UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

United States Council for International Business (USCIB) Comments on Initiation of Section 301 Investigations of Digital Services Taxes

Docket No. USTR-2020-0022

July 15, 2020

The United States Council for International Business (USCIB) welcomes the opportunity to provide comments on this investigation into the adopted, proposed or considered Digital Services Taxes of Austria, Brazil, the Czech Republic, the European Union (EU), India, Indonesia, Italy, Spain, Turkey and the United Kingdom (UK) (collectively the "DSTs" or individually the DST of a particular jurisdiction). USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and regulatory coherence. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. As the U.S. affiliate of the International Chamber of Commerce, the International Organization of Employers and Business at OECD (BIAC), USCIB has a unique global network through which it provides business views to policy makers and regulatory authorities worldwide and works to facilitate international trade and investment.

This submission addresses the questions set forth in the request for public comments in connection with this investigation, 85 FR 34709.

While the focus of this submission is whether the identified DSTs violate Section 301, USCIB would like to emphasize that USCIB supports a multilateral solution to the specific issues of the appropriate taxation of the digitalizing economy. The DSTs under investigation are a poor choice to address the tax issues arising from digitalization of the economy and will work against the economic recovery they are intended to help fund. Rather, the U.S. should work cooperatively to find an appropriate multilateral solution to taxing the digitalizing economy that does not unduly burden U.S. interests and fosters certainty for business.

Because a balanced-negotiated solution that addresses the tax challenges arising from the digitalization of the economy is preferable to increasing trade tensions, USCIB urges USTR to strive to achieve such a multilateral solution. USCIB members are concerned about the discriminatory and distortive implications which these enacted and proposed DSTs represent. USCIB members also believe that tariffs are rarely appropriate, should only be considered after following appropriate procedures and be appropriately targeted, and should not interfere with economic recovery from the COVID pandemic.

There is, however, no consensus among USCIB members concerning whether retaliation by means of tariffs may ultimately be appropriate in these circumstances. In this case, many express deep concern about the potential cost of tariffs involving over 30 countries - both Section 301 tariffs and possible retaliatory tariffs - to U.S. businesses, consumers and the broader economy. Some USCIB members support retaliation after other alternatives have been exhausted because unconstrained DSTs are a form of trade restraint that will themselves have a negative impact on U.S. competitiveness, negatively impacting the broader economy and job creation. USCIB urges USTR to diversify its tools for enforcement and use them strategically in service of an optimal outcome for the entire U.S. business community in these cases.

USTR should engage with each of these countries toward a balanced-negotiated outcome

Consistent with the prioritization of multilateral action, the ultimate goal of any U.S. action with respect to the DSTs should be the removal of discriminatory DSTs. USTR should also seek commitments from the respective countries to resolve their concerns through the OECD's inclusive framework process on the taxation of the digitalizing economy and to avoid future unilateral actions that would have a discriminatory impact. Because a balanced-negotiated solution that focuses on the taxation of the digitalizing economy is preferable to increasing trade tensions, USCIB urges that USTR strive to achieve such a solution. Because these taxes, as described more fully in the appendix at the end of this letter, may violate the nondiscrimination articles and/or business profits articles of U.S. tax treaties, the government should include use of the mutual agreement procedure process as part of its discussions with other countries where such treaty relationships exist.

Discriminatory unilateral measures have been proliferating. USTR should take these measures into account when negotiating new trade agreements and make elimination of such measures an objective of any trade negotiations with a country or bloc that imposes a discriminatory DST.

<u>Engage through multilateral channels</u>

To that end we urge the Administration to engage in a dialogue with each of these countries to negotiate an acceptable outcome focused on the taxation of the digitalizing economy that includes the elimination of discriminatory DSTs (and any other discriminatory unilateral measures) including through multilateral negotiations that are taking place at the OECD. USCIB supports this focused multilateral process and supports U.S. leadership in this process. USCIB believes that any changes to the international tax system should be achieved through a broad-based consensus to resolve fairly the tax challenges of the digitalizing economy that taxes net income, recognizes losses and avoids double taxation. Changes should be modest and recognize that there are sectors where the existing rules work appropriately. This process should move forward quickly; countries should not resort to unilateral measures while that process is ongoing. The United States should also insist on the retroactive revocation of any unilateral measures as part of an OECD solution, including these DSTs. Any OECD solution should include an agreement to remove any and all unilateral measures enacted both before and during the negotiation process.

