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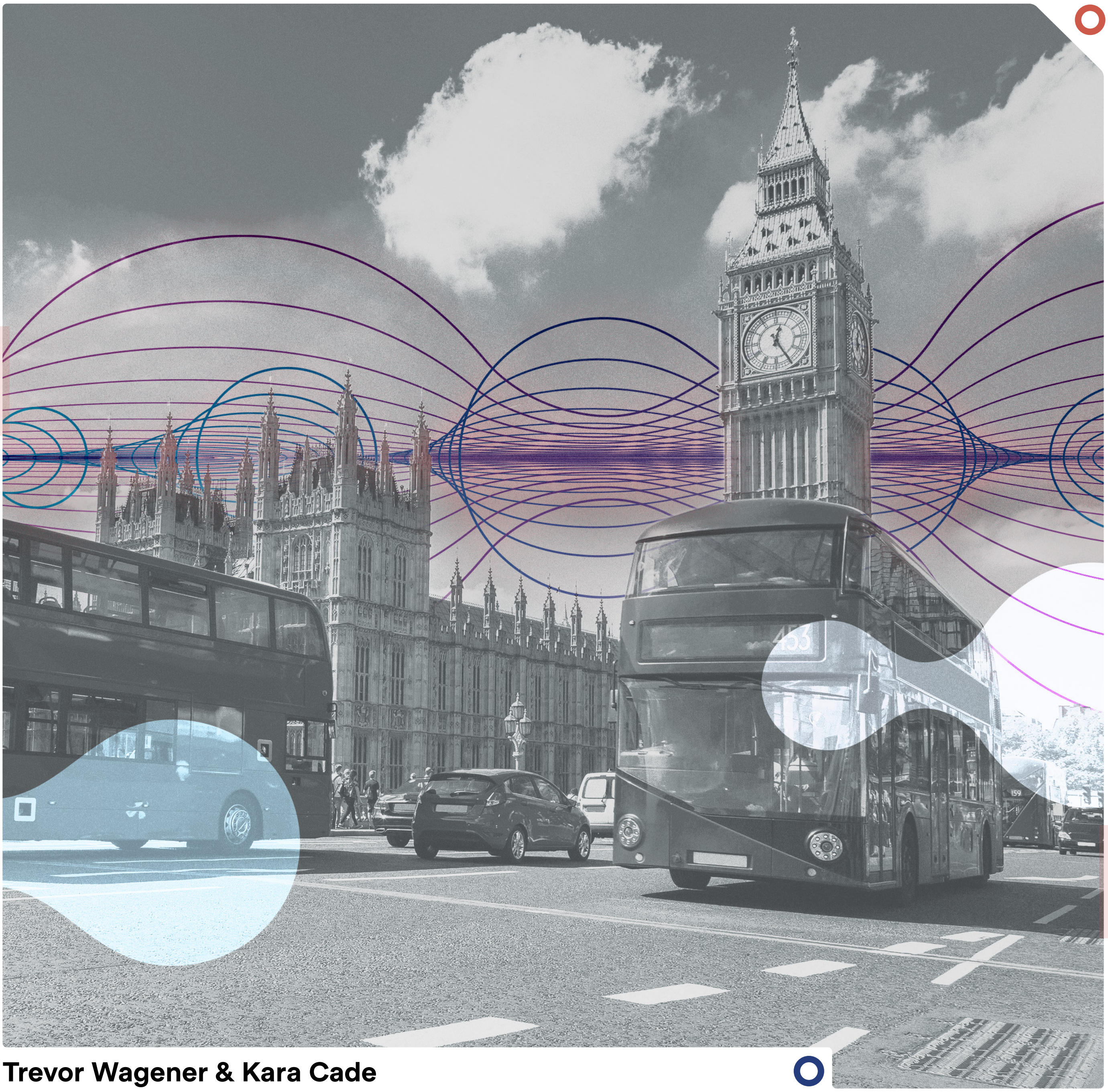
# Impact of the Liberal Democrats Proposed Increase to the UK Digital Service Tax



