising revenue) derived from the provision of:

- A social media platform;
- A search engine; or
- An online marketplace.

It is time-limited in the sense that the UK Government, like France, has committed itself to removing the tax once an international consensus is reached regarding how to tax the profits of groups providing these types of services.

However, there are few signs that any such international consensus is likely to materialise in the short term.

What is the threshold?

The UK DST will apply to a group (defined as a parent and all of its consolidated subsidiaries) where its worldwide revenues in respect of any of the three categories of activity listed above exceed £500 million, provided that more than £25 million of such revenues are attributable to UK users.

For example, in the case of advertising revenue, “attributable to UK users” means the target of the advertising is users in the UK. A “UK user” is a person (an individual or a business) normally located in the UK.

US reaction

With several US-headed multinationals falling squarely into these newly taxable categories and exceeding the threshold revenue test, it is perhaps unsurprising that these developments have not been welcomed by the US government or potentially affected US companies.

Indeed, the Office of the United States Trade Representative (USTR) has commenced an investigation under Section 301 of the Trade Act of 1974 to determine whether the French DST (announced before the UK’s) is discriminatory, which could lead to retaliatory action against French imports on the part of the US.

Several of the grounds for investigation cited by USTR with regard to the French DST (the rate of which is slightly higher than the UK’s, at 3 percent) apply to the UK DST as well. These include alleged discrimination against US companies—since the level of the threshold (EUR 750 million for the French DST) means only the largest companies, which tend to be the US-headed companies, are caught; the tax’s extra-territoriality; the taxation of revenue rather than profit; and, in USTR’s view, “a purpose of penalizing particular technology companies for their commercial success”. Unlike the UK’s prospective only DST tax, the French DST incorporates a retroactive feature too (to January 1, 2019).

At this stage, it appears that the UK and France have every intention of continuing along the path that they have begun to tread, notwithstanding the opening of the USTR investigation.

Hunton Andrews Kurth LLP will be pleased to discuss the potential relevance of these developments to your business in further detail.

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