Among other options, USCIB believes that the U.S. government should also consider pursuing discussions under the auspices of the World Trade Organization (WTO).

The Digital Services Taxes as considered, proposed or enacted are likely unreasonable and discriminatory

USCIB believes that there are certain hallmarks of the DSTs under investigation that suggest they are discriminatory or unreasonable. These hallmarks include: application only to nonresidents; a high-monetary threshold for application, which may substitute for a rule explicitly applying the tax only to nonresidents; a gross-basis tax that is intended as a substitute for a net basis tax on net income, particularly if the rate of tax is high and the tax is likely to result in double or multiple taxation the proportionality of the tax to total system profits; and the procedure followed in adopting the tax, taxes adopted with little opportunity for comment or to put new systems into place to comply with the tax are more likely to unreasonable in their application. USTR should also review public statements of government officials. That is, many of the countries considering or enacting DSTs have said that they are targeting U.S. based companies or "tech giants." These statements are evidence of discriminatory intent and a concerning precedent for all U.S. industry. USCIB believes that the DSTs referenced above are potentially[1] actionable under Section 301 because they exhibit the hallmarks described above. In our comments, where countries have not fully enacted their DST proposals, we are analyzing those proposals based on what has been currently proposed or is likely to be implemented, as well as comments made by local officials regarding these proposals. Depending on their final design, they may, therefore, discriminate against U.S. companies. The Appendix at the end of this letter identifies the aspects of each measure that we believe are potentially discriminatory or unreasonable in each of the DSTs. The high-level conclusions of with respect to the DSTs are summarized here.

The following DSTs either explicitly apply only to nonresidents or impose high thresholds intended to exclude domestic enterprises: Austria, Brazil, the EU, India, Indonesia, Italy, Spain, Turkey and the UK.

The following DSTs apply a high rate of tax that may exceed system profit (or in some cases revenue from the transaction): Austria, Brazil, the Czech Republic, the EU, India, Italy, Spain, and Turkey.

The following DSTs were adopted with little or no notice of the provisions or with inadequate time to adapt systems to comply with the DSTs: India, Italy, and Turkey.[2]

The following country representatives made statements consistent with discriminatory intent: Austria, Czech Republic, Italy, Spain, Turkey, and the UK.

Many of the proposed DSTs seem to be based on the 2018 EU proposal, which was not adopted. This proposal was analyzed in depth in USCIB's comment letter to the European Commission.[3] The USCIB letter covers many technical issues that would create significant issues if the EU

[1] As not all of the above referenced DSTs have been enacted there is a possibility of modification before adoption. The measure as finally adopted would need to be analyzed to determine whether it is discriminatory or unreasonable.

[2] Because some DSTs are still under discussion, it is impossible to conclude on the reasonableness of the process since it is still ongoing.

[3] https://www.uscib.org/uscib-content/uploads/2018/07/EU_letter_on_digital_directives_July_26_2018_final.pdf

proposal were adopted as proposed in 2018. These issues include the definition of user, the allocation of taxable in-scope revenue to a particular jurisdiction, the difficulties of identifying the location of user, the difficulty of tracking data to a user and concerns with privacy protections – even the privacy protections of the enacting or proposing jurisdictions. The compliance burdens imposed as result of this poor design may result in the DSTs based on this design being considered unreasonable. This increase in compliance costs and resources required to comply with DSTs is particularly unhelpful, at a time when businesses' resources should be focused on responding to the impact of the global pandemic, not additional tax compliance. Further, while not adopted, statements and decisions were made throughout its crafting that evidenced the discriminatory nature of the European Commission (EC) proposal, so widespread adoption of these proposals is also revealing about the intent of these offshoot proposals.

