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**Submission to USTR Section 301 Investigation of France's Digital Services Tax**

The European Centre for International Political Economy (ECIPE), Brussels, welcomes the opportunity to contribute to the investigation on Section 301 regarding France's Digital Services Tax. ECIPE is an independent and non-profit policy research think tank dedicated to trade policy and other international economic policy issues of importance to Europe.

The following comments address the motivation of the French government underlying its DST law and the extent to which it is unreasonable and discriminatory.

**Misrepresentation of the "Fair Share of Tax" debate**

The French government claims that digital companies that are headquartered outside France pay little or no tax on their corporate income. The French government's accusations resonated well in French media and continue to shape public opinion in and beyond France. Another strand of the debate, which is less discussed in the media, concerns corporate income tax payments of digital companies that sell goods and services to French customers, without having a taxable physical presence in France.

The question of whether digital companies are paying their fair share of taxes has also become a central political concern in Brussels (at the EU-level), France and other EU Member States. There is indeed a good case to make for fair taxation. Uneven effective corporate tax rates impact on citizens' perceptions of fairness and distort progressivity in taxation. Differences in effective tax rates can also distort competition and tax revenues.

At the same time, due to nationally-fragmented tax laws and national tax exemption policies, some policymakers have failed to draw informed conclusions to draw informed conclusions about tax fairness, e.g. whether and where individual companies pay a certain fair share of tax.

The reasoning of the French government builds on misleading statistics that originated from the European Commission's General Directorate for tax affairs (TAXUD). The Commission's numbers are for hypothetical companies and have been criticised for being deceptive in various respects.

The French government also ignores that French exporters' profits, i.e. profits from exports of companies that do not have a taxable physical presence abroad, are exclusively taxed in France rather than their export markets. Moreover, the French DST is equivalent to a tariff on US services exports to France. Due to its legal design, the tax effectively discriminates against large corporations, of which many are headquartered in the US. Indeed, French officials repeatedly referred to the term GAFA tax, implying a tax specifically targeted at US-based multinationals Google, Apple, Facebook and Amazon.

**False assumptions on what companies actually pay in tax on their income**

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Referring to numbers published by the European Commission in 2017 (under the French EU Tax Commissioner Pierre Moscovici), the French Finance Minister Bruno Le Maire repeatedly claimed that "most digital giants pay some 14 percentage points less tax than European small-and-medium sized companies [in the EU]." Therefore, according to the French government, a tax on the revenues of large digital services companies would contribute to fairer taxation. The French government has never substantiated this claim, which was used as the sole justification for this unprecedented tax.

The French government refers to numbers that are based on a theoretical tax model, which assumes far-fetched hypothetical situations. The model has been applied in a study commissioned by the tax department of the European Commission in 2016.[1] Several tax experts, including the modellers themselves, i.e. the researchers commissioned by the European Commission, repeatedly clarified that their hypothetical numbers cannot be used to compare the tax burdens of "digital" and "traditional" companies or determine whether these companies pay their fair share of tax or not.[2] Moreover, the source that French politicians cited outlines that many EU Member States even apply lower tax rates for IP-intensive companies than the US and Japan.[3]

Real-world data for effective corporate tax rates (ECTRs) demonstrates that there is no systematic difference in the effective tax rates of digital or non-digital (traditional) companies. Moreover, studies show that many traditional companies headquartered in France and other EU Member States show very low effective corporate tax rates. Their effective tax rates are often much lower than those of digital corporations, including the largest tech companies headquartered in the United States. Bauer (2019), for example, outlines the following numbers for the period 2012 to 2017.

US-based Alphabet (Google), Facebook, Microsoft and Amazon, show relatively high ECTRs for the period 2012 to 2017, i.e. 26.8%, 27.7%, 28.2% and 28.2% respectively.

[1] See European Commission (2018), p. 18, as well as ZEW (2016, 2017).

[2] The following public statement has been released on: "The study does not calculate EATRs [Effective Average Corporate Tax Rates] using tax information for actual companies or sectors; more importantly, the study cannot be used to compare the tax burdens of 'digital' and 'traditional' companies. See: https://www.pwc.com/us/en/press-releases/2018/understanding-the-zew-pwc-report.html.

In interviews with Bloomberg, Law360, and Disco, Prof. Spengel of ZEW, lead author of the European Commission-commissioned study, made clear that the study does not support conclusions that the digital sector is undertaxed. In summary, the ZEW-PwC study enables a comparison of the relative attractiveness of certain countries' tax regimes for intangible assets developed through R&D. It does not analyze the effective tax rates of actual enterprises or allow conclusions to be drawn regarding corporate taxes paid by the "digital sector"."

[3] See PwC and ZEW publication "Digital Tax Index 2017: Locational Tax Attractiveness for Digital Business" Models Executive Summary. Available at https://www.pwc.de/de/industrielle-produktion/executive-summary-digitaliiserungsindex-en.pdf.

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By contrast, Renault, the French car-maker shows an average effective corporate tax rate of 17.6% for the period 2012 to 2017 (6Y average). Valeo, a French automotive supplier shows a 6Y ECTR of 19.5%. Capgemini, a French consultancy company shows a 6Y ECTR of 21.5%. Essilor Luxottica, a France-based international optics company, shows a 6Y ECTR of 21.4%.

