The Treasury's move on taxing digital companies is welc...

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Published: January 12, 2026, 8:14 pm

The government published new proposals yesterday to address the issue of how digital companies (Google, Amazon, Apple, Spotify, et al) might be taxed when many of them have worked out ways to minimise the profits they attribute to countries like the U.K. even if they are, like Facebook, now recording their sales in this country.

The consultation document is as clear as mud, including wonderous passage such as this:

The participation and engagement of users is an important aspect of value creation for certain digital business models, and is likely to be reflected through several channels, such as the provision of content or as a contribution to certain intangibles such as brand.

The preferred and most sustainable solution to this challenge is reform of the international corporate tax framework to reflect the value of user participation. It is important that the members of the OECD's Inclusive Framework make progress in developing multilateral solutions, and to assist this process the paper sets out some of the government's initial considerations on what this could include.

As set out at Autumn Budget, in the absence of such reform, there is a need to consider interim measures such as revenue-based taxes.

I doubt anyone has got their heads round all of this as yet. What I have, perforce (because I have had other things to do) done is concentrate on the government's preferred long term solution rather than the interim one. There is good reason: what this reveals is some radical rethinking of its position on tax and moves it a very long way in the direction of my proposed reform of corporation tax, which would be the adoption of unitary taxation.

Unitary taxation uses a formula based on the economic substance of the activity undertaken by a company to apportion a share of group profits of an entity to the countries where it works. This has always been firmly resisted by the nUK to date in favour of the OECD 'arm's length pricing method' that assumes that all the subsidiaries of multinational corporations are wholly independent of each other and can be taxed as if they trade with each other independently in a well functioning market place. As I have long said of this system, if you tax on the basis of fairy tales you get incredible results (literally) and that is exactly what we did get.

How do I know the Treasury is moving on? These paras say so:

3.60 The government recognises that it’s not likely to be possible to use the arm’s length approach for measuring that share, or determining how that share then breaks down between specific user jurisdictions.

3.61 However, it believes that the profit split approaches suggested above could serve as a practical alternative for approximating the proportion of principal 21 companies’ profits — which have been calculated through the application of the arm’s length principle — relevant to user participation rather than other functions performed by principal companies.

And what is it that they are discussing? Fundamentally whether or not the profit of the companies being considered is not as such generated by the contractual and other relationships recorded in their accounts, which we know are open to considerable distortion as to the location in which they are recorded, but are instead due to the interaction of users with the company. So, to give a very direct example, is the value of Wordpress created by whatever fees I pay them for using the software that runs this blog or by the fact that I add content that uses Wordpress in the UK, meaning that at least some of the profit for Wordpress should be attributable to this country because it is here that I add value to Wordpress by using their software which readers of this site can determine?

I welcome the Treasury's realisation that the time when the accounts of a company could be relied upon as a basis for tax are over.

And I welcome the fact that they now realise economic substance matters.

And I welcome their tentative steps towards finding value drivers as a basis for apportioning profit.

All are moves in the right direction.

But what would be really useful is for the Treasury to say that this is the time to move all international corporation tax in this direction. It has to be the way to go. They need to get on with it. So far what they are doing is a compromise and far too timid.

The twenty first century demands twenty first century tax solutions, not those made in the 1920s and 30s. We have the latter. Now is the time to change, for good, and to lay the OECD arm's length principle to rest.