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International: An Updated Look at the UK DST

Abstract: Baker McKenzie tax partners explore substantial changes in the international tax environment since the UK enacted its DST in 2020.

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HM Treasury recently released a report on the five-year anniversary of the UK digital services tax, in response to the parliamentary mandate to "conduct a review of digital services tax and prepare a report of the review."[1] Regrettably, the report missed an important opportunity to reexamine whether the policy justifications that were advanced to support the Digital Services Tax (DST) at the time of its enactment five years ago continue today. Putting aside whether the stated rationales justified the extraterritorial tax in 2020, the changes since then in the international tax framework — including the implementation of the base erosion and profit-shifting reforms, changes in US tax law, and the resulting changes in the tax obligations of digital sector multinational enterprises — seriously challenge those policy justifications for a DST today. The OECD itself has documented the consequences of these developments in its recent "stocktake" report on the implementation of the BEPS reforms. In addition, both the developments in international tax law over the past several years and public statements that the members of the OECD/G20 inclusive framework on BEPS intend to reengage in their discussions on taxation of the digital economy provide countries with an opportunity to revisit the arguments generally made to support DSTs and reconsider how to effectively achieve countries' tax policy goals.

In more detail

HM Treasury first stated its intention to introduce a DST in 2017.[2] The proposal was based on assumptions and policy views expressed at that time that require reconsideration in light of subsequent developments. In our view, DSTs have functioned more as a tool to address competition and trade goals, rather than serving as an income tax mechanism based on sound tax principles. This is apparent both from the discussions that countries had when introducing and adopting their DSTs — which largely focused on in-state businesses' ability to compete with international businesses — and the U.S. response to DSTs, which was primarily a trade-based response (including the opening of section 301 investigations and advocating for the elimination of DSTs in its trade negotiations). Despite its technical structure as a tax on income, the fact that a DST is imposed on gross receipts from the sale of goods or services into the taxing jurisdiction means that DSTs function mechanically as a tariff or a back-door VAT. Further, like other VATs, the economic burden of the tax is ultimately borne by customers when the enterprise passes on the costs to the market.[3] The use of DSTs has led to significant instability in both the tax and trade arenas. If countries are interested in reorienting the DST discussion from a trade-based discussion to a tax-focused discussion, this is an opportune time to do so.

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[1] Finance Act 2020, part 2, section 71(1).

[2] See HM Treasury, "Corporate Tax and the Digital Economy: Position Paper" (Nov. 2017).

[3] As the House of Commons Public Accounts Committee noted in a 2023 report, "payers of the tax can, and are, passing the cost on to users." See Committee of Public Accounts, "The Digital Services Tax" (5 April 2023).

This article first discusses how the UK DST functions as a trade tool — through its original discriminatory intent against US businesses and its ongoing negative impacts on the US-UK trade relationship — and then addresses the tax policy arguments made in support of the UK DST at the time of its enactment.

The general implementation of pillar 2, including the introduction of qualified domestic minimum top-up taxes (QDMTTs) in many jurisdictions, has produced some degree of relative stability at this stage in the reassessment of the international tax framework. The next step apparently will be for inclusive framework members to reengage on the taxation of the digital economy. That review, however, should consider the extensive changes that have been made to the international tax framework over the past several years, including those that are directly relevant to the taxation of large digital MNEs.

The most significant developments in international tax law and practice that directly affect where digital services providers report profits and pay tax today include:

- US tax reform in 2017, followed by further modifications to the global intangible low-taxed income regime in 2025 that eliminated qualified business asset investment and reduced the section 250 deduction, such that the US tax system imposes full worldwide taxation of profits at the US parent level for US MNEs
- Revisions to the OECD transfer pricing guidelines that have caused significant changes to the allocation of intangible profits between states resulting from the new guidance relating to the entitlement to tax returns on intangible property
- The OECD's pillar 2 project, which has encouraged many states that formerly were popular destinations for locating intellectual property rights to adopt a globally agreed minimum tax, reducing the incentives for MNEs to locate IP rights in those jurisdictions

Today, many traditional investment hubs have adopted a minimum tax, and the tax rate differentials that existed when the BEPS project began no longer exist, significantly changing the tax landscape for MNEs.

