

INTRODUCTION OF DIGITAL SERVICE TAX BY FRANCE
TARGETING US DIGITAL COMPANIES-
POLICY RESPONSE BY UNITED STATES

by
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Abstract

Modern day digital economy poses challenges for taxation system based on traditional rules of physical presence and transfer pricing rules. Prolonged multilateral efforts are yet to come out with a final globally acceptable solution. Consequently, many countries have begun taking unilateral measures to tax their digital economy. These steps violate the accepted norms of international taxation. The latest decision by France in the form of Digital Service Tax goes a step further in being tailor made to target US based digital companies while excluding the French companies from the tax net. This paper explores the existing position and the available options for a response by US side and recommends taxation of French companies at double the prevalent rate as the preferred option. For this purposes, the paper recommends issuance of an executive order by the President of the United States in exercise of the power vested in him by Section 891 of the Tax code 26. The papers claims that this would provide a sufficiently strong reply to France action with immediate impact and also recoup the revenue losses to the US government. The paper also explains how it would be a good deterrence for other countries that are in the process of introducing similar legislations.

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MEMORANDUM

To: THE PRESIDENT OF THE UNITED STATES OF AMERICA
From: NEELAM SHUKLA
Subject: Introduction of Digital Service Tax by France
Date: April 26, 2020

Action Forcing Event

On 2nd December 2019, the United States Trade Representatives issued its report on France Digital Service Tax, prepared in pursuant to an investigation under section 301 of Trade Act of 1974¹. This investigation was in response to the levy of a digital service tax of 3% by the French government on revenue from digital services earned in France by multinational enterprises. This tax was applied from retrospective effect (from 1st January 2019), though the President of France finally signed the bill on July 2019. French officials and ministers often referred to it as “GAFA Tax” (Google, Apple, Facebook, Amazon Tax), which explicitly indicates that this tax is targeted mainly towards US based companies².

Statement of Problem

The Digital Service Tax (DST) introduced by France, will not only impose a burden on US companies but will also erode the tax base of United States. DST being a gross revenue tax is not only a bad tax policy but also a threat to the international tax system. It violates the core canons of the international tax system that taxes should be imposed on income rather than revenues and that states have the right to tax their residents.

¹ Section 301 Investigation report on France’s Digital Services Tax
<https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-frances-digital-services-tax>

² ibid.

The DST is a substantively new tax that will require new reporting and accounting systems to implement. It will have significant bearing on companies' tax reporting and recordkeeping responsibilities, as well as their overall tax liability. The DST makes these changes effective immediately upon the law's publication and retroactively for the seven months preceding its announcement. This contravenes the principle of tax certainty, as well as specific OECD guidelines. The levy of a tax with retrospective effect is not only against the 'Principle of certainty' of taxation (particularly in the international tax arena) but is unprecedented and extremely burdensome for the companies. The U.S. Chamber of Commerce said that the tax would generate revenue of approximately 500 million euros (\$554 million) per year, the majority of which will be paid by U. S. firms³. It will also cost U.S. firms millions of dollars to conduct 'significant re-engineering of accounting system to ensure that they can accurately assess liability.

The existing framework under 'Double Taxation Avoidance Agreement' (DTAA) between US and France does not provide for these taxes to be eligible for credit against taxes due in US⁴, This would therefore increase the total taxes paid by U.S. multinational companies in jurisdictions around the world, and impose excess financial burden on these companies. Any effort to allow credit would effectively force the U.S. Treasury (and U.S. taxpayers) to subsidize tax rates imposed by foreign jurisdictions. Neither of the scenarios is in the fiscal interests of the nation.

The statement in 2018 by the French Finance Minister Bruno Le Maire at an informal meeting that "We want to tax American tech giants, but certainly we don't

³ John G. Murphy, Senior Vice President for International Policy, U.S. Chamber of Commerce <https://www.uschamber.com/comment/us-chamber-comments-docket-no-ustr-2019-0009-initiation-of-section-301-investigation-of>

⁴ US-France Tax Treaty: <https://www.irs.gov/pub/irs-trty/france.pdf>

want the Chinese to tax Louis Vuitton" betrays the true reason behind this DST⁵. It is anything but an effort for fair taxation. It is an effort to garner extra revenue from US companies while sparing their own companies and economies. This dual standard is at the core of the problem.