The DSTs have been justified by assertions that the digital sector is undertaxed.[4] The analysis purporting to support under taxation has been rebutted.[5] Even if the sector were undertaxed, a gross basis tax on revenue is an unreasonable response. A gross basis tax restricts commerce because companies will be forced to choose among unacceptable options: raise prices to cover the additional cost of the tax or cease to do business because the business is uneconomical.

Section 301 permits action after a finding that a foreign government has adopted an act, policy, or practice that is unreasonable and burdens or restricts U.S. commerce. While it is difficult at this point to conclude with respect to each of these taxes because some are still being considered and the current public information is spotty at best (e.g., the EU), USCIB believes that the DSTs under investigation are likely actionable because the application of the taxes is discriminatory and unreasonable.

The DSTs are likely inconsistent with obligations under the WTO and may violate applicable U.S. Income Tax Treaties

WTO

Because the DSTs are potentially discriminatory, as discussed above, USCIB believes that the DSTs likely violate the national treatment obligation of the General Agreement on Trade in Services (GATS).[6] The national treatment principle requires WTO Members to treat foreign services and services suppliers no less favorably than its own like services and services suppliers. Accordingly, a discriminatory tax is in violation of this obligation under the GATS. In addition, USCIB understands that USTR has requested bilateral consultations with each of the ten jurisdictions that have adopted or are considering DSTs that are under investigation. In the course

[4] The European Commission's Impact Assessment of the EC digital services tax claimed that the traditional business model has an average tax rate of 23.2%, while the average tax rate for a digital company is only 9.5%. These figures were based on a study conducted by the Zentrum fur Europäische Wirtschaftsforschung Gmbh ("ZEW").
[5] The ZEW study's author later clarified that the EC's reliance was misplaced as it misinterpreted the findings. Jack Schickler, EU Study's Author Doubts Digital Transactions Undertaxed, Law360 (Mar. 6, 2018). "Understanding the ZEW-PwC Report," https://www.pwc.com/us/en/press-releases/2018/understanding-the-zew-pwc-report.html (publicly rejecting the assertion that digital companies are undertaxed).
[6] GATS Article XVII.

of these consultations, USCIB would urge USTR to probe these jurisdictions' views as to whether the measures are consistent with the WTO Agreement, including the GATS.

U.S. Income Tax Treaties

For the reasons outlined below, USCIB believes the DSTs may conflict with certain provisions of U.S. income tax treaties, which is important because it further reinforces the conclusion that these taxes are unreasonable – they violate both tax and trade standards.

Nondiscrimination Articles

The United States has income tax treaties with Austria, the Czech Republic, India, Indonesia, Italy, Spain, Turkey and the United Kingdom. It does not have an income tax treaty with Brazil or the EU (although there are U.S. income tax treaties with the vast majority of EU countries). All U.S. income tax treaties contain a nondiscrimination article, the scope of which varies. The nondiscrimination article typically guarantees a form of national treatment (which differs somewhat from the corresponding trade agreement standard) and applies to all taxes imposed by the treaty partner, regardless of whether they are considered "income taxes" otherwise covered by the treaty. USCIB believes the non-discrimination obligation may prevent the imposition of discriminatory DSTs, even if they are not income taxes that are otherwise covered taxes under the income tax treaty.

Covered Taxes

In order for a tax to be subject to all of the provisions of an applicable income tax treaty, it must be a covered tax. If the DSTs are covered taxes under an applicable income tax treaty, then not only would the nondiscrimination article apply, but the other provisions of the convention would also apply. In that case, the imposition of the DSTs would violate the permanent establishment and business profits articles of the relevant treaties, since those articles prevent the imposition of income taxes on the business profits of nonresidents that are not attributable to a permanent establishment the nonresident has in the taxing country. Countries have attempted to design these taxes so that they are not considered covered taxes (which is more evidence of discriminatory intent), so the question of whether they are covered taxes is not clear cut. The appendix goes into this topic in more detail. USCIB believes that in all of the cases in which the country imposing the DST has an income tax treaty with the United States, an argument can be made that the DST is a covered tax.