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# I. Key Takeaways

- The United Kingdom started imposing a digital services tax (DST) in 2020. In the 2024 UK General Election, the Liberal Democrats proposed an increase from 2% to 6% on revenues from social media companies, search engines, and online marketplaces.
- The UK DST directly targets U.S. companies – Amazon, Apple, eBay, Facebook, and Google – and was specifically designed to discriminate against these large digital service companies.
- The UK DST, as designed, goes against best practices of tax design. It taxes gross revenues instead of income, which results in double taxation on U.S. companies, and penalizes companies with lower profit margins.
- In the absence of any pass-through to UK customers, an increase in the DST from 2% to 6% would cost U.S. companies an additional £1.4 billion a year in direct tax obligations, bringing total DST collections from U.S. companies to £2.1 billion per year, or about $2.7 billion USD per year.
- With pass-through to UK consumers, after accounting for reduced quantity demanded and the value of worsened competitive dynamics, U.S. companies are harmed by $4.4 billion per year. UK consumers in aggregate pay 1.5% more (£0.7 billion) yearly for 4.2% less quantity.
- The United States Trade Representative (USTR) has already found that the UK DST is intended to unfairly target U.S. companies, uses a selection of covered services and revenue thresholds that discriminate against U.S. companies, is unreasonable because it is inconsistent with international tax principles, burdens or restricts U.S. commerce, and is based on public rationales in the United Kingdom that are unpersuasive. In response, USTR already imposed retaliatory tariffs on the UK. The USTR terminated the retaliatory tariffs only under the expectation the UK DST would be removed and U.S. companies would be credited for their DST liabilities. However, in the event of a DST increase to 6% rather than removal of the UK DST, the UK government should expect retaliation from the USTR in the form of increased tariffs.

| Scenario | Harms to U.S. Companies | Lost American Jobs |
|---|---|---|
| No Pass Through | $2.7 billion per year | 3,575 |
| Pass Through | $4.4 billion per year | 5,914 |

## II. Background

The United Kingdom introduced the United Kingdom digital services tax (DST) as part of the Finance Bill 2020. The UK Government imposed a 2% digital services tax on social media companies, search engines, and online marketplaces with revenues of more than £25 million in the UK and more than £500 million worldwide.[1] United Kingdom policy papers identified that 30 companies were impacted by this rule, but did not specifically disclose which companies. However, they did say that the majority of the tax will be paid by a few large businesses that relate to advertising revenue and online marketplaces. The UK also acknowledged that the majority of the companies that are impacted by the DST are U.S. companies, including Amazon, Apple, eBay, Facebook, and Google, which was further confirmed by media reports. The United States Trade Representative (USTR) concluded that the DST was specifically designed to discriminate against large digital service companies that are headquartered in the United States.[2]

In addition to directly targeting U.S. companies, the design of the tax goes against best practices of tax design. The UK DST currently taxes gross revenues instead of income, which is "inconsistent with prevailing principles of international corporate taxation." The UK applying the tax to gross revenues will result in a double taxation. The taxation also incurs liability prior to its date of enactment, which is inconsistent with the principle of retroactivity. It also is "structured to extend corporate taxation beyond the international tax principle of a permanent establishment, making the DST unfairly extraterritorial. According to the United States Trade Representative (USTR), it "is unreasonable as it is inconsistent with prevailing principles of international taxation."[3]

The UK DST introduces high compliance and administrative costs that will burden leading U.S. digital companies in comparison to their UK competitors, risking competition in the digital space. For example, companies will have to determine if they will need to pay the DST by assessing whether their business activities are in the provision of a search engine, social media platform, or online marketplace; determine the global revenues from their search engine, social media platform, or online marketplace products; determine how much revenue is attributable to the UK, and then compare that with the revenue thresholds; and then if they are above the thresholds, the business will pay the relevant DST.[4] Each of these steps introduces administrative cost burdens only on U.S. companies that they have not previously accounted for, while UK companies are not impacted.