This has started a trend amongst countries to take up unilateral measures in the name of addressing the tax challenges of digitalization of economy. 35 countries are known to be in various stages of implementing different versions of digital service tax⁶. If left unchecked they would only go on to unduly exacerbate the tax troubles for the U.S. multinational companies on foreign soils and pose a threat to the US revenues.

History/Background

France and other countries like Austria, Hungary, Italy, United Kingdom etc. seek to levy taxes on revenue earned by multinational corporations (MNCs) in certain “digital economy” sectors from activities linked to the user-based activity of their residents⁷. These proposals have generally been labeled as “digital services taxes” (DSTs). It is a reflexive, unilateral step by certain countries to the realization that the existing rules fail to capture their right share of taxes from the digital economy. The run up to DST starts with the challenges caused by the emergence of the digital economy, along with the multilateral and unilateral efforts that have developed in response.

⁵ Hellmann Andreas, American Tax Reforms, November 15th, 2018

⁶ Taxation of the digitalized economy:
<https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf>

⁷ Report of Congressional Research Service titled- Digital Services Taxes (DSTs): Policy and Economic Analysis and available at <https://fas.org/sgp/crs/misc/R45532.pdf>

The digital economy, by creating new business models that challenge the traditional concept of physical proximity to target markets, also challenges the traditional rules of taxation and leads to conflicts on allocation of taxing rights to various stakeholders. They have allowed shifting of profits and avoidance of taxes by multi-national enterprises. The Organisation for Economic Co-operation and Development (OECD) identifies three important phenomena facilitated by digitalization – scale without mass, reliance on intangible assets, and the centrality of data – to be posing serious challenges to elements of the foundations of the global tax system⁸

The fact that digitalization posed challenges to the global tax system was felt by the world community as early as the 1998 Ottawa Conference of Finance Ministers⁹. The OECD pursued this work, getting the endorsement of the G-20 in 2013 for its action plan to tackle the challenges to the taxation of the digital economy¹⁰. This culminated in OECD submitting its detailed Action Plan on Base Erosion and Profit Shifting on 19th July 2013¹¹. It is no coincidence that the first action plan proposed in the report was that to address the tax challenges of the digital economy. The action plan brought to the fore several options that were being considered as possible solutions. It deliberated on extending the nexus rules to include SEP (significant economic presence) concept with an option like the modified deemed

⁸ Note by OECD in its report titled- Tax Challenges Arising from Digitalisation available at <https://www.oecd.org/tax/beps/beps-actions/action1/>

⁹ OECD Ministerial Conference "A Borderless World: Realising The Potential Of Global Electronic Commerce": [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=sg/ec\(98\)14/final&doclanguage=en](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=sg/ec(98)14/final&doclanguage=en)

¹⁰ Communiqué-G20 Meeting of Finance Ministers and Central Bank Governors Moscow, July 20, 2013: <http://www.g20.utoronto.ca/2013/2013-0720-finance.html>

¹¹ Release of OECD titled- Closing tax gaps - OECD launches Action Plan on Base Erosion and Profit Shifting -<https://www.oecd.org/tax/beps/closing-tax-gaps-oecd-launches-action-plan-on-base-erosion-and-profit-shifting.htm>

profits method to allocate profits¹². The action plan also examined ‘Withholding tax’ (a standalone gross basis final withholding on payments made to non-resident providers of goods and services online as a possible option along with the equalization levy. However, it did not zero in on any one proposal in view of the much work that needed to go in before reaching such conclusion. The French DST is a version of this withholding tax.