Conclusion

USCIB believes that these DSTs are potentially actionable under Section 301. We encourage the U.S. government to pursue a negotiated solution including through multilateral channels such as the OECD and the WTO and complete its investigation of the DSTs identified in this notice.

There is, however, no consensus among USCIB members concerning whether retaliation by means of tariffs may ultimately be appropriate in these circumstances. In this case, many express deep concern about the potential cost of tariffs involving over 30 countries – both Section 301 tariffs and possible retaliatory tariffs – to U.S. businesses, consumers and the broader economy. Some USCIB members support retaliation after other alternatives have been exhausted because unconstrained DSTs are a form of trade restraint that will themselves have a negative impact on U.S. competitiveness, negatively impacting the broader economy and job creation. USCIB urges USTR to diversify its tools for enforcement and use them strategically in service of an optimal outcome in these cases.

USCIB appreciates the opportunity to provide these comments and would be pleased to discuss them further.

Appendix—Descriptions of DSTs

Austria

The Austrian DST was enacted in October of 2019 with effect from January 1, 2020. It applies a 5% gross basis tax to revenue from online advertising services. DST payments are due on a monthly basis and the first payments were due in March of 2020. While there is a similar tax on print media advertising there are significant differences. First, the digital tax has a €750 million global revenue threshold that is not limited to in scope revenues and a local revenue threshold of €25 million, so it will effectively exclude Austrian providers of digital advertising. This is consistent with the expressed intent of the Austrian Chancellor, Sebastian Kurz. On December 29, 2018, he said: "We will take a national step. We will introduce a digital tax in Austria… The aim is clear: taxation of companies that make large profits online but barely pay taxes."[7]

A memorandum of understanding concerning the Austrian tax provides that up to €15 million of the tax revenues will be set aside to fund "the digital transformation process of Austrian media."[8] This is explicitly protectionist and is likely to be an illegal subsidy.

Brazil

The Brazil tax has not yet been enacted and would become effective at the beginning of the calendar year following enactment provided that there is at least a 90-day period between the date of enactment and the beginning of the following calendar year.

The bill would apply to digital companies with previous-year global revenues exceeding BRL 3 B (USD 578 MM) and with gross revenue in Brazil that exceeds BRL 100 MM (USD 19 MM). According to the bill, the taxable events are data transmission, advertising on digital platforms, and marketplaces sales for final users or consumers located in Brazil. The DST rates would vary from 1% to 5%, depending on the revenue range: 1% levied on amounts up to BRL 150 MM/USD 28 MM; 3% on amounts exceeding BRL 150 MM/USD 28 MM and under BRL 300 MM/USD 57 MM; and 5% on the amount exceeding BRL 300 MM/USD 57 MM.

Again, the high revenue threshold may be considered de facto discrimination against U.S.-based companies, even though the thresholds are facially neutral.

Unlike the Austrian tax and like the EU proposal the EU did not adopt, the Brazilian tax applies to digital marketplace fees and sales of data. These two categories raise additional difficult issues. A tax of 3% or 5% may exceed entire taxable profits. Thus, companies will be forced to choose among unacceptable options: raise prices to cover the additional cost of the tax or cease to do business because the business is uneconomical. While companies sometimes can and do pass along these costs to customers, the imposing these costs on nonresidents is protectionist.

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[7] https://www.reuters.com/article/eu-tax-digital-austria-idUSL8N1YY086
[8] https://transferpricingnews.com/austria-mulling-5-digital-tax-on-large-businesses/

The taxation of transmission of user data with respect to users located in Brazil is enormously complex.[9] It is uncommon for raw data to be sold. It is unclear whether DSTs applying to the transmission of data only apply to raw data or whether it applies to data that has been subject to data analysis. Further, data has a relatively short-shelf life, so ideally any rules concerning data would take that into account, although it is not clear how that would be done. Finally, many countries are adopting privacy rules and requiring companies to track user data for tax purposes might violate privacy rules.

Czech Republic

The Czech proposal is being considered by the Czech parliament and is expected to be effective on January 1, 2021. The DST would impose a 7% tax (although this might be reduced to 5%) on three revenue streams: performing a targeted digital advertising campaign; revenue from the use of a multilateral digital interface and provision of consumer data.