Other developments since the UK enacted its DST also play important roles in changing where digital services providers report their profits and pay taxes today. These developments include:

- Increased transparency of MNEs and the jurisdictions in which they report income and pay taxes through (i) the required automatic exchange of certain tax rulings and (ii) the implementation of country-by-country reporting rules and information sharing of CbC reports among jurisdictions create important new guardrails against improper profit shifting
- Changes to bilateral tax treaties as a result of BEPS, including changes to the definition of a permanent establishment, prevent MNEs from improperly avoiding PE status in a jurisdiction
- The adoption of CFC rules by many jurisdictions, as described in BEPS action 3, has significantly reduced profits booked in low-tax jurisdictions and led to a better realignment of MNEs' profits in the jurisdictions in which they have substantial business activities[4]
- The adoption of interest limitation rules, as described in BEPS action 4, has reduced excessive interest payments to low-tax jurisdictions
- Domestic antiabuse legislation in many countries, including via EU directive, has materially reduced tax and substance mismatches based on hybrid arrangements

Because the principal targets of the DST were always US digital services suppliers, changes to the obligations of those groups resulting from changes to US domestic law since 2018 is a central factor relevant to a reassessment of the policy assumptions underlying the DST. Recent reforms to US international tax law in 2017 and 2025 have materially reduced the incentives for US groups to transfer intangibles to low-tax jurisdictions. Those reforms in fact created strong incentives for US groups that had located IP rights overseas in jurisdictions with tax rates below the US rate to repatriate those rights to the United States. Many DST-paying groups have done just that.

As discussed in more detail below, (i) concerns about digital companies not paying the right amount of tax in the right places always ignored the entrepreneurial risk-taking functions and costs incurred outside market jurisdictions — these arguments have even less weight today because US-based digital companies generally do not have a disproportionately low global effective tax rate, and many have repatriated their IP from low-tax jurisdictions; (ii) digital services sector companies paying a majority of the UK

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[4] OECD, "A Decade of the BEPS Initiative: An Inclusive Framework Stocktake Report to G20 Finance Ministers and Central Bank Governors," at 82 (15 September 2025) (the stocktake report).

DST had significant investments in the United Kingdom in 2020 and have only increased their investments in the country since then, countering arguments about "scale without mass"; and (iii) the proposition that digital services sector companies create taxable value through interactions with users in the users' states in a manner that justifies tax rights for the users' states was, and remains, a theory designed to support a result rather than one based on sound tax policy. It is not the user's interaction with the product or service provided by a digital services sector company that changes or improves the company's product or service; rather, it is the activities undertaken by the company's employees and the research and investment made by the company that lead to product or service changes or improvements. In our view, the "user value" theory ignores the fact that the principal benefit arising in the user engagement is the benefit provided by the supplier to the user to allow the user access to products and services at low or no cost.

The DST has been a primary accelerant to the instability of the international tax framework because of the fact that it is a baldly extraterritorial tax and its targeting of a particular class of taxpayers. Historically, the DST was intended to be a temporary measure. The tax reporting circumstances of many of the targeted groups have changed; the time has come for its repeal.

DST tainted by original discriminatory intent

The policy goal of the UK DST was to impose tax on certain well-known US-based MNEs providing digital services in the three defined categories of social media platforms, search engines, and online marketplaces. This was known, understood, and frequently acknowledged during the development and enactment of the DST. During the consideration of the DST and various potential amendments to it, members of Parliament repeatedly stated that the DST was intended to be imposed on "American big tech"[5] and "international technology giants — that is, Google, Facebook, and Amazon,"[6] and the "Facebooks, Googles, and Amazons of this world."[7] At no point in the Parliamentary discussion of the tax did any MP suggest that any non-US company would be subject to the DST. One MP supported the DST based on competition grounds, arguing that it would create a level playing field, drawing a contrast between the targeted enterprises and "honest British businesses."[8]

The available data demonstrates that the intention to tax high-profile US businesses was realized: In the first year of collection, 90 percent of the UK DST was collected from five companies.[9] It is commonly assumed that all five are US-parented groups. Although it is reasonable to believe that there are more non-US enterprises subject to DST today than there were in 2020 and that the range of companies in scope of the DST may be modestly broader than when the tax was enacted, it also would seem obvious that the vast majority of actual DST collections still come from US-based companies. To the extent that any of the new DST taxpayers are UK-based groups, that is a healthy indication of the emergence of a more balanced cross-border trade in digital services.

The DST and friction in US-UK trade

Even though its purpose is to tax the business profits of nonresident enterprises that otherwise are not subject to the United Kingdom's normal tax nexus rules, the fact that the tax is imposed on gross revenue means that the tax functions economically as a tariff. Ironically, by enacting its DST in 2020, the United Kingdom thus acted as the first mover in the trade dispute over tariffs by launching this new sector-specific imposition.