Following a mandate by G-20 Finance Ministers in March 2017¹³, the Inclusive Framework on BEPS, an intergovernmental working group of OECD, through its Task Force on the Digital Economy (TFDE), has been working to bring about a consensus-based solution to these challenges¹⁴. As on date, the OECD has come out with public consultation documents to address these problems broadly under two pillars that deal with ‘Allocation of taxing rights’ and ‘other BEPS issues’ respectively. It is expected that the Global Community will come out with a workable solution by the end of Year 2020 and such solution would be accepted for adoption by all member countries¹⁵. Negotiations are under progress.

However, the steps being taken were felt insufficient to address the concerns that emerge out of digitalization of economy fully and timely. Several of the countries have therefore been actively exploring the option of a unilateral fix to this problem.

While efforts have not been limited to European countries, efforts to develop policy

¹² Final report of OECD on Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 available online- <https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf?expires=1583641876&id=id&accname=guest&checksum=A49FC465852ACB4C1509355AB9BE6417>

¹³ Communiqué-G20 Finance Ministers and Central Bank Governors March 18, 2017, Baden: <http://www.g20.utoronto.ca/2017/170318-finance-en.html>

¹⁴ OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors available at -<https://www.oecd.org/tax/beps/oecd-secretary-general-tax-report-g20-finance-ministers-riyadh-saudi-arabia-february-2020.pdf>

¹⁵ Communiqué: G20 Finance Ministers and Central Bank Governors Meeting February 23, 2020, Riyadh: <http://www.g20.utoronto.ca/2020/2020-g20-finance-0223.html>

principles and justifications in support of these specific taxes on digital economy markets have primarily been driven by politicians and commentators in Europe, including the United Kingdom¹⁶. The various proposals in Europe to tax the digital economy share many of the features of digital taxation options discussed in the OECD BEPS report.

In March 2018, the European Commission announced a digital tax package containing two proposals. The first proposal would expand the definition of permanent establishment to include cases where a company had significant economic activity through a “digital presence,” thereby allowing European Union (EU) members to tax profits that are generated in their jurisdiction even if a firm does not have a physical presence. The second was to be an “interim tax” on certain revenue from digital activities: selling online advertising, online marketplaces (facilitating the buying and selling of goods and services between users), and sales of data generated from user-provided information. The second was to be in levied till the first proposal is fully in place¹⁷. Media reports indicate that the EU-wide proposals had stalled partly due to disagreement among member states with different economic interests and questions as to whether the proposals would be legal under EU law¹⁸.

France had been active in leading this initiative at EU level. However, as French officials realized that this was not going to pass through European Union, they moved on to unilaterally enact their own DST¹⁹. The grounds put forward is that it addresses

¹⁶ Report of Congressional Research Service titled- Digital Services Taxes (DSTs): Policy and Economic Analysis- available at <https://fas.org/sgp/crs/misc/R45532.pdf>

¹⁷ Proposal for a ‘Council Directive’ on the common system of a digital services tax on revenues resulting from the provision of certain digital services available at <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=COM:2018:148:FIN>

¹⁸ Report of Congressional Research Service titled- Digital Services Taxes (DSTs): Policy and Economic Analysis- available at <https://fas.org/sgp/crs/misc/R45532.pdf>

¹⁹ Tax on digital services in France:
<https://www.roedl.com/insights/tax-digital-services-france>

the alleged under-taxation of digital companies until the negotiations in the OECD can produce a multilateral agreement on the international tax system. The whole process, from release of proposal to the passage of law by both houses of French Parliament has been very swift with little time for debate or understanding of its true intent or implications. The bill was submitted for consideration the French Parliament on March 06th 2019 and was signed into a law on July 24th 2019²⁰.

It is ironic that the OECD, based in Paris, is working for a multilateral consensus based solution that is fair and appropriate to taxpayers and jurisdictions while France moved to undermine this effort by putting in place a unilateral DST. As per a chronology of efforts documented by the USTR in its 301 report, US officials have made repeated attempts to explain and convince the French authorities from enacting the DST and to work with others and US for a multilateral solution. Various officials from US embassy in Paris, US Treasury, State department met many French officials on multiple occasions to explain and encourage them to desist from resorting to such step²¹.