The proposed Czech DST would apply only to companies generating €750 million in annual global revenues for all services and CZK 100 million (approximately $4.2 million) of in country revenues for covered digital services. Further, companies whose revenues from covered digital services do not exceed 10% of total revenues in Europe would be excluded from the DST, but subject to notification obligations. This seems designed to carve out European companies. The threshold for targeted ad campaigns and the provision of user data is greater than CZK 5 million in turnover (about $218,000). These thresholds appear to apply separately, so a company with 4 million in ad revenues and 2 million in data transmission revenues would not be subject to the DST. The digital interface threshold is based on 200,000 users. A user is any natural person, legal entity, or unit without legal personality who accesses the interface through a technical device. There may be significant difficulties in identifying and locating users that may make it difficult to apply the user threshold.

The Czech DST whether at the 7% or 5% rate is very high for a gross basis tax that is intended to substitute for a net income tax on digital services income.

The European Union

As mentioned above, there is currently no live EU DST proposal that can be critiqued. USCIB has, therefore, assumed that any new EU proposal would be similar to the prior proposal, which was deeply flawed. The EU proposal had a global revenue threshold of €750 million and €50 million of taxable revenue within the EU. These thresholds, while facially neutral, are designed to exclude most EU businesses and reach U.S.-based multinationals.

The 3% rate of tax may exceed entire taxable profits. The EU justified its proposed DST by asserting that the digital sector is undertaxed on its income.[10] The analysis purporting to support

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[9] See the USCIB comment letter referenced above.

[10] The European Commission's Impact Assessment of the EC digital services tax claimed that the traditional business model has an average tax rate of 23.2%, while the average tax rate for a digital company is only 9.5%. These figures were based on a study conducted by the Zentrum fur Europäische Wirtschaftsforschung Gmbh ("ZEW").

under taxation has been rebutted.[11] Even if the sector were under taxed, a gross basis tax on revenue would be an unreasonable response. As mentioned previously, a gross basis tax may exceed total system profits and would therefore have to passed on to consumers of the digital service, which, if the tax is discriminatory, would be protectionist.

The prior EU proposal was also unreasonable in the way it was proposed to be applied. The DST applied to appearances of digital advertisements even though it is common for revenue only to be earned by the digital provider when a viewer clicks on the ad. The definition of a user for purposes of taxing a digital marketplace was unclear and likely internally contradictory. The standard for determining how to determine the source of revenue from data transmission was likely impossible to apply because it would require global tracking of all data indefinitely and did not take account of privacy rules.

India

The expansion of the Indian equalization levy (EL) was introduced as a last-minute amendment to the 2020 Finance Bill, was adopted March 27, 2020, and became effective April 1, 2020. There was, therefore, no opportunity to provide stakeholder comments and no time to implement the new tax during the four-day period between the date of enactment and the effective date. This lack of process is a hallmark of unreasonableness.

The tax, by its terms, applies to essentially all nonresident e-commerce sales of goods and services to India, and sales of advertisements to nonresidents if targeted at persons resident in India or using an Indian IP address. Thus, the tax is discriminatory as it only applies to non-Indian e-commerce businesses and amounts to a tariff on U.S. Exports sold to Indian residents. The tax seems to apply to gross revenues from the sale or service, even if the person is acting as an intermediary and the revenue from the transaction is a small fraction of the total transaction revenue. Thus, this tax could exceed not only the total system profit but the total revenue from the transaction. (It is worth noting that the existing equalization levy that applies to digital advertising at a 6% rate, similarly, affects non-residents in a discriminatory manner.)