The continuing existence of the DST has contributed significantly to trade tensions with the United States. The US administration has not been shy in criticizing what it views as other jurisdictions' extraterritorial actions that have the effect of "hindering" the success of US technology companies and "appropriating revenues" that the administration believes rightfully belong to the United States.[10] President Trump has instructed his administration to respond to these extraterritorial actions by "imposing tariffs and taking such other responsive actions necessary to mitigate the harm to the United States"[11] and explicitly instructed the US Trade Representative to consider whether to renew its section 301 trade investigation into the UK's DST (as well as whether to renew the

[5] See the comments of Sir Edward Davey in the House of Commons (1 July 2020).

[6] See the comments of Mr. Andrew Mitchell in the House of Commons (1 July 2020).

[7] See the comments of Dr. Rupa Huq in the House of Commons (1 July 2020).

[8] Id.

[9] UK Committee of Public Accounts, supra note 3.

[10] See generally the White House, "Defending American Companies and Innovators From Overseas Extortion and Unfair Fines and Penalties" (21 February 2025) (the presidential memorandum).

[11] See id. at section 2.

section 301 trade investigations into other countries' DSTs).[12] The president also instructed the Treasury secretary to determine whether any foreign country subjects US citizens or companies (including those in the digital economy) to discriminatory or extraterritorial taxes or any other tax measure that (i) undermines the global competitiveness of US companies, (ii) is inconsistent with any US tax treaties, or (iii) is otherwise actionable under section 891 of the IRC or any other legal authority.[13]

US trade associations have taken notice of the presidential memorandum and, on 3 June 2025, a group of trade associations wrote to Treasury Secretary Scott Bessent, Commerce Secretary Howard Lutnick, and US Trade Representative Jamieson Greer, encouraging them to take action against the UK and Canadian DSTs.[14] For the UK DST, trade associations asserted that US companies have paid an estimated USD 2 billion and encouraged the administration to "continue prioritizing the elimination of the United Kingdom's DST as part of the US-UK Economic Prosperity Deal."

In addition, although proposed section 899 was ultimately removed from the One Big Beautiful Bill Act (P.L. 119-21) before it was enacted in July 2025, Congressional Republicans and administration officials have stated that reintroducing proposed section 899 in the future is not off the table.[15] Section 899 as originally drafted subjected taxpayers resident in jurisdictions that impose "unfair foreign taxes" on nonresident taxpayers to increased tax rates on their US-source income. As reflected in the Senate draft of the OBBBA, it would apply to jurisdictions that impose DSTs and diverted profits taxes.[16]

Further escalation of this trade dispute over the DST would be unfortunate. The international tax system today cries out for movement toward stability, and the announcement that inclusive framework jurisdictions intend to reengage on the taxation of the digital economy provides countries with an opportunity to develop a mechanism, grounded in sound tax policy principles, that provides that stability. Accordingly, this is an opportune time for countries to engage in a tax-principles-based discussion regarding the digital economy.

UK DST arguments require reconsideration

Global ETRs of targeted MNEs in line with OECD Pillar 2

When the UK DST was in development, policymakers commonly asserted as a justification for the tax that (i) digital companies paid low rates of income tax globally, and (ii) relatedly, digital companies held their IP in low-tax jurisdictions through artificial structures. Those assertions were overstated when the United Kingdom enacted its DST in 2020, and they are even less persuasive today as a justification for continuing the tax. US-parented digital companies do not have a particularly low global ETR compared with companies in other sectors. Publicly available data from US-based MNEs that are within the scope of the UK DST, including data filed with the SEC, indicates that these companies generally had global ETRs in the mid- to high teens for their 2025 tax years (the most recent year for which such data is available), comfortably exceeding the minimum tax rate established by the OECD's pillar 2 project.

The belief that enterprises supplying digital services universally hold their IP in low-tax jurisdictions also is outdated, at least for US groups. In 2017 Congress enacted the Tax Cuts and Jobs Act, which incentivized many high-profile US digital services companies to repatriate their IP to the United States. Other groups moved IP from tax haven jurisdictions to their operational hubs with considerable business substance. Moreover, as discussed below, the BEPS stocktake report (published in September 2025) found that the wide adoption of BEPS changes has meaningfully changed the allocation of IP profits within MNE groups.