None of these efforts were of any avail. Though the French Officials stated that it would be a transient tax and would be repealed after the OECD reaches a solution, they failed to incorporate provisions to this effect in the bill that has since been made a law²².

²⁰ France: Digital services tax (3%) is enacted: <https://home.kpmg/us/en/home/insights/2019/07/tmf-france-digital-services-tax-enacted.html>

²¹ Report on France's Digital Services Tax Prepared in the Investigation under Section 301 of the Trade Act of 1974
Pages 7&8: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf

²² *ibid*.

It is pertinent to note that pursuant to the French move, several European countries have announced, proposed, or implemented a digital services tax (DST).²³

Policy proposal

The goal of this policy proposal is to provide a mechanism that recoups the extra expenditure to the US companies and thus the US Treasury. The proposal also aims to provide a reason for France to withdraw its DST while simultaneously providing deterrence for other countries like Austria and UK to not proceed with their proposals of taxation of digital economy focused on US companies.

This 1934 provision of the U.S. tax code (Section 103 of the 1934 Act) titled ‘Doubling of rates of tax on citizens and corporations of certain foreign countries’ makes it mandatory for the President, upon a finding that U.S. companies or citizens are being subject to discriminatory taxes, to make a proclamation to that effect and double the rates of tax imposed by sections 1, 3, 11, 801, 831, 852, 871, and 881 of the tax code in the case of each citizen and corporation of such foreign country. The law provides that the proclamation is to be effective until a finding of discriminatory taxes being withdrawn by that erring country is made. This tax however has a cap of 80% of the taxable income of the taxpayer before deductions²⁴.

This provision may be invoked to mandate a tax on the global revenues of the large firms with taxable presence in United States but incorporated in countries like France that seek to tax the digital income of the US companies. In light of the express mandate available through this section, it is proposed that the President issue an Executive Order for the levy of tax at double the prevailing rates in case of such

²³ Article by Tax Foundation titled-Digital Services Taxes in Europe available at <https://taxfoundation.org/digital-tax-europe-2020/>

²⁴ 26 U.S. Code § 891. Doubling of rates of tax on citizens and corporations of certain foreign countries: <https://www.law.cornell.edu/uscode/text/26/891>

foreign countries. The order should mention France and also provide for automatic application to all countries in case of which the proclamation of finding of discriminatory tax treatment of US citizens and corporations is made by the President. As the French DST envisages a levy of taxes in case of US digital companies only, the scope of the executive order may be restricted to French companies. The IRS under the Department of treasury may be entrusted with the responsibility of the administration of such executive order.

The tax rates could be a mirror image of the taxes the respective countries seek to impose on US companies. The thresholds to be set for taxation could also correspond those set by the respective countries. The proclamation is to be effective in and from the tax year in which it is made and for all such tax year when the proclamation lasts. The sunset period of such taxes could be either of two dates of events: acceptance of the global consensus solution by the respective countries and complete implementation of the consensus solution in the domestic economy as also applicable to the US companies operating in such economies or repeal of the unilateral DST. Necessary protection carve-outs to continue the tax if the DST continues to apply in the respective countries in any other form may need to be included as well.

This order would affect about 4,800 French subsidiaries in the U.S²⁵. As these foreign corporations are required to file their tax returns in Form-1120 F, appropriate changes in tax rates need to be made in relevant columns in the form and the instructions for filling the form that has to be issued for the relevant tax years. As tax returns are updated every year, no separate costing is possible to be attributed at this point of time. Therefore, no separate costs and so financial allocation for effecting the changes would be warranted at this point of time.

²⁵ The US- France 2019 Economic Report: https://frenchtreasuryintheus.org/wp-content/uploads/2019/09/2019-France-U.S.-economic_full-report.pdf

Policy analysis

One may argue that the tax implication from the French DST is too small to warrant a national response. However, the stakes are of a magnitude larger than \$500 million that France expects to collect in the first year. It sets a precedent for other countries, especially in Europe that are at various stages of considering a similar tax. Non-response or a less vigorous response from the United States would only encourage many other countries to follow suit. Absence of timely response from the United States would also take the urgency away from the multilateral negotiations presently under progress with the Inclusive Framework of the OECD.

