

IAB UK: Response to Digital Services Tax Consultation

28 February 2019

Background

IAB UK is the trade association for digital advertising, representing over 1,200 of the UK's leading brands, agencies, media owners and technology providers. We have a Board¹ comprised of 25 leading businesses in the sector. Our purpose is to build a sustainable future for digital advertising, a market that was worth £11.55bn in the UK in 2017.

The IAB is actively engaged in working towards the optimal policy and regulatory environment for the digital advertising market to continue to thrive. We also seek to promote good practice to ensure a responsible medium.

Summary

The IAB's consultation response is focused on addressing how successful the Digital Services Tax (DST) is likely to be in meeting its stated policy aims and what risks of unintended consequences exist.

Given the Government's intention, stated in the DST consultation document, that the tax is intended to be 'narrowly-targeted', full consideration should be given to the impact it is likely to have on the industry as a whole, in three key respects:

First, the likelihood that the tax will result in advertising services provided by in-scope companies becoming more expensive for advertisers (businesses buying advertising from media owners or publishers). Increased costs would affect brands and businesses and likely reduce consumption in the market, affecting all companies involved. Increased costs of working directly with larger platforms directly in scope of the new tax would also affect smaller businesses, who often use those platforms as they provide them with cost-effective advertising options. Advertisers are unlikely to reduce their activity on these platforms, as they offer the reach and services that advertisers want. This will potentially reduce the amount of money available to spend elsewhere, which other content providers rely on to help fund the provision of content and services.

Second, it is likely that any increased costs in the market will be filtered down through the advertising supply chain. With the market being so tightly interconnected, proper consideration should be given to whether the DST will actually achieve its aim of being a narrowly-targeted tax, or whether in fact the impact of the tax will be felt by the wider industry as a whole. It would be difficult to avoid collateral damage across the sector and a negative effect on competition. A tax on revenue may also create a disincentive for competitors to set up and grow in the UK market and impact on mid-market players who drive competition and provide choice.

¹ https://www.iabuk.com/member-directory?title=&company_type=All&company_badges%5Bboard_member%5D=board_member&sort_bef_combine=title+ASC

Third, the UK Government is undertaking various streams of work that affect digital advertising, and the effect of a new tax on the industry needs to be considered alongside other factors. A competitive UK ad market needs a policy and legislative approach to digital advertising that is holistic and coordinated, and that tax is only one part of this. Other relevant considerations include the likely impact on competition, investment and downstream beneficiaries of advertising spend, such as content creators. The Government should also ensure that the design of the DST aligns with other Government policy aims including those set out in the Digital Charter to make the UK the best place to start and run a digital business, and those that underpin the Furman review of competition in the digital economy. At the least, the Government should take into account the outcome of the Furman Review in its design of a new tax.

The UK ad industry needs a coherently designed and well-targeted regulatory, tax and competition framework that maximises competition, is fair, supports growth and innovation and encourages existing and new companies to participate in the UK market, so that the UK can continue to be a world-leader in digital advertising.

General comments

Consideration should be given to who is ultimately likely to bear the burden of the DST. Historically, studies have shown that new revenue taxes are nearly always passed on down the supply chain². The interconnected nature of the online advertising market was set out effectively in the recent study *Online advertising in the UK*, commissioned and published by the DCMS.³ This market complexity, and the way in which advertising space is bought and sold means there is a real risk that the cost of the DST, whilst aimed at some of the biggest digital service providers, will be passed down the supply chain.

Given that smaller companies often buy services from or through larger companies, the additional costs arising from a tax on revenue would have a knock-on effect throughout the market. There is a risk therefore that the tax will have a negative impact on out-of-scope businesses, including small and medium sized businesses (SMEs), who – despite the revenue thresholds and safe harbour provisions – will bear the impact of the DST in a way that does not appear to be not in line with the Government’s stated policy intention.

There may be a risk that the DST produces distortive effects on economic activity, particularly against SMEs. With Turkey having recently introduced a new digital tax on cross-border online advertising services, it may be that lessons can be learned from its impact, in relation to the impact on the cost of buying advertising for brands⁴.

