By Email

and

By Post

12 September 2019

Corporate Tax Team
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Dear Sirs

Response to HMRC and HM Treasury technical consultation on the UK digital services tax

General comments

1. This letter has been written on behalf of UK Finance, the International Swaps and Derivatives Association ("**ISDA**"), the Global Foreign Exchange Division and the Commodities Working Group of the Global Financial Markets Association ("**GFMA**") and the European Venues and Intermediaries Association ("**EVIA**"). A short description of each association is set out in the Appendix.

2. We welcome the Government's efforts to reform the corporate tax rules to achieve a fair tax system and address the tax challenges arising from digitalisation. We support the Government's position that a sustainable long-term solution will involve an internationally coordinated approach through the G7, G20 and OECD fora. In this regard, we welcome the Government's commitment to disapplying the digital services tax ("**DST**") once an international solution is in place.

3. In the event that the Government decides to proceed with the DST ahead of an international regime, it is important that the DST legislation is targeted, proportionate and

does not have unintended consequences. We welcome the decision of the Government to consult with businesses and stakeholders during the technical consultation to ensure that the DST delivers the intended results.

Financial services exemption

4. We note in paragraph 3.62 of the HM Treasury paper "Digital Services Tax: response to the consultation" (the "**Consultation Response**") that the stated policy objective of the DST is "to tax unrecognised value created by the participation of users in the digital economy". The inclusion of financial services within the scope of the legislation would not be consistent with this objective and we understand that this view is shared by HM Treasury.

5. Notwithstanding the above, we consider that as currently drafted the DST legislation would have a number of unintended consequences for the financial services industry, which we set out below.

Unintended consequences of the draft legislation

6. As currently drafted, the DST legislation would tax derivatives and exchanges/venues dealing in oil, gas, commodities, carbon credits, spot FX and crypto-assets, among other assets. We understand that this is contrary to the stated policy objective of the DST, and appropriate steps should be taken to fix this. We suggest how this could be achieved below and we also discuss various other technical points of the draft legislation.

Section 6 – Online financial marketplace

7. This letter focuses on section 6 and several points where we believe it currently provides insufficiently clear exemption for all financial services platforms and services.

a) Definition of "financial asset"

8. We understand that the intention of the Government is to include derivatives in the definition of "financial asset", given the importance of derivative marketplaces for the UK economy. However, we consider that as currently drafted the "financial asset" definition under sub-section 6(3) technically does not extend to derivatives, since not all derivative positions are financial assets; most obviously, they can be liabilities. In this regard, we note that the same issue arose in the context of the UK securitisation tax regime and the solution adopted was to expressly include derivatives in the "financial asset" definition (see paragraph 2 of the Taxation of Securitisation Companies Regulations 2006).

9. There are other products which are not or may not always be "financial assets" for the purposes of sub-section 6(3). These include (but are not limited to) oil futures, gas futures, commodities trading, carbon credits, forward FX, spot FX and crypto-assets (including cryptocurrencies). Cash is also unlikely to be a "financial asset", and given that some transactions in cash may fall outside the "payment service provider" exemption, we would suggest that markets in cash products should also be clearly excluded.

10. We would therefore suggest that the "financial assets" term is expanded to include all the above specific products.

11. This alone would, however, risk excluding some financial products that we have not identified or which (given the pace of fintech innovation) do not currently exist. We would therefore suggest that, in addition to listing specific products, a general reference is included to contracts of a financial nature. One approach would be to use the definition of "financial contracts" in point 100 of Article 2(1) of Directive 2014/59/EU (the Bank Recovery and Resolution Directive). Moreover, the risk that the list of financial products becomes outdated could be managed by the legislation giving HM Treasury (or HMRC) the power to add further products to the "financial assets" definition by Statutory Instrument.

12. In this regard, we would also suggest including in the legislation a statement of intent that the exclusion for financial services should apply in the circumstances outlined in paragraphs 16 and 17 of this letter, and confirming that (for the avoidance of doubt) financial platforms do not generate user value.

b) Status of the provider

13. In the draft legislation two conditions must be satisfied for the exemption under section 6 to apply. The first relates to "financial assets", discussed above, and the second relates to the status of the provider.

14. We are concerned that the "provider" condition would exclude a significant proportion of financial providers/venues from the exemption. Some products which should in principle benefit from the exemption can be traded on venues with an unregulated provider (for example oil, gas, commodities trading, carbon credits, spot FX and crypto-assets). In other cases, an affiliate of the provider must be regulated, but the provider itself does not have to be.

15. Similarly, other unregulated platforms would also fall outside the financial services exemption as currently drafted. An example is online bulletin boards, which do "facilitate the sale by users of particular things" but are not required to be authorised persons or a recognised investment exchange since they do not support the execution of transactions.

16. We see two possible ways to remedy this. First, the "provider" condition could be broadened to deal with the above cases. Alternatively – and in our view preferably – the "provider" condition could be removed so that the subject of the exemption is the nature of the products traded and not the regulatory status of the exchange/venue operator. This would avoid the potential economic distortions (and even perhaps State aid) that could result from treating two identical venues differently on the basis of the regulatory status of their providers.