The invocation of Section 891 of the tax code retains the decision-making with regards to the response solely in the hands of the United States. It also serves as a ready template for action by the government to embark on a swift action as and when any country seeks to target US companies unfairly. The basis for arriving at a finding required in the current case is already available in the form of investigation by the USTR.

The provisions of Section 891 of the Tax code have been brought into the code in 1934 as Section 103 of the 1934 Act. It is interesting to note that this provision was enacted to counter the then French government's efforts to unduly tax the dividend declared by the US companies to its French subsidiaries and also taking the global income of the American Companies for deciding upon the quantum of taxation. It was only after this provision was inserted into the Act that French Government came around to ratifying the treaty with United States to avoid double

taxation in 1934²⁶. Thus, there is historical evidence of the effectiveness of this provision that too in the case of France itself.

However, since then, even though invoking these provisions has been a subject matter of deliberation on many an occasion, they have never been invoked. The effectiveness of a financial disincentive is well evidenced by the reaction of the French government to the threat of retaliatory tariffs pursuant to Section 301 investigation, recently concluded in December 2019 by the USTR²⁷. Based on the findings of the investigation, the United States called for public hearings to decide upon the nature of retaliatory tariffs. Faced with impending tariffs on its exports to United States, France deferred the collection of the DST due in April and October of this year to December 2020. The goal of the present proposal is to put in place a permanent reason for France to withdraw its discriminatory provisions against US companies' altogether and also serve a deterrence to other countries from following the France model. Invoking section 891 provisions proved to be an effective mechanism even at the time of its insertion to the Code.

The Peterson Institute for International Economics (PIIE) an independent nonprofit, nonpartisan research organization, in its recent research article titled "How Congress Can Help Overturn the French Digital Tax" proposed that the US Congress pass legislation invoking the provisions of Section 891 to provisionally mandate a tax on the global revenues of large firms based in France, Italy, and other DST countries, when those firms sell goods or services in the US market²⁸.

²⁶ Internal Revenue Code severely punishes countries which impose extraterritorial taxation:<https://isaacbrocksociety.ca/2013/02/02/internal-revenue-code-severely-punishes-countries-which-impose-extraterritorial-taxation/>

²⁷ Section 301 Investigation Report on France's Digital Services Tax:
https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf

²⁸ Peterson Institute for International Economics, Gary Clyde Hufbauer, How Congress Can Help Overturn the French Digital Tax, January 7, 2020

The experience with France during the events leading to insertion of Section 103(now 891) in 1934 as explained in the earlier paragraphs, coupled with the current response of the French government to the threat of retaliatory tariffs indicate that the proposed action would serve as clear and substantive remedy for the situation that may emerge, if the France finally decide to impose these discriminatory taxes. It would also spell out a clear and present danger for all other countries that intend to go down this path of unilateral discriminatory taxation of digital services. It would thus be fully successful in achieving its goal.

Challenges for the proposal:

This proposal is likely to face challenges on three counts:

- ‘Last in time’ Rule of for the purpose of interpretation of Section 891 with reference to tax treaties.
- Violation of the national treatment commitments under the DTAA²⁹
- Complaint before WTO.

The last in time rule is a legal principle, which resolves questions of supremacy between a treaty and a conflicting act of Congress. When a self-executing treaty and a federal statute relate to the same subject, courts will always attempt to construe them so as to give effect to both, if that can be done without violating the language of either. However, if the two are inconsistent, the one that was entered later in date will control over the other³⁰. Applying this rule, there is scope for one to argue that because all the tax treaties have been executed well after 1934 (when section 891

<https://www.piiie.com/blogs/realtime-economic-issues-watch/how-congress-can-help-overturn-french-digital-tax>

²⁹ A Constructive U.S. Counter to EU State Aid Cases:

<https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2670&context=facpub>

³⁰ Treaties as Laws: A Defense of the Last-in-Time Rule for Treaties and Federal Statutes:

<https://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=1538&context=ilj>

was inserted in the code), the tax treaty providing for non-discrimination and national treatment of the citizens and concerns of each other would prevail over the provisions of section 891. This argument, while having some force, has a strong counter argument in the fact that this is a temporary arrangement mandated by statute specifically aimed at countering the discrimination being meted out to US citizens and concerns that violate the same principles equally³¹.

