The Bottom Line

JUNE 2020 | VOL. 42

DIGITAL TRADE WAR ON THE HORIZON

Summary

The U.S. Trade Representative announced June 2 that their office is investigating Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey, and the United Kingdom for implementing or planning to put forward new taxes on digital services. The subject has sparked division between the U.S. and France before, and it could ultimately mean higher tariffs for these countries.

Background

Under current international tax rules, multinationals generally pay corporate income tax where production occurs rather than where consumers or users are located. Through the digital economy, businesses derive income from users abroad, but without a physical presence, are not subject to corporate income tax in that foreign country. The OECD (Organization for Economic Cooperation and Development) has argued that highly digitalized companies may pose a special challenge to national tax bases and current international tax law. Multinationals contest that taxing profits based on where users reside would effectively tax their income more than once. The OECD has been in negotiations with over 130 countries to adapt international tax law as it applies to these digital service providers. The current proposal would require multinational businesses to pay some of their income taxes where their consumers or users are located—a project referred to as Base Erosion and Profit Shifting (BEPS).

However, despite these ongoing multilateral negotiations, several countries have decided to move ahead with unilateral measures to tax the digital economy. These measures target specific multinationals in a narrow range of business models meant to reflect the claimed sources of user value. The Commission's proposal was aimed at activities wherein "the participation of a user in a digital activity constitutes an essential input for the business carrying out that activity and which enable that business to obtain revenues therefrom."

Current Status

The international community has been trying to address legitimate international tax concerns. There are clear cases wherein companies have used the international rules to reduce their taxes in ways which, though legal, were not intended by policymakers. The countries that have decided to proceed with the Digital Services Taxes have proposals that would only cover profits from three business models:

1. Those placing ads targeting users of a digital interface based on their data profiles;
2. Those providing a multisided digital platform that allows users on one side of a transaction to interact with users on other sides, including the purchase of goods and services; and
3. Those selling users' data. At a time when citizens are being encouraged to embrace online trade to curb the spread of COVID-19, the new tax would capitalize on the growth of the sector. The United States strenuously objects to these taxes because the only targets would be American companies, such as Amazon, Google, Facebook, and Apple.

Impact

France has said that if international talks fail, tech firms will still have to pay the tax. The taxes have initiated a Section 301 investigation—the same justification for the punitive duties on Chinese products. Any U.S. trade sanctions over digital services taxes will be met with a swift EU-wide response, the French Finance Ministry warned. "Trade sanctions threats are not acceptable, and the EU would react swiftly and decisively in case they were to materialize," a spokeswoman for the French Ministry of Economy and Finance said.

RESOURCES:

Digital Services Taxes in Europe (Tax Foundation)
D.S. Taxes: A Bad Idea Whose Time Should Never Come (ITIF)
U.S. Investigates Countries Planning Digital Taxes (CNBC)