The IAB would urge assumptions about margins and profitability to be tested in a more comprehensive impact assessment, in order to understand how the costs of the DST may be passed down to out of scope companies and buyers/advertisers, and what impact this might have on the

² For example, Besley and Rosen, 1999, *Sales taxes and prices: An empirical analysis*

³ *Online advertising in the UK*, Plum, January 2019:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/777996/Plum_DCMS_Online_Advertising_in_the_UK.pdf

⁴ <https://www.pwc.com.tr/en/hizmetlerimiz/vergi/bultenler/2019/turkey-introduces-withholding-tax-on-online-advertising-revenue.html>

industry as a whole. As mentioned above, a tax that has the potential to affect the wider industry – whether directly or indirectly – should not be considered in isolation.

In the meantime, Government should support efforts to accelerate the OECD process to agree an international approach. The OECD has noted how difficult (‘if not impossible’) it is to ring-fence the digital economy from the rest of the economy for tax purposes⁵, but the best chance any such efforts have will be as one global solution, avoiding the costs and burdens that would result from numerous unilateral proposals in the UK and elsewhere.

Question 1: Do you agree the proposed approach of defining scope by reference to business activities is preferable to alternative approaches?

Question 2: Do you have any observations on the proposed features used to describe the business activities in scope of the DST?

Question 3: Do you think the approach to scope negates the need for a list of exemptions from the DST?

More clarity is needed on how certain terms that will be used to determine what is in or out of scope will be defined.

The DST consultation document states that the tax is focused on those business models ‘for which the participation of a user base can reasonably be considered a central value driver, critical to the success or failure of the business.’⁶ This definition of ‘user participation’ is ambiguous and open to interpretation. Additionally, the consultation document states the tax will target businesses that ‘derive significant value from the participation of their users’⁷, but again this ‘significant value’ is vague and lacks definition. For example, it could potentially include not only users of a public-facing online marketplace, but also business customers of digital advertising ‘marketplaces’ used to buy and sell digital advertising space in a purely transactional nature. The ‘users’ of these business-to-business services do not create value through their participation in the service or product being sold, although they may drive other benefits, such as efficiency. However, there appears to be no distinction drawn in the proposals, in terms of defining scope, between business models that do derive ‘significant value’ from user participation, in the ways described in paragraph 2.6 of the consultation, and those that do not.

Paragraph 2.8 of the consultation states that ‘*the nature of the relationship between certain businesses and their users is different to the more traditional relationship between a business and its customers. Users play a role beyond creating demand for a product. Instead they co-contribute to a business offering, and help to develop and improve that offering on an unprecedented scale in a way that is vital to the performance of the business.*’ It is not clear to us the rationale for applying the DST to all businesses that can be considered to be a ‘marketplace’ with no related criteria as to whether they generate value from user participation. It is not necessarily the case that the users of a business-to-business advertising marketplace benefit from their users in the way described above. They may simply have a traditional business-customer relationship. The Government should clarify

⁵ *Addressing the Tax Challenges of the Digital Economy, Action 1 2015, Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, p.11, <https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf?expires=1551198250&id=id&accname=guest&checksum=BBB02B83A9CE44B0EEA6FBF122B84609>

⁶ Digital Services Tax: consultation, p.7, 2.10

⁷ *Ibid*, p.4, 1.17

its policy intention in relation to these businesses and define the scope of the DST in relation to the interaction of both criteria, i.e. business models and ‘in scope’ user participation.

The consultation document proposes defining in-scope businesses by reference to specific business activities and then isolating revenue streams associated with those business activities. The definitions of in-scope business activities are broad and vague which creates uncertainty for wide range of digital businesses on the boundaries of the business models that are the main targets of the proposed tax. If the specific revenue streams that are within the scope of DST (i.e. those that derive value from users) were more clearly defined, it could then be determined whether these revenues relate to one of the in-scope business activities.