17. We can see that HMRC may be concerned that the "provider" condition is necessary to stop avoidance – e.g. a provider of consumer auctions adding a certain percentage of financial trades to its platform to gain exemption for the consumer business. However we would suggest that the artificiality of such avoidance should make it straightforwardly countered by the existing TAAR. Notwithstanding the above, if HMRC is still concerned about avoidance, one option would be to increase the threshold in section 6(1)(b) in

respect of revenues arising in connection with the facilitation of trading or creation of financial assets from 50% ("more than half") to, say, 80% of the "relevant revenues".

c) Guidance

18. The draft guidance currently does not provide any further detail on what is meant by "…arising in connection with the providers' facilitation of the trading or creation of financial assets". We would take the words "arising in connection" to have a broad meaning, but it would be helpful if that could be confirmed.

19. It would also be helpful if HMRC could confirm that it will take a "light touch" approach to businesses that would ordinarily be expected to be outside the scope of the DST. Such an approach would prevent the DST causing significant administrative burden for entities that are not within the intended scope.

Section 4 – Meaning of "digital services activity" etc

20. We understand that the intention behind the "social media platform" and "online marketplace" definitions in section 4 is that all conditions must be satisfied in each case before an online platform can be considered as falling within the scope of that definition. However, the current drafting of sub-sections 4(3) and 4(4) does not include the word "and", which we assume is a drafting error.

21. The term "interaction" in the "social media platform" definition under sub-section 4(3)(a) suggests that an online sales platform could fall within both the "social media platform" definition and the "online marketplace" definition. The drafting could be read as suggesting that a person who is selling something to another person is "interacting" with that person, and that sharing information about the product is "sharing content". This is problematic given that the financial services exemption applies only to online marketplaces, and not social media platforms. We understand that the various types of "digital services activity" are intended to be exclusive to each other, since an online sales platform clearly is not supposed to fall within the "social media platform" definition, but this should be clarified.

22. The term "internet search engine" is not defined in the draft legislation. It is important to clarify that this term means software that searches the entire internet, and not software that searches some other body of data but is accessed via the internet (for example, a "site search" function on a particular website, such as the search box at the top of gov.uk). We are concerned that if this clarification is not made, a significant number of financial services that are not search engines in a true sense would fall within scope of the DST. Examples include pre-trade services, such as the provision of searchable data feeds and potentially regulators' databases and registers. It is our understanding that the Government does not intend to tax such services, but this point should be put beyond doubt.

23. The reference in the "online marketplace" definition under sub-section 4(4) to the "sale" by users of things means that, without clarification, the DST could accidentally extend to post-trade services. We understand that this result is not intended, since post-trade services do not facilitate the "sale" of things even if they have elements of marketplaces (as the "sale" has already happened). By way of example, in a typical derivative clearing arrangement,

two parties enter into a derivative with each other and subsequently this is replaced by derivatives between each party and the central counterparty. Another example is a portfolio compression system where again, after an automated matching process, multiple parties' derivatives are all replaced with a smaller number of derivatives that have an overall equivalent economic effect. In neither example is there a "sale" in commercial terms, and so we consider it would be helpful for the word "sale" in the "online marketplace" definition to be clarified so that it is clear it bears its ordinary commercial meaning.

Section 5 – Meaning of "UK user"

24. The term "established" in the "UK user" definition under sub-section 5(b) creates uncertainty as to the entities that would be caught by the term. For example, we expect that the London branch of a US-incorporated financial institution is "established" in the UK for this purpose, but that the New York branch of a UK-incorporated or resident financial institution is not. It would be helpful to clarify this point.

25. Once again, we are grateful for the opportunity to provide comments to HMRC and HM Treasury on the technical consultation for the DST. We should be grateful for the opportunity to meet HMRC and HM Treasury to discuss our comments further. In the meantime, we remain at your disposal to answer any questions.

Yours faithfully

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Appendix

UK Finance

UK Finance is the collective voice for the banking and finance industry operating in and from the UK. Representing more than 250 domestic and international firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 71 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.

GFMA – Global Foreign Exchange Division

The Global Foreign Exchange Division ("GFXD") of the Global Financial Markets Association ("GFMA") was formed in co-operation with the Association for Financial Markets in Europe ("AFME"), the Securities Industry and Financial Markets Association ("SIFMA") and the Asia Securities Industry and Financial Markets Association ("ASIFMA"). Its members comprise 25 global foreign exchange ("FX") market participants, collectively representing the majority of the FX inter-dealer market. Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

GFMA – Commodities Working Group

The Commodities Working Group ("CWG") of GFMA focuses on regulatory issues specific to banks operating in the financial and physical commodities markets. CWG's work centres around the creation of a more level regulatory playing field for the commodity markets, advocating consistency and avoiding duplication among legislative measures. For more information, visit http://www.gfma.org.

EVIA

Originally founded in 1967 and renamed as MiFID II commenced in 2018, the European Venues and Intermediaries Association (EVIA) promotes and enhances the value and competitiveness of wholesale markets trading venues, platforms and arranging intermediaries.

It provides members with co-ordination and a common voice to foster and promote liquid, transparent and fair markets. As a highly respected focal point for the industry, EVIA delivers a clear and certain channel of communication with central banks, governments, policy makers and regulators.