[1] "Report on the United Kingdom's Digital Services Tax", Office of the United States Trade Representative, https://ustr.gov/sites/default/files/files/Press/Releases/UKDSTSection301Report.pdf

[2] "Report on the United Kingdom's Digital Services Tax", Office of the United States Trade Representative, https://ustr.gov/sites/default/files/files/Press/Releases/UKDSTSection301Report.pdf

[3] "Report on the United Kingdom's Digital Services Tax", Office of the United States Trade Representative, https://ustr.gov/sites/default/files/files/Press/Releases/UKDSTSection301Report.pdf

[4] "Report on the United Kingdom's Digital Services Tax", Office of the United States Trade Representative, https://ustr.gov/sites/default/files/files/Press/Releases/UKDSTSection301Report.pdf

The tax's retroactivity also has an additional burden for U.S. companies that impacts their users. The "UK DST requires companies to implement complex new business and financial reporting systems to capture new transaction data. While the UK DST is only retroactive for a relatively short period of time, the UK DST provides no grace period for implementation." This means that companies can either redesign their system or incur costly audit risks in an attempt to capture data from months prior. Both of these choices are extremely costly and only impact U.S. companies.[5] As designed, the UK DST directly targets U.S. companies, and introduces a myriad of high compliance and administrative costs their UK competitors are not currently facing; hurting competition and innovation in the digital space.

In June 2021, as a response to the UK DST, the USTR announced they had concluded investigations on Digital Services Taxes in six countries, including the United Kingdom, and found that the DST was inconsistent with the principles of international taxation and directly discriminated against U.S. companies. In response, the United States imposed additional retaliatory tariffs on goods from the UK for up to 180 days to provide "additional time to complete the ongoing multilateral negotiations on the international taxation at the OECD and in the G20 process."[6] The U.S. Trade representatives imposed duties of 25% on United Kingdom Products, with an estimated trade value of $887 million in 2019.[7]

In November 2021, the USTR decided to halt the retaliatory tariffs based on the assumption that the UK DST would be removed and cease to operate, with a further expectation that U.S. companies' DST liabilities would be creditable.[8] In essence, this was a termination of action predicated on the expectation that the UK DST's harm to U.S. companies would end soon and already incurred harms to U.S. companies would largely be offset by credits against other taxes. However, the UK DST has not yet ended, and in September 2023, the Liberal Democrats in the United Kingdom called on the Government to triple the tax on social media companies and search engines, from 2% of a company's revenues to 6% of a company's revenues.[9] The Office for Budget Responsibility forecasted that the 2% tax rate will cost the taxed companies £0.7 billion in Fiscal

5 "Report on the United Kingdom's Digital Services Tax", Office of the United States Trade Representative, https://ustr.gov/sites/default/files/files/Press/Releases/UKDSTSection301Report.pdf

6 "USTR Announces, and Immediately Suspends, Tariffs in Section 301 Digital Services Taxes Investigations", Office of the United States Trade Representative, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/june/ustr-announces-and-immediately-suspends-tariffs-section-301-digital-services-taxes-investigations

7 OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE [Docket Number USTR–2021–0007] Notice of Action in the Section 301 Investigation of the United Kingdom's Digital Services Tax, Federal Register, https://ustr.gov/sites/default/files/enforcement/301Investigations/UK_DST_Action.pdf

8 OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE Termination of Actions in the Section 301 Digital Services Tax Investigations of Austria, France, Italy, Spain, and the United Kingdom and Further Monitoring, Federal Register, https://ustr.gov/sites/default/files/enforcement/301Investigations/86%20FR%2064590.pdf

9 "Triple tax on social media giants to boost mental health in schools", Liberal Democrats, https://www.libdems.org.uk/press/release/triple-tax-on-social-media-giants-to-boost-mental-health-in-schools

year 2024-25[10], and an increase to 6% is expected to cost the companies an extra £1.4 billion a year.[11] If the call for an increase in the UK DST from the Liberal Democrats becomes actual policy, the UK government should expect retaliation from the USTR, already outlined in previous Federal Register notices, of additional tariffs on UK companies as a direct response to discriminating against and burdening U.S. companies.

## III. Modeling DST Job Loss Impacts

Assuming that workers represent variable costs, a simple estimation methodology for job losses from lost revenues is to divide the lost revenues by the marginal revenue per employee, assuming that marginal revenue equals average revenue per employee. Based on analysis of financials from leading U.S. digital services firms, this study estimates average revenue per employee at covered digital service offerings of approximately $744,000.

As a result, for each scenario, this study estimates job losses by dividing U.S. digital exporters' lost revenues by $744,000.