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[12] See id. at section 3. During President Trump's first term, the Office of the US Trade Representative conducted a section 301 trade investigation into the United Kingdom's DST. In a report published on 13 January 2021, the USTR concluded, among other things, that the UK DST "by its structure and operation, discriminates against US digital companies." See Office of the US Trade Representative, "Section 301 Investigation Report on the United Kingdom's Digital Services Tax" (13 January 2021). It is this investigation from Trump's first term that the 21 February 2025, presidential memorandum instructed the USTR to consider renewing.

[13] See presidential memorandum, supra note 10, at section 3.

[14] See letter from Computer and Communications Industry Association (CCIA) et al. to Treasury Secretary Scott Bessent, Commerce Secretary Howard Lutnick, and US Trade Representative Jamieson Greer (3 June 2025).

[15] See, e.g., Cady Stanton, "GOP Taxwriters Call for Quick Action on Global Minimum Tax Accord," Tax Notes Int'l, 8 December 2025, p. 1734; Naomi Jagoda, "Treasury Official Kies Floats 'Revenge Tax' Revival: BGOV Tax," Bloomberg Daily Tax Report, 10 September 2025.

[16] We note that the UK diverted profits tax also was designed to tax profits of nonresident entities that lack the normal juridical nexus with the United Kingdom.

It would be difficult to overstate the incentives introduced by the US legislative changes under the TCJA and, more recently, the OBBBA, to eliminate low- or no-tax results. In particular, the TCJA added the GILTI regime, which imposed a minimum tax on most foreign earnings of US-parented MNEs, especially income attributable to intangibles. The GILTI regime was the world's first true minimum tax on global income, designed to increase US taxes on income earned offshore, particularly in low- or no-tax jurisdictions. Congress tightened the GILTI rules in the OBBBA by enacting the net controlled foreign corporation tested income (NCTI) regime as the next-generation GILTI regime, which made US taxation of all offshore earnings even more robust than under the GILTI regime. In particular, the NCTI regime eliminates the previous exclusion from GILTI income equal to a return on QBAI owned by a US-parented MNE's CFCs and reduces the section 250 deduction on NCTI from 50 percent to 40 percent.

As a result of changes to US law under the TCJA and the OBBBA, US-based MNEs can no longer achieve the tax reduction results from IP migrations that contributed to the launch of the BEPS project in 2013. As a direct result of the changed US and foreign tax environment for offshore earnings, many US-based MNEs repatriated their IP from offshore locations to the United States. Even for US-based MNEs that did not repatriate their IP, the TCJA ensured that those MNEs paid a minimum level of US tax even if the assets were held in low- or no-tax jurisdictions.

This sea change in the US taxation of US MNEs' offshore earnings has been recognized by the members of the inclusive framework as creating a "robust" minimum tax regime for offshore earnings.[17] To date, the United States is the only jurisdiction that the inclusive framework has identified as having already "implemented a tax regime which incorporates minimum taxation requirements with respect to the domestic and foreign income of MNE Groups headquartered in that jurisdiction" so as to justify the US system operating side-by-side with the pillar 2 regime.[18] Not only does the United States meet the minimum taxation requirements, including a global inclusion rule and domestic minimum tax rules, but the side-by-side package effectively requires the United States to maintain those rules on a go-forward basis because a "stocktake" is scheduled to occur in 2029.

The problematic 'scale without mass' argument

The OECD BEPS action 1 report noted that developments in technology and the global economy may make it easier for companies to sell goods or services into foreign markets while maintaining a smaller footprint in those foreign markets than was previously possible. This in large part is a correct observation across many sectors, but it is not unique to digital services enterprises. In fact, the scale without mass argument to justify a DST appears to be a digital-services-specific reversal of the trading in/trading with distinction generally found in UK law (and international tax practice more generally). In general, when an enterprise is "trading in" a jurisdiction, it is conducting business in that jurisdiction and is subject to tax there (typically, because it has a physical presence there). When an enterprise is "trading with" a jurisdiction, it is selling products or services into a country without a physical presence there and therefore is not typically subject to tax. Supporters of a DST may argue that digital services sector companies should be treated as "trading in" the United Kingdom, but that would apply this tax principle differently, depending on the industry. For example, it is generally agreed that a Portuguese wine exporter that sells wine to UK customers is "trading with" the United Kingdom and, as a result, the wine exporter is not subject to U.K tax. There is no tax policy reason to treat digital services sector companies differently from nonresident wine exporters when digital services sector companies provide goods or services to UK residents.

Even if there were a valid tax policy rationale for making such a distinction between industries, the scale without mass argument warrants closer analysis.