Similarly, Volkswagen, the German car-maker, shows a comparatively low 6Y average ECTR of 20.5%, while Deutsche Post, Germany's major logistics services supplier, shows a 6Y average ECTR of 15.0%, and Deutsche Telekom, Germany's major telecommunications operator, shows a 6Y average ECTR of 19.1%.[4]

Moreover, the 6Y average ECTRs of digital companies constituting the MSCI World Technology and the MSCI World Software and Services indices were 24.8% and 27.8%. By contrast, considerably lower average ECTRs are found for large (and generally more traditional) companies headquartered, for example, in Spain (IBEX35 companies) and Germany (DAX30) companies, for which 6Y average ECTRs amount to 23.4% and 24.1% respectively.

It should be noted that real-world ECTRs, which are usually based on audited financial reports, suffer from some limitations, which can lead to a distorted picture about what and where companies actually pay in taxes on their profits over a certain period of time. Nevertheless, ECTRs are commonly used by professional investors as a tax burden and profitability indicator for individual companies. It is important to understand that there is no systematic difference in the ECTRs of digital or non-digital companies. Notions that certain digital companies are generally undertaxed compared to non-digital companies are therefore highly misleading and seem to be guided by political ideology rather than empirical evidence.

**Discrimination by design**

Some French officials demand that in the future digital companies' profits are taxed in the country of the customer/user. The French Finance Minister also argued that a tax system for the 21st century has to build on the value of data. At the same time, the French government still accepts that, under current international tax rules, profits from exports are taxed in the country where value added takes place. Through the DST, the French government fundamentally deviates from this principle.

With the DST, the French government applies an entirely new set of tax rules for a selected group of large companies with certain – narrowly defined – digital business models. However, in practice, they act in a discretionary and inconsistent manner. One which is in contradiction to its stated objective of taxing data-intensive business models.

First, the French DST deliberately discriminates against certain narrowly defined business models. While online intermediation and online advertisement services are subject to the

[4] For more data on ECTRs of EU-headquartered companies, see appendix of Bauer (2019).

French DST, services that are based on "digital interfaces" for the delivery of digital content are excluded from the tax.

Second, the final law was designed specifically to exclude one of France's best-known digital companies, Criteo. Criteo is excluded from the French DST due to this narrow definition. To date, France has not identified a single French or European company that will be directly affected by the DST. France's Secretary of State for Digital Affairs, Mr Mounir Mahjoubi, has explicitly stated that no European companies will be subject to this tax.[5]

Third, many companies with traditional, less digital business models – large and small – export to countries in which they do not have a taxable physical presence. The profits generated from these exports are still taxed in the country where value added takes place. The French government disguises that numerous French exporters do not use physical permanent establishments to market their goods and services in other countries. Despite the implementation of a new DST, the French government upholds long-standing tax rules for its own companies, i.e. those with business models other than the ones specified in the DST law. The French government continues to accept standard tax treatment for exporters that do not have a taxable presence in their export markets. Their new DST policy is therefore hypocritical.

Fourth, the French government does not call for a completely new tax model based only on the destination of sales, which would create a level playing field and may potentially contribute to more transparency, legal certainty and greater levels of tax fairness.

**Appropriateness and proportionality of the French DST**

The French DST targets large companies' gross revenues. Economic theory as well as empirical evidence on consumption taxes suggests that sales taxes (incl. taxes on value-added) are passed on to consumers. Tax incidence analysis demonstrates that the French DST has the economic effect of an excise tax on intermediate services. Several studies on the impact of DSTs (for Spain, Germany, France and the EU-level) conclude that a DST is to a large extent borne by the purchasers of taxable services, i.e. companies buying online advertising services, marketplace listings, or user data, and the consumers downstream from those transactions.

Indeed, on 1 August 2019 Amazon notified sellers of the change in its pricing policies for the French market, which takes effect October 1: "Following the creation of a 3 percent digital services tax in France, we would like to inform you that we will have to adjust our referral fee rates on Amazon.fr to reflect this additional cost," the company told sellers. Other companies affected by the tax are likely to follow suit.

[5] See L'Express article "Taxation des GAFA: la France peut-elle faire cavalier seul?" from 3 Januar 2019. Available at https://lexpansion.lexpress.fr/actualite-economique/taxation-des-gafa-la-france-peut-elle-faire-cavalier-seul_2055669.amp.html.

The precise size and distribution of the pass-through effects depends on firm characteristics, but it is clear that the burden of a tax on revenues from digital services will to varying extents be passed on to users. For business users, e.g. SMEs that rely on online advertisement services to reach new clients, for example, the economic magnitude of the pass-through effect would be much higher for low or negative margin operations. Depending on company characteristics and the level of competition, business users will pass on the DST to consumers, workers and company owners.

It should be noted though that the French DST decreases the competitiveness of those companies that formally have the pay the tax as their (B2B) customers have to bear higher prices as a result of the tax. Even if the tax is only partly passed-through to the companies' customers, the French DST increases the cost for those businesses that are explicitly covered by the legislation. These businesses face a comparative disadvantage vis-à-vis all those companies that are excluded from the tax.

Accordingly, the French government fails to address the central problems of international corporate tax law. With the DST, the French government distracts public and political attention away from its own distortionary tax exemption rules, e.g. deductions for IP and research and development expenditures, which have been implemented to benefit companies established and taxed in France. The French DST renders France's corporate tax system even more complex without tackling the real problems in domestic and international corporate taxation. Due to well-recognised though complex incidence effects, i.e. the distribution of the tax burden among the users of those digital services that fall under the DST, the French government in fact increases tax complexity, opaqueness and unfairness of corporate taxation in France.

**Conclusion**

Summarising the above, the French government's misrepresentation of US-based digital companies' effective corporate tax burden, the discriminatory design of the French DST and the inappropriate and disproportionate nature of it, warrants a finding by the USTR that the French DST is actionable under Section 301.

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