Further, as drafted, the definition of in-scope business activities in many cases could be subjective and could apply very broadly. As such, identifying which lines of revenue fall in scope will not be an insignificant task for businesses, requiring new reporting structures to be created for the task of identifying which of their services fall into the in-scope business models. This is particularly complex for businesses that have integrated in-scope and out-of-scope business activities, and may prove a disproportionate amount of complexity and uncertainty for both business and HMRC, for a tax which is intended to be temporary.

As a result of the significant potential for overlap and uncertainty, it would be preferable to have an explicit list of business models and revenue streams which would be excluded – or even those that would be included – in the DST’s scope. Annex A of the consultation document begins to set such a list out, but this would need to be expanded and made more specific and comprehensive.

Question 7: Do you have any observations on the proposed approach to defining a user?

Question 8: Do you think the proposed approach for determining user location for the purpose of the DST is reasonable?

Question 9: Do you think there is a need for mechanical rules to determine what is considered a UK user in certain circumstances?

As set out above, the definition of what a constitutes a ‘user’ and ‘user participation’ should be made clearer, as well as the criteria to be used to determine whether or not a business derives ‘significant value’ from user participation.

Under the current proposals set out in the consultation document, if business customers of digital advertising marketplaces are deemed to constitute ‘users’, a significant part of the programmatic advertising market would fall inside the scope of the DST. 80% of digital display advertising is sold programmatically, with 17% of this being sold through an open marketplace (representing some £650m to the UK economy)⁸. This appears to be at odds with the Government’s stated policy intention (as set out on p.4 of the DST consultation document) that the DST will be ‘narrowly targeted’ and is not intended to be a generalised tax on businesses that provide digital services, collect data or generate revenue from online advertising.

As identified in the DST consultation document, there are also significant challenges associated with identifying user location. Users do not need to provide location information when an ad impression

⁸ IAB UK/PwC Digital Adspend Study, 2017: <https://www.iabuk.com/research/iab-pwc-media-owner-sales-techniques-most-2016>

is viewed, and therefore often the only means to identify user location would be by way of IP address of the user. However, VPNs, proxy servers and certain search engines are often used to mask a user's location, meaning IP addresses can be inaccurate. A pragmatic approach should be taken by Government on this issue, and guidance may be needed to help a business decide whether a user is based in the UK, and how best to ascertain this both legally and ethically.

Question 28: Do you have any comments on the summary of impacts?

A more comprehensive impact assessment, covering the economic impact to the digital advertising industry, is needed. In particular, the Government needs to demonstrate how the design of the tax will ensure that it does not become a generalised tax on businesses that generate revenue from digital advertising, whether directly or indirectly.

This is a complex market, with a large number of intermediary businesses working closely to connect brands with publishers or media owners, some of whom will be in the scope of the DST⁹. The DST will in effect be a business cost, and while we understand that it is intended to target a relatively narrow group of companies operating specific business models, consideration must be given to who economically bears the cost of the DST. Those companies that the Government intends to target generate revenue from digital advertising due to their ability to help advertisers reach their target audiences efficiently and at scale. There is a risk of the cost of the DST being added to the cost of the services that those businesses provide to their business customers (e.g. by being added to the cost of the advertising space they sell), meaning the tax's cost could end up being borne not by the in-scope businesses themselves, but by their business customers instead, including a large number of SMEs. This could have an unintended impact on demand and supply throughout the supply chain.

The digital advertising supply chain operates on high volumes but low margins and many players – aside from the market leaders – would be unable to absorb additional costs as a result of the DST. This could also have unintended consequences for competition in the 'intermediary' part of the supply chain. Many of these companies have invested in the UK digital advertising market and in cross-industry self-regulation to help ensure a responsible and world-leading sector. However, these companies are faced with increasing costs and challenges, including those arising from the current economic and regulatory climate, and a further revenue-based tax could be extremely detrimental to their businesses, many of which operate on relatively low margins. Even with a high de minimis threshold, given that smaller companies often buy services from or through larger companies, the additional costs arising from a tax on revenue would have a knock-on effect throughout the market.

⁹ *Online advertising in the UK*, Plum, January 2019:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/777996/Plum_DCMS_Online_Advertising_in_the_UK.pdf