HM Treasury

Autumn Budget 2017
Corporate tax & the digital economy

- **While the digital age has brought undoubted benefits, it poses a significant challenge to the long-term sustainability of the international corporate tax system. The Budget sets out how the UK will meet this challenge.**

1. The government has made substantial progress towards its aim to create a corporate tax system that is both competitive and fair. The UK's corporate tax rate is now the lowest in the G20 and the government has been at the forefront of global efforts to ensure multinational companies pay the right amount of tax wherever they operate.

2. However, the government recognises that the development of the digital economy represents perhaps the biggest challenge that the international corporate tax system currently faces.

3. The UK taxes multinational firms in line with its international tax treaties. This international treaty framework is designed to ensure that these firms' profits are taxed in the countries where they create value. Currently the framework determines where value is created based on physical factors of production, e.g. where a company's key decision makers are located.

4. The digital economy's emergence has put this system under pressure, creating imbalances between those firms with and without a physical presence. Certain digital businesses, like social media platforms or search engines, create value in ways that are not reflected in existing tax rules. These businesses rely on the active participation of users. This means that while UK users are contributing value to these companies, existing international rules do not take account of this value in determining how much of their profit is subject to UK corporation tax.

5. This is not sustainable. The international corporate tax system needs to be updated for the digital age. The Budget sets out the government's response to this challenge. It:

    - announces action to stop primarily digital multinationals shifting profits to low tax countries in the form of royalty payments. This will raise £800 million by March 2023

    - calls for an ambitious international process to ensure the global tax standards are updated to reflect the value created by the active participation of users on digital platforms

    - sets out the UK's plan to work with like-minded international partners to explore interim measures to increase UK tax revenues from certain digital businesses. If necessary, the government is prepared to act alone in the absence of sufficient international progress

6. Together, these steps help to ensure that all businesses – both digital and bricks and mortar – operate on a level playing field within the corporate tax system.

Further detail on changes to withholding tax rights on royalties

7. Companies often charge other firms royalties to be able to use their intellectual property (IP). IP can include the patent for a technology or the copyright over software. In some cases, multinational companies pay royalties between different parts of their group.

8. It is normal international practice for countries to impose a withholding tax on royalties which arise in their country.

9. Under current rules the UK only taxes royalties if they are paid by a company with a UK presence. It does not tax royalties paid by foreign companies without a physical UK presence i.e. companies that generate revenue from the UK while basing themselves in another country. This is the case even if the royalty is paid in connection with sales that the company is making to UK customers. For example:

    - Multinational A is a technology group that holds its IP in a 'low or no tax' regime. It charges a UK company a royalty for the licence to use the IP. The UK company uses the IP to sell products or services to UK customers. The UK government can tax the royalty payment that the UK company has made

    - However, the same multinational group can charge one of its subsidiaries based in another foreign country a royalty for the licence to use the IP it holds in a low or no tax regime. That subsidiary, which has no physical presence in the UK, uses that IP to sell products or services to UK customers. Under this scenario, the UK cannot currently tax the royalty payment that the foreign subsidiary has made for the use of the IP

10. The Budget makes changes so that any royalty payment made in connection with UK sales to a low or no tax jurisdiction will be subject to tax, even if the group has no taxable UK presence under current rules. The government will respect the international obligations in the UK's tax treaties in the application of the measure.

11. It brings multinationals that hold IP in low or no tax jurisdictions, where that IP is used (by the multinational) to generate revenue from the UK market, within the scope of the UK's withholding tax.

12. The government is making this change because the royalty:

    - is being paid in connection with sales to UK customers

    - ends up in a jurisdiction where it is not being taxed

13. It will prevent multinationals from gaining an unfair advantage by locating IP in low or no tax jurisdictions, and so will level the playing field.

14. The government will consult on the detail of the measure. It will come into effect in April 2019 and is expected to raise £800 million by March 2023.