The tax does not apply to a nonresident operating through a permanent establishment (PE) if the income is connected to that PE. The mutually exclusive relationship between the Equalization Levy and income tax on companies with PE, creates significant ambiguity for non-resident firms where PE is in dispute. For non-resident firms with uncertain PE status, there is risk of double impact as there is no legal certainty against risk of prosecution, levy on interest, or other penalties for underpayment of the tax. At the same time, there is no mechanism to guarantee a refund or offset overpaid taxes, should the company be deemed to have PE (and therefore not be subject to the EL). The DST may also violate double taxation principles. India's existing goods and services tax (GST) imposes an 18% tax on the supply of goods and services and is already charged on the import of online services. On top of that, the EL is chargeable on the supply on these services,

[11] The ZEW study's author later clarified that the EC's reliance was misplaced as it misinterpreted the findings. Jack Schickler, EU Study's Author Doubts Digital Transactions Undertaxed, Law360 (Mar. 6, 2018). "Understanding the ZEW-PwC Report," https://www.pwc.com/us/en/press-releases/2018/understanding-the-zew-pwc-report.html (publicly rejecting the assertion that digital companies are undertaxed).

unless the activities are effectively connected with onshore PE. The result being that these imported goods and services are subject to double taxation. Further, the PE exclusion for EL implies that, where PE Income tax is applicable, EL is not applicable. In other words, EL in-substance acts as a substitute for Income tax and therefore is an indirect way of levying income tax which would otherwise not be applicable based on Double Taxation Avoidance Agreement signed between two countries. A probable outcome of this DST would be to force companies to localize operations in India.

Indonesia

The Indonesian government enacted the Government Regulation In Lieu of Law No. 1/2020 (Perppu-1) on March 31, 2020 with immediate effect. The law includes expansive new income tax rules imposed on nonresident ecommerce providers of goods and services, including an Electronic Transactions Tax (ETT) that is Indonesia's version of a digital services tax. The law was enacted under emergency measures and no opportunity was provided to submit comments. The lack of opportunity for public consultation prior to enactment of the law demonstrates the unreasonableness of the rules.

Perrpu-1 includes significant economic presence (SEP) rules that expand Indonesia's taxing rights over non-Indonesia residents by requiring foreign businesses to pay Indonesian income tax even when those businesses have no presence in Indonesia under existing permanent establishment rules in Indonesia's bilateral tax treaties. As such, this provision isn't in-line with existing international tax norms. The ETT provisions are meant to serve as a backstop to the SEP rules and impose a gross revenue tax on businesses who won't be subject to the SEP rules when an applicable treaty prevents their application, such as under the U.S.-Indonesia treaty. The effective of these rules is that U.S. e-commerce companies who provide goods and services to Indonesia recipients are subject to the gross basis ETT law even when the U.S.-Indonesia treaty would otherwise apply.

The ETT is discriminatory as it applies solely to non-Indonesian e-commerce businesses and it creates additional barriers to trade by imposing a tariff on U.S. exports to Indonesia. Moreover, public comments by Indonesian government officials specifically indicate that the law is intended to target U.S. multinationals to provide additional tax base for Indonesia and that the ETT rules are intended to mimic the French DST. These comments further demonstrate Indonesia's discriminatory intent behind the enactment of these rules.

The Ministry of Finance must issue implementing regulations to enable taxpayer compliance with the SEP and ETT provisions of Perrpu-1. These regulations will clarify necessary information such as the applicable tax rates, scope of the rules, and any applicable thresholds. However, based on the statutory provisions, the ETT law is strikingly similar to India's equalization levy in that it solely taxes non-resident ecommerce businesses and imposes a gross revenue tax on transactions involving goods and services sold to Indonesia-based customers.

Italy

The Italian DST was enacted in December of 2019 and became effective on January 1, 2020. The first DST payment is due in February 2021, although there are not yet implementing regulations, which creates significant uncertainty concerning the calculation of the tax.

The Italian DST imposes a 3% tax on revenues from: digital advertising services, intermediation and marketplace services, and data transmission. The Italian DST suffers from the same problems as the other DSTs based on the failed EU proposal. That is, the global revenue threshold of €750 million is intended to and does protect domestic service providers from the application of the tax. The local activity threshold (€5.5 million) is also relatively low, so that a company with €800 million of global revenue and €6 of local revenue would be subject to the tax, while a domestic company with €600 million of entirely Italian revenue would not be subject to the DST.

Spain

The Spanish DST is currently being considered by the Spanish Parliament and may be adopted in the third or fourth quarter of this year. It will become effective 3 months after its publication.