Proponents of DSTs expressed this point in two ways:

- First, they argued that digital companies could increase revenue with no marginal costs, apparently believing that revenue growth does not require commensurate investments in personnel and assets. This view was always incorrect, because digital services enterprises have always made significant personnel and asset investments, and no business could grow without commensurate incremental investments in personnel and assets. The largest digital services suppliers are now some of the largest employers in the global economy. Investments in data centers and other communications infrastructure total in the billions of dollars annually.
- The second argument was that much of that investment is made in countries outside of the market states — that is, that digital services sector companies may not have sufficient "mass" in a jurisdiction to result under normal transfer pricing principles in the desired quantum of taxable income. This phenomenon is not unique to digital services

[17] See, e.g., the remarks of Irish Minister for Finance Simon Harris, in Irish Department of Finance release, "OECD Side-by-Side Agreement Statement" (5 January 2026).

[18] See OECD, "Tax Challenges Arising From the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two), Side-by-Side Package," at para. 14 (2026).

providers; enterprises from all sectors always have directed their investment to locations in which they could optimize their business success, and all global businesses seek to capture the efficiencies created by the world's digital communications infrastructure to centralize functions where possible. If this point were a legitimate policy foundation for the tax, the tax would need to be much more broadly applied than just to the narrow set of DST targets.

Of all the countries that impose a DST, the scale without mass argument is the least persuasive for the United Kingdom, especially regarding US MNEs. Digital services sector companies had a large geographic footprint in the United Kingdom when the UK DST was enacted in 2020 and have substantially increased that footprint since then in number of UK employees and value of assets.

For example, on 16 September 2025, Google announced the opening of a data center in Waltham Cross, Hertfordshire, as part of a two-year, GBP 5 billion investment in the United Kingdom.[19] The UK government has actively (and successfully) encouraged investment in domestic personnel and assets in this sector. In 2025 the UK government published a Digital and Technologies Sector Plan stating that, "by 2035, our vision is for the UK to be one of the top three places in the world to create, invest in and scale-up a fast-growing technology business."[20] The investments made to date and those the UK government is encouraging through its Digital and Technologies Sector Plan lead to substantial tax payments by the major digital enterprises, including corporation taxes, property taxes, and social taxes on employment, plus payments by employees of individual income taxes.

The globalized economy makes remote sales possible by any number of enterprises, including those that are not primarily digital services companies, and business efficiencies always focus on reducing costs outside of core development, production, and customer support activities through centralizing business functions. UK groups, of course, also take advantage of the benefits of a globalized and digital economy, so they reap the same benefits when selling into markets outside the United Kingdom. The DST applies unilaterally, thus ignoring the reciprocal trade benefits that accrue to UK exporters that follow the same centralized investment models responding to the same incentives that the globalized economy offers to digital services suppliers.

The 'user-generated value' argument issue

The proposition that digital services sector companies create taxable value in the users' states through interactions with users sufficient to constitute tax nexus in those states for the nonresident ignores the simple point that an enterprise can create value only by exercising its own functions, assets, and risks. The "user-generated value" argument fails to acknowledge the distinction between the creation and delivery of the service (the digital services sector company's entrepreneurial efforts, including risk-taking and significant investments in research and development) and the consumption of the service (the user enjoys access to information and services on a low- or no-cost basis).

Any data that an enterprise may collect during the provision of its service does not improve the technical capability of the service itself. The data does not change the provider's software architecture or affect any algorithm. The value creation occurs when the provider's employees construct systems to allow the enterprise to structure the data received, identify and develop additional products and services or improvements to products and services that would benefit users, and then implement those decisions that improve the product.

This relationship between users and digital services sector companies is fundamentally no different from the relationship between customers who shop at a retail business and use the retail business's customer loyalty card. Retail customers who use a customer loyalty card provide data to the business about their purchases and preferences, but any value generated from that data is attributable to how the retail business uses the data to improve the products and services it offers to its customers.

A digital services business creates value through its engineers, managers, developers, software architects, and designers, who develop, deliver, and support the digital services. As the BEPS action 1 report acknowledged, the "investment in and development of intangibles is a core contributor to value creation and economic growth for companies in the digital economy."[21] US-parented digital services sector companies make massive investments in R&D: The European Commission found that, in 2024, US companies invested EUR 421 billion in information and communications technology (ICT) R&D compared with only EUR 49.6 billion in ICT-related R&D investment by European companies.[22] Investments in tangible assets, such as data center premises and related equipment, as well as communications infrastructure, are also important. The digital services sector companies and their

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[19] See Google release, "Google Opens Waltham Cross Data Centre as Part of Two-Year GBP 5 Billion Investment in the UK to Help Power Its AI Economy" (16 September 2025).