Most of the Double Tax Avoidance Agreements (DTAA) that US have entered into is based on the US model of the DTAA. Binding arbitration is a standard part of this model (Article 25 of the Model agreement)³². So, there is also a possibility that the other country government, be it France or any other country (ex. Belgium, Canada, Germany etc.) that has arbitration clause in its DTAA with US, may seek arbitration³³.

However, both legal challenge and arbitration are time staking propositions. By the time these proceedings reach a conclusion, the day-to-day implications of the proposed change would be causing sufficient impact to encourage the erring country to withdraw these discriminatory changes to law.

As regards the complaint before WTO is concerned, in the last 25 years of its existence the Dispute Settlement Board of WTO had only heard 10% of its cases on tax matters³⁴. It is to further note that WTO essentially examines the disputes related

³¹ How Congress Can Help Overturn the French Digital Tax: <https://www.piie.com/blogs/realtime-economic-issues-watch/how-congress-can-help-overturn-french-digital-tax>

³² United States Model Income Tax Convention: <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf>

³³ Mandatory Arbitration Of Disputes Pursuant To Tax Treaties: The Experience Of The United States: https://www.wu.ac.at/fileadmin/wu/d/i/taxlaw/institute/WU_Global_Tax_Policy_Center/Arbitration/12_article_arbitration_of_disputes_pursuant_to_tax_treaties_the_experience_of_the_united_states.pdf

³⁴ Michael Daly, Is the WTO a World Tax Organization? A Primer on WTO Rules for Tax

to trade and not tax. There is therefore a possibility that it may be denied from admission itself. However, there exists a slim chance that the WTO may find it to be a matter that has indirect impact on trade and admit it for examination. That situation would be a redundant contemplation as the decision of France, as and when it starts collecting the discriminatory taxes is a fit case of filing of dispute before WTO and so would precede the application of the Section 891 by United States. Lastly, the decision of the WTO is appealable and in any case, its effectiveness would be dependent on the respective countries accepting it and implementing it.

There is also a possibility that France may raise concerns on the grounds of fairness and equity towards the French companies and citizens. However, since the measure is in retaliation to the iniquitous and unfair action by France towards US companies by way of levy of DST, that is inevitable.

The authority to administer an executive order must flow from the constitution itself or from the mandate granted by the United State Congress to pass such orders³⁵. The present proposal deriving its authority from Section 891 of the tax code satisfies the earlier requirement.

As mentioned in the proposal, the implementation of the proposed order would only require a change in status and tax rate columns of Form 1120-F and the processing software to enable systems automatically calculating taxes for the defined category of taxpayers at different rates. It is thus an exercise that requires minimal additional resources in terms of manpower and time for implementation. It is thus

Policymakers, IMF Fiscal Aff. Dep't (Mar. 2016), ("Since 1995, taxation has been the cause of over 40 of the 500 disputes . . . submitted to the WTO's Dispute Settlement Body . . .").
<https://www.imf.org/external/pubs/ft/tnm/2016/tnm1602.pdf>

³⁵ The Power of the President: The Roles of Executive Orders in American Government:
<https://lawshelf.com/shortvideoscontentview/the-power-of-the-president-the-roles-of-executive-orders-in-american-government>

administratively and technically feasible. The financial cost for the implementation of the proposal is also minimal with no requirement of earmarking any resources separately.