The Spanish DST imposes a 3% tax on revenues from: digital advertising services, intermediation and marketplace services, and data transmission. The Spanish DST suffers from the same problems as the other DSTs based on the failed EU proposal. That is, the global revenue threshold of €750 million is intended to and does protect domestic service providers from the application of the tax. The local activity threshold (€3 million) is also relatively low, so that a company with €800 million of global revenue and €6 of local revenue would be subject to the tax, while a domestic company with €600 million of entirely Spanish revenue would not be subject to the DST.

Mr. Jaime Mas, Area Coordinator of the General Sub-Directorate for International Taxation of the General Directorate of Taxes of the Ministry of Finance of Spain explained that the original intent of Spain's proposed DST was to tax Silicon Valley companies such as Apple, Google, Facebook, Amazon and Microsoft, but that Spain's WTO commitments required that Spain not discriminate against non-resident companies.[12] Thus, there is evidence that the DST, while facially neutral is designed to reach U.S. companies.

Turkey

The Turkish DST was enacted in December of 2019 and is effective as of March 1, 2020. The DST payment mechanism and timelines are still unclear, despite the tax liability accruing on the books.

The Turkish DST imposes 7.5% tax on digital advertising services; selling any audible, visual or digital content through a digital environment and services provided in a digital environment including listening to, watching, or playing such content in a digital environment; services provided for creating and operating digital environments which users may interact with each other; and intermediation services provided in a digital environment relating to these three categories.

[12] Hacienda tratara de evitar la doble imposicion en la "tasa Google," EXPANSION (June 1, 2018).

The President has the authority to increase the tax to 15% on any of the categories, if he so chooses. This ability to unilaterally double the applicable rate is a hallmark of lack of process.

The global revenue threshold is €750 million of in scope revenue and the local revenue threshold is approximately $3.5 million. Again, these thresholds are designed to, and we believe do, exclude Turkish companies.

Turkish Treasury and Finance Minister, Berat Albayrak, in the context of taxing the digital economy, advocated taking the necessary steps "to support our local economy and sustain Turkey's competitive advantage".[13]

The exceedingly high rate and the broad scope are hallmarks of a discriminatory tax. This rate is so high that it may be difficult to pass on, which may have the intended effect of reducing foreign competition.

UK

The draft UK finance bill that will adopt the UK DST is expected to be adopted in mid-July and will be retroactively effective on April 1, 2020. The DST imposes a 2% tax on gross revenue from certain business models rather than on gross revenues of certain types of income. Those business models are the provision of a social media platform, a search engine, or an online marketplace.

The global revenue threshold is £500 million; and the local revenue threshold is £25 million. These thresholds are designed to exclude local businesses even if they have significant local activities. The UK DST has a safe harbor for low-profit or loss-making businesses, which is of course welcome, but is also an indication that the DST is intended to tax corporate profits that they would not be permitted to tax under an income tax treaty because these companies would not have a permanent establishment in the UK.

Mr. Philip Hammond, the then Chancellor of the Exchequer, has stated that the DST "will be carefully designed to ensure that it is established tech giants rather than our tech start-ups, shoulder the burden of this new tax…(sic)[14]

[13] https://www.dailysabah.com/economy/2019/02/28/turkey-to-avoid-tax-losses-from-digital-economy-services#:~:text=Treasury%20and%20Finance%20Minister%20Berat%20Albayrak%20signaled%20that,speech%20at%20the%20134th%20Tax%20Council%20meeting%20yesterday.

[14] https://thehill.com/policy/technology/413672-uk-proposes-targeting-tech-giants-with-digital-services-tax

U.S. Income Tax Treaties

Covered Taxes

In order for a tax to be subject to all of the provisions of an applicable income tax treaty, it must be a covered tax. The provisions concerning covered taxes are generally found in Article 2 and follow three general models. The first model lists taxes of both signatories that are covered at the time of signature and provides that identical or substantially similar taxes adopted after signature are also covered taxes. This is the narrowest model and of the treaty countries whose DSTs are under investigation these countries follow that model: the Czech Republic, India, and Spain, Therefore, in order to be a covered tax, the DST would need to substantially similar to an existing covered tax. To the extent such countries have existing gross basis covered taxes on business activity income earned by nonresidents (e.g., India's tax on technical service fees), a good argument may be made that the DST is a substantially similar tax.