[20] See UK Government, "The UK's Modern Industrial Strategy: Digital and Technologies Sector Plan" (2025).

[21] OECD, "Addressing the Tax Challenges of the Digital Economy, Action 1 — 2015 Final Report," at 65 (2015).

[22] See Elisabeth Nindl et al., "The 2025 EU Industrial R&D Investment Scoreboard," European Commission (22 December 2025).

employees — not users — invest in and develop these intangible assets. The mere existence of users in a jurisdiction does not permit the nonresident to claim tax losses in the users' state on account of the R&D and capital investment the enterprise makes to develop products for that market.

Revisions to the OECD transfer pricing guidelines based on the work in actions 8-10 emphasize that returns to intangibles should flow to those places where development, enhancement, maintenance, protection, and exploitation functions are performed. Users do not perform these functions; the enterprise's developers and engineers do.

The data collected arising from user interactions is both more limited in nature and more analogous to the type of data collected by companies not subject to the UK DST than what the DST's supporters suggest. For example, in the case of search engines, by far the most important data that is collected from the user to select relevant ads to display are the text of the search query, and an approximation of the user's location. Those two data points don't change the software or algorithms that underlie a search engine's functionality or its ad serving architecture. All improvements to the service itself are the result of engineering work undertaken by the company's employees to develop software that can capture and organize the data acquired, identify and develop additional products and services or improvements to products and services that would benefit users, and then implement those decisions that improve the product.

Many companies that are not subject to the DST collect similar data from their customers, such as streaming services and even traditional retailers of goods and services that sell their goods and services through their own websites. Retailers have used loyalty card programs for decades to capture extensive data, and they use that data in ways analogous to how digital services sector companies use the data they acquire — that is, retailers take the data provided by customers through the use of loyalty cards to identify, develop, and improve the products and services that they offer their customers.

In the case of a social media platform, supporters of the UK DST have argued that the posting of user-created content by some users to attract the views of others creates value that justifies extraterritorial taxation of the nonresident enterprise. This argument ignores the fact that most users on a social media platform are consuming content posted by others, posting little original content, and/or posting little content that is viewed by others outside their network of family and friends. To the extent that value is created by these activities, it is not comparable to the value created by the software engineer who wrote the code that allows users to post and display content on the platform in the first place.[23] Most users are, in fact, deriving a benefit from the social media platform — the ability to consume news and entertainment, keep in touch with family and friends, and market themselves and their expertise in a low- or no-cost way. While there may be social media users who can be classified as content creators and whose content is widely viewed by persons outside their own social network, these users tend to be outliers and — more importantly — these users tend to be compensated directly by the platform or advertisers. Compensation paid to content creators has increased dramatically since 2013 when the BEPS project was launched.[24]

Regardless of whether the company is subject to the DST, the benefit an enterprise may derive from user data results from the contributions of personnel and assets of the enterprise to develop software tools to aggregate, structure, analyze, and deploy that data. The benefit to the business arises not from the raw data itself (each data point itself normally has no intrinsic value), but from the algorithms that make use of the captured data to enhance the goods or services offerings of the supplier. Whether the company collecting the data is a digital company or a traditional retailer that also sells goods through its own websites, the information collected on user location and preferences is used to improve the supplier's goods and services or to develop more effective marketing campaigns. The user-created value theory is an effort to justify tax nexus for nonresidents that is not based on sound tax policy.

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[23] See generally the discussion on user-created content in Joe Kennedy, "Digital Services Taxes: A Bad Idea Whose Time Should Never Come," Information Technology & Innovation Foundation (13 May 2019).

[24] While the size of the content creator economy is difficult to measure, and average earnings are often significantly skewed by a small number of content creators that may have hundreds of millions of followers over multiple platforms, academic literature demonstrates that the size of this economy has grown substantially. In 2017 the influencer marketing economy in the United States was estimated to be USD 1.7 billion, which grew to USD 9.7 billion by 2020 and was estimated to reach USD 13.8 billion in 2021. Presumably, the influencer marketing economy in the United States is even larger today. See Lin William Cong and Siguang Li, "A Model of Influencer Economy," National Bureau of Economic Research Working Paper No. 31243 (May 2023).

