HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Sir William Cash MP
Chair
European Scrutiny Committee
14 Tothill Street
House of Commons
London
SW1H 9NB

Dear Bill

21 July 2018

7419/18: Proposal for a COUNCIL DIRECTIVE laying down rules relating to the corporate taxation of a significant digital presence

7421/18: COMMISSION RECOMMENDATION of 21.3.2018 relating to the corporate taxation of a significant digital presence

7418/18: COMMUNICATION FROM THE COMMISSION TO EUROPEAN PARLIAMENT AND COUNCIL Time to establish a modern, fair and efficient taxation standard for the digital economy

7420/18: Proposal for a COUNCIL DIRECTIVE on the commons system of a digital services tax on revenues resulting from the provision of certain digital services

1249/17: COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL: A Fair and Efficient Tax System in the European Union for the Digital Single Market

Thank you for your report of 13 June 2018 on the above-listed documents from the European Commission, following our explanatory memorandum of 4 May 2018. I will address the questions from that report in turn.

You ask whether there are any relevant updates to the aspects of the proposals which the government has identified as requiring further exploration. The government continues to consider the various aspects of the proposals, and of options in this space generally, in consultation with business and our international partners. With regard to the proposed rules for taxation of a significant digital presence, this includes consideration of how profit attribution rules might operate in a way that is workable in practice and how permanent establishment criteria can be made proportionate, so that a permanent establishment will usually only exist in cases where a business has substantial activity in a given jurisdiction.

With regard to the proposed Digital Services Tax (DST), government work is underway to consider a number of design questions. This includes the possibility of building in features to mitigate the impact of a revenue tax on less profitable or loss-making businesses. It also includes continued consideration of the proper scope of the tax, and whether the Commission's approach to formulating the scope is the most effective method. The government is also looking at ways to add detail to the provisions of the Directive which attribute revenues between member states, to ensure it meets the objective of allowing Member States to tax the value created by users in their jurisdiction.

You ask what yield the Commission's estimated €5bn overall yield from the DST could entail for the UK. The €5bn estimated yield is included in the Commission's impact assessment for the proposals. The impact assessment includes a range of possible yield figures and it should be noted that €5 billion is the upper limit of that range. A footnote to the impact assessment states that without the UK the yield estimate would reduce by about 30%, but cautions that the figure "might be related to the underlying data being allocated to jurisdictions according to either where the company providing the service is located or where the revenue payment originates from". It therefore would not necessarily be sound to assume that the yield to the UK would be 30% of €5bn (€1.5bn).

You ask whether, if the UK were to introduce a similar measure to the DST unilaterally, it would have a different yield than the yield to the UK from the DST. That would depend on a number of decisions regarding the base and rate of such a tax. However, if it was identical to the DST the theoretical yield would likely be similar in the two cases, as the UK would be asserting a taxing right on revenues from the same set of services. The transfer between EU Member States that you mention in your report would be an administrative arrangement which has been proposed to reduce the compliance burden for companies providing taxable services to several Member States. Such arrangements are an example of the merits of undertaking such action multilaterally.

You ask what the impact would be on the implementation of Directive 7419/18 if the US did not agree to change its tax treaties. It is hard to calculate what the effect would be on tax receipts in the EU. However if Member States were not able to change their tax treaties this would be likely to seriously limit how much extra revenue the new tax framework raised for Member States. The question of how effective the Directive would be if other countries did not agree to change their treaties is one of the key challenges which the government has identified for the proposal. However, it considers the proposal to be valuable as a basis for further international discussion.

You ask about the government's stated intention for the UK to leave the Digital Single Market, and the effect this will have on the UK's ability to attract digital

businesses. The UK economy is fundamentally strong, with a highly competitive digital economy. The UK will not participate in the EU's Digital Single Market post-exit, as a result of our departure from the Single Market. As the Prime Minister said in her Mansion House speech this is a fast-evolving sector. It will be important to have domestic flexibility, to ensure the regulatory environment can always respond nimbly and ambitiously to new developments. The government is determined to ensure that the UK's digital economy continues to be world leading and an attractive location for businesses to invest. As set out in the government's recent White Paper, in our new strategic partnership with the EU we will be aiming for the freest possible trade in services between the UK and EU Member States.

You ask some questions about future tax relations between the UK and EU Member States. Tax measures currently associated with our EU membership will be the subject of negotiations. Further announcements on changes to tax legislation arising from EU Exit negotiations will be made as and when progress in talks enables the government to do so.

You ask about Council discussions. Initial discussions have taken place at Council on these proposals. The June European Council agreed conclusions that work on the issue should be taken forward. The Austrian Presidency, which began at the beginning of July, has said that this issue will be a priority for them.

I would like to clarify one point from your report. You state in paragraph 0.26 that "companies will be able to deduct the tax as a cost from their corporate tax base". While the Commission state that they expect that this would be the case, it would be for each state to determine whether they would allow the tax as a cost when calculating taxable profit there.

I am copying this letter to Lord Boswell, the Chair of the House of Lords European Union Committee; Foeke Noppert, Clerk to the Commons Committee; Christopher Johnson, Clerk to the Lords Committee; Matthew Manning, Clerk to the Lords Financial Affairs Subcommittee; Les Saunders, Department for Exiting the EU; and Barbara Armstrong, Nerys Levin, and Chris Wordsworth, HM Treasury.

Yours sincerely
Mel

MEL STRIDE MP