The second model states that covered taxes include income taxes. It then lists existing taxes of both signatories that are covered at the time of signature and provides that identical or substantially similar taxes adopted after signature are also covered taxes. This is somewhat broader than the first model since there is a general category of "income taxes". Under this model, a new tax could be considered a covered tax even though it is not identical or substantially similar to the existing covered taxes if it were considered an income tax. Of the countries whose DSTs are under consideration Austria, Italy, and Turkey follow this model.

There is not an easy or clear answer to the question of whether the DSTs would be income taxes under this standard. Suffice it to say that there are many gross basis taxes that are considered income taxes – taxes on interest, dividends, rents, and royalties are commonly imposed on a gross basis – and certain countries also impose such taxes on technical services income and both view those taxes as covered income taxes under their tax treaties and seek to preserve their right to impose those taxes on nonresidents.[15] A gross basis tax may be an income tax and given the background concerning adoption of these measures to counter the perceived absence of an income tax on U.S. based multinationals, a reasonable case can be made that these DSTs are covered taxes under the U.S. – Austrian, Italian, and Turkish treaties. The result of these DSTs being treated as covered taxes would mean that the respective income tax treaties prohibit their imposition because they are imposed even in the absence of a permanent establishment and without regard to rules concerning the attribution of profits (the tax is assessed on revenue). This strengthens the case that imposition of these taxes is unreasonable.

The final model provides a more elaborate definition of a covered tax. The U.S. - UK income tax treaty fits in this category. The relevant language[16] of Article 2 is as follows:

[15] See, Article 12A (Fees for Technical Services) the Unite Nations Model Double Tax Convention between Developed and Developing Countries – 2017; see also India's tax on fees for technical services and the treatment of fees for included services under Article 12 of the US-India Tax Treaty.
[16] The U.S. – UK treaty also applies to identical or substantially similar taxes.

1. This Convention shall apply to taxes on income and capital gains irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and capital all taxes on income and capital gains all taxes imposed on total income, or on elements of income, including taxes on gains from the alienation of property.

3. The existing taxes to which this Convention shall apply are:

    a. In the case of the United States …

    b. In the case of the United Kingdom:

        i. The income tax;

        ii. The capital gains tax;

        iii. The corporate tax; and

        iv. The petroleum tax.

USCIB believes that the UK DST is a covered tax under Article 2, and therefore may only be imposed consistent with the provisions of Treaty Article 5 (Permanent Establishments) and Treaty Article 7 (Business Profits).

Neither the Technical Explanation of the treaty (nor the OECD Model on which it based) provides any guidance concerning the interpretation of this language. A reasonable reading, however, would include the DST as a covered UK tax. The DST is not one of the enumerated taxes, but that list is not exclusive. The proper question is whether the DST is imposed on total income, total capital or elements of income or capital. The DST is imposed on gross revenues. Revenues are clearly an element of income – i.e., gross revenues are a starting point for determining total income. As explained above, the UK government is concerned that digital companies are under-taxed on their income. Thus, the intent of the DST is to find another way to reach the income of the affected companies. Given the broad language of the definition of "UK tax" and the clearly expressed intent to reach undertaxed income of digital companies, the DST should be considered a covered tax. The fact that the UK DST exempts companies with losses or low margins also indicates that the tax is intended to be a tax on income. As a covered tax, the DST would have to comply with the rules of Article 5 and Article 7, which it clearly does not. Therefore, USCIB believes that the DST would violate the U.S.-UK Income Tax Treaty in cases in which it is applied in the absence of a permanent establishment. USCIB believes that in all cases, the application of the DST violates the Business Profits Article.

The U.S.-UK Income Tax Treaty is consistent with longstanding international norms on the taxation of income of nonresident companies, and a unilateral departure from that norm is evidence of unreasonableness.