BEPS reforms have achieved their goals

The action 1 report indicated that "the BEPS measures are expected to better align the location of taxable profits with the location of economic activity and value creation."[25] The stocktake report, published on 15 September 2025,[26] makes clear that, only a few years after the BEPS project recommendations were announced, the BEPS project has been remarkably effective in better aligning profits with substance and reducing base erosion. In particular, the stocktake report focused on evidence that taxable profits and substance are better aligned. This conclusion certainly is relevant when reevaluating the UK DST.

The stocktake report notes that the ratio of profits to employees in investment hubs has decreased by 27 percent since the launch of the BEPS project,[27] indicating a reduced shifting of profits, an increase in economic substance in investment hubs, or both. In addition, the stocktake report suggested that business fundamentals are increasingly driving where MNEs' profits are located, noting that profits have become less sensitive to tax rates, especially very low tax rates.[28] The observation that profit ratios in investment hubs have decreased must mean that some of those profits have shifted to market states.

BEPS actions 2, 3, 4, and 5 all addressed risks that the OECD/G20 found to be present in the digital economy. For example, measures consistent with BEPS action 2, which was intended to address different rules among jurisdictions that could lead to hybrid mismatch arrangements or stateless income, were adopted by 45 jurisdictions (including the United States) by 2025, representing more than three-quarters of global GDP.[29] BEPS action 3 aimed to revise CFC rules to reduce opportunities for profit shifting to lower-tax jurisdictions and long-term deferral of taxation. As of 2025, 56 jurisdictions have implemented CFC rules consistent with action 3, representing 78 percent of worldwide outward foreign direct investment.[30] As noted above, the US NCTI regime is the most comprehensive in the world in imposing minimum tax on all offshore earnings of US MNEs. Action 7 responded directly to commercial structures used by some digital services enterprises. That action was intended to — and did — strengthen the definition of a PE in tax treaties, with the goal of expanding the circumstances under which a nonresident entity selling into a market state will have a PE in that state. Actions 8-10 addressed some of the value creation concerns by updating transfer pricing rules to work better in a modern, global economy. Domestic legislation inspired by the BEPS project has significantly accelerated the direction of travel of the BEPS recommendations, such as the EU's antiavoidance directives.

Taken together, these BEPS reforms directly address the concerns expressed in the United Kingdom's November 2017 position paper that HM Treasury indicated may be more prevalent among digital businesses, including the increased centralization of global businesses, challenges in applying the transfer pricing rules, and whether users generate material value. We note that the UK DST was introduced before any of the BEPS-inspired changes had had time to change taxpayer behavior.

The stocktake report focused only on the original BEPS actions and thus did not address the additional effects of pillar 2. The outcome of pillar 2 also directly responds to some of the concerns raised by the OECD at the commencement of the BEPS project — in particular, by causing many countries that have been the beneficiaries of IP investment to increase their tax rates to at least the agreed global minimum. We note that, even after the implementation of the side-by-side agreement, countries will retain their newly enacted domestic minimum taxes, which will directly address concerns that these investment hubs offer unwarranted incentives to move IP profits to low- or no-tax jurisdictions.

Containing the normalization, extraterritorial, and unilateral taxes threat

The UK DST is plainly extraterritorial. Its principal targets are nonresident entities that are not otherwise subject to corporation tax in the United Kingdom, including those protected by tax treaty from taxation on business profits. This extraterritorial tax violates basic principles of customary international tax law. Under those principles, a jurisdiction should not endeavor to impose a tax on the

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[25] OECD, supra note 21, at 137.

[26] Stocktake report, supra note 4.

[27] Id. at 9.

[28] Id.

[29] Id. at 17.

[30] Id.

profits of a person that does not have juridical nexus with the taxing state.[31] The fact alone that a nonresident makes sales to customers in a state should not be regarded as establishing a genuine link to that state that would justify an extraterritorial tax.

Extraterritorial and unilateral taxes are inherently destabilizing to the international tax framework. That framework is based on mutually agreed allocations of taxing rights, based on agreed concepts of source of income, tax nexus, and value creation. The persistence of DSTs will encourage other instances of extraterritorial and unilateral taxation. Proliferation of that sort of tax can only further destabilize the international framework.

Much of the destabilizing nature of the DST arises from HM Treasury's insistence that the DST "will not be within the scope of the UK's double tax treaties" and therefore "will not be creditable against UK Corporate Tax."[32] As a tax applied to gross receipts, the United Kingdom argues that the DST is outside the scope of covered taxes under its double tax treaties. This view ignores the obvious point that the entire purpose of the DST is to impose tax on the business profits of certain nonresident digital services providers because those nonresidents are not otherwise subject to UK corporation tax.