As per the latest statistics (2016) published by the IRS, there are 120,719 Foreign Controlled Domestic Corporations (Corporation's with greater than 50% of stock held by a single foreign person)[FCDC] in United State, and they have together paid \$53,941 million in taxes in tax year 2016³⁶. Of these companies, 3322 belong to France. They paid \$3459 million as taxes in the year 2016³⁷. Their total receipts from US markets in 2016 have been \$306,280 million³⁸. The Executive Order, if passed, in case of French FCDC's alone, would yield tax revenues far more than that extracted from US companies by France. They simultaneously would render all these corporations uncompetitive in their respective markets. Most of these corporations are big corporations in France itself³⁹. The loss of US markets for these companies would have a cascading effect on the overall health of these companies and thus on the financial health of the French economy. A situation that France and for that matter any other country would want to avoid, at any cost. The effectiveness of the proposal would this be total and immediate. It is thus an efficient mechanism producing maximum effect.

³⁶ SOI Tax Stats - Foreign-Controlled Domestic Corporations- Table under classification-Country of Foreign Owners and Age of Corporations :
<https://www.irs.gov/statistics/soi-tax-stats-foreign-controlled-domestic-corporations>

³⁷ *ibid.*

³⁸ *ibid.*

³⁹ The United States & France 2019 Economic Report:
https://frenchtreasuryintheus.org/wp-content/uploads/2019/09/2019-France-U.S.-economic_full-report.pdf

Political analysis

The key stakeholders for the issue on hand are: U.S. digital companies with significant business presence in France subjected to the DST; the US Government that would lose out its revenue; the French Government that came out with the DST to begin with and now needs to take the remedial action; and the French companies and citizens that are also US taxpayers.

A strong and healthy digital industry is imperative for the overall wellbeing of the large workforce and their families. Such a large workforce is well distributed across the states of USA and are important across the aisle electorally. The digital companies that are immediately in the cross hairs of the French DST are predominantly American companies like Google, Amazon, and Facebook. The DST is basically focused on these American companies as is evidenced by the fact that many of the French ministers and officials commonly referred to it as GAFA Tax⁴⁰. These companies have all along been up in arms against the levy of the DST and had actively lobbied with French Government^{41,42}. They however failed to elicit any favorable response. The impact of the discriminatory DST on their business performance has also been submitted to the USTR during its investigation under section 301 of the TD Act⁴³. It has been the consistent stand of these US digital companies that the United State should respond against the DST⁴⁴.

⁴⁰ GAFA tax: a major step towards a fairer and more efficient tax system:
<https://www.gouvernement.fr/en/gafa-tax-a-major-step-towards-a-fairer-and-more-efficient-tax-system>

⁴¹ Tech giants rip new French digital taxes:
<https://thehill.com/policy/technology/457958-tech-giants-rip-new-french-digital-taxes>

⁴² US tech companies call on France to abandon digital tax plans:
<https://www.ft.com/content/33f7cd26-c28d-11e9-a8e9-296ca66511c9>

⁴³ Section 301 Investigation Report on France's Digital Services Tax:
https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf

⁴⁴ Tech giants push for tariffs as fight over French tax heats up:
<https://www.politico.com/news/2020/01/07/tech-giants-tariffs-france-095668>

The US digital companies have also been advocating their cause through trade advocacy groups like Computing Technology Industry Association (CompTIA) and The Computer & Communications Industry Association (CCIA). Both these groups have been vociferous in criticizing the unilateral action(s) by France and others like European Union and Britain. They have also been supportive of the actions being taken by United State to discourage these actions⁴⁵⁴⁶⁴⁷. Therefore, both US digital companies and their employees are likely to welcome the proposal and the protection it offers to these companies on foreign lands.

The United States government that is staring at the possibility of losing out on its revenue because of the DST is another important stakeholder of this entire process. It has been the consistent stand of the United States to disapprove the unilateral measure by France⁴⁸. Both United States Treasury as well as State Department has regularly conveyed to their French counterparts the stand of the United States government that France should contribute to the emergence of global consensus solution rather than resorting to unilateral discriminatory measures^{49, 50}. This proposal being in line with the position taken by the State Department as well as United States

⁴⁵ CompTIA Opposes France's Digital Services Tax (DST): [https://www.comptia.org/newsroom/press-releases/2019/09/03/comptia-opposes-france-