## IV. Impact Scenarios

### SCENARIO 1:
### 6% Tax on U.S. Digital Firms' Gross Receipts in the UK, Zero Pass-through

In this scenario, it is assumed that U.S. firms targeted by the UK DST do not pass any of the costs on to customers in the UK. As a result, the impact to U.S. firms is equal to 6% of UK revenues, and therefore equals the magnitude of tax revenues collected by the UK DST: £2.1 billion GBP per year, or about $2.66 billion USD.

At $744,000 in revenues per employee, this translates to U.S. job losses of 3,575.

| 2023-2024 Covered UK Revenues of Targeted U.S. Firms | 2023-2024 UK DST Tax Obligation at 6% | Revenue per Employee | Lost American Jobs |
|---|---|---|---|
| $44.3 billion | $2.7 Billion | $744,000 | 3,575 |

[10] "Economic and fiscal outlook - March 2023", Office for Budget Responsibility, https://obr.uk/efo/economic-and-fiscal-outlook-march-2023/

[11] "Triple tax on social media giants to boost mental health in schools", Liberal Democrats, https://www.libdems.org.uk/press/release/triple-tax-on-social-media-giants-to-boost-mental-health-in-schools

SCENARIO 2:

### Tax on U.S. Digital Firms' Gross Receipts in the UK, 100% Pass-through

The CCIA upper-bound estimate assumes that the 6% effective DST tax rate on U.S. digital firms' UK gross receipts is accompanied by a 100% pass-through to UK consumers or businesses expressed as a 6% price increase, and an assumption that the resulting effective price increase to UK customers causes a 4.2% decline in quantity demanded for U.S. firms.

The total losses to U.S. digital firms are estimated as follows: U.S. digital firms begin the analysis with approximately $44.3 billion in covered revenues in the UK. A 4.2% decline in quantity demanded leaves U.S. firms with $42.5 billion in revenue, a loss of $1.86 billion in gross revenues. However, the remaining $42.5 billion in revenues is subject to a competitive disadvantage due to competitors not targeted by the UK DST being excluded from its impacts, and risks loss of market share to less efficient firms not discriminated against by the UK DST. The harms to targeted U.S. digital firms from this competitive disadvantage are estimated as equal to the 6% tax on the remaining revenues, about $2.5 billion. This reflects the competitive vulnerability imposed on targeted U.S. firms by having to raise prices when non-targeted competitors do not.

The aggregate value of the targeted U.S. digital firms' lost revenues and the competitive harm they face is about $4.4 billion.

At $744,000 in revenues per employee, this translates to U.S. job losses of 5,914.

| 2023-2024 Covered UK Revenues of Targeted U.S. Firms | 2023-2024 UK DST Tax Obligation and Competitive Harm with Pass-Through | Revenue per Employee | Lost American Jobs |
|---|---|---|---|
| $44.3 billion | $4.4 Billion | $744,000 | 5,914 |

## V. Contagion Risk as an Unquantified Additional Impact

The United Kingdom is a close trading partner of the United States and is considered both an ally and a friend, with the two countries maintaining a longstanding Special Relationship in recognition of the close ties across all levels of government and society between the two countries. If the United States allows one of our closest allies and trading partners, with whom we have strong, binding commitments to not discriminate against U.S. companies, to not only enact a DST policy but also treble it to 6% of gross receipts, costing U.S. digital exporters north of two billion dollars and north of three thousand jobs, a precedent will have been set. If an increased UK DST were to go into effect without protest, investigation, and retaliatory research.ccianet.org

response from the United States, nothing can stop any other countries, even those with whom we have free trade agreements, from doing the same by citing the UK precedent, which would expand the cost to U.S. companies, workers, exports, and tax base further.

## VI. Conclusion

The LibDem proposal to triple the UK DST would increase harms to U.S. businesses to between $2.7 billion and $4.4 billion annually, which would reduce export revenues and income for U.S. businesses and their shareholders, threaten between 3,575 and 5,914 American jobs, and reduce the size of the U.S. tax base, harming U.S. government fiscal outcomes. Moreover, if the United States fails to protest, investigate, or retaliate in response to a tripling of the UK DST, a precedent will have been set that increases the risk of global contagion for DSTs targeting U.S. digital exporters. Such contagion risks significantly increasing the costs to U.S. businesses, workers, exports, and tax base.