Despite HM Treasury's statement, it is not at all clear that the DST is, in fact, outside the scope of covered taxes under UK double tax treaties. It is clear that withholding taxes are imposed on gross receipts but are considered to be covered taxes. The OECD model tax convention in article 2 defines covered taxes to include taxes on total income or on elements of income. There is little doubt that the purpose of the DST was to impose tax on the business profits of certain nonresidents that otherwise have no tax nexus with the United Kingdom under normal international tax principles. The DST would seem to be a tax on the nonresidents' total income.

The DST Is a blunt instrument

The narrow and targeted scope of the UK DST raises serious policy issues under the principles of neutrality and fairness as expressed by the Ottawa Framework.[33] While the DST purports to address the tax challenges of the digital economy, it was always highly engineered to apply only to a small subset of digital services suppliers, while explicitly excluding the broader digital services sector beyond the three named categories. There is no obvious tax policy rationale for segregating different segments of the digital services sector and imposing a DST on some segments but not others. The justifications that the targeted taxpayers allegedly rely on intangible property held in low-tax jurisdictions, allegedly have scale without mass, and have tax nexus in the market state because they collect data from their users would equally apply to other digital services providers that are not within the three specified business models that are targeted by the DST. Moreover, many of the concerns that HM Treasury cited in imposing the DST on search engines, social media platforms, and online marketplaces also arise in more traditional sectors of the economy that rely on digitalization to improve the development and delivery of their goods and services.

As a result, digital services companies that are subject to the DST are overtaxed vis-à-vis other companies in the broader digital services sector. The most extreme cases of overtaxation occur for startup, growing, and low-margin enterprises that are subject to the DST. While the United Kingdom's consultation on its DST acknowledged that "revenue-based taxation can cause challenges under certain circumstances," including for loss-making businesses or those businesses with low profit margins,[34] its solution to this challenge does not provide effective relief in many cases. While the UK DST includes an alternative calculation mechanism for low-margin businesses that, on its face, appears to impose a lower rate than the normal DST rate, in practice, this purported solution results in businesses with low profit margins paying a higher ETR on their actual profits, if any, than higher-margin businesses.[35]

The House of Commons' Public Accounts Committee heard testimony that high-volume, low-margin businesses that are not eligible for the alternative calculation method may see their UK earnings effectively wiped out by the DST.[36] While the United Kingdom has described this alternate-basis tax rule as relieving low-margin or loss-making companies from the DST, it is important to note that the margin that is tested is earnings before interest, taxes, depreciation, and amortization, not operating income, so groups can still be subject to this tax on gross revenue even if they are loss making when accounting for depreciation and amortization.

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[31] See generally American Law Institute, Restatement of the Law Fourth, the Foreign Relations Law of the United States, para. 402 (2018).

[32] See HM Treasury, "Budget 2018: Digital Services Tax."

[33] Adopted at the 1998 OECD Ministerial Conference on Electronic Commerce.

[34] See HM Treasury, "Digital Services Tax: Consultation" (Nov. 2018).

[35] See Public Accounts Committee, supra note 3.

[36] For the Public Accounts Committee's report, see supra note 3.

For all companies in its scope, the UK DST effectively imposes a second level of tax in addition to the corporate income tax.[37] This was intentional — the United Kingdom's consultation document for the proposed DST explicitly stated that it would not be creditable against the UK corporation tax. The rationale for the lack of creditability was that "the rate of the tax has already been set at a level which the government believes... will achieve a proportionate and fair outcome."[38] This is both circular ("the tax rate is fair because we believe it is fair") and discriminatory. No other industry (or subset of an industry) is subject to two levels of UK tax.

Building on the achievement of the pillar 2 project to successfully implement a minimum tax in many jurisdictions, including traditional investment hubs, the announcement by the inclusive framework jurisdictions to reengage on the taxation of the digital economy provides an opportunity to reconsider the arguments made in support of the UK DST (as well as the DSTs of other countries). It is time to repeal the UK DST and reorient the treatment of digital businesses around sound tax policy principles.

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[37] In a 2023 report by the House of Commons Public Accounts Committee, the committee observed that "some companies face potential double-taxation for the same transactions — first by Digital Services Tax taxing the revenue, then Corporation Tax taxing the profit." See Committee of Public Accounts, supra note 3.

[38] See HM Treasury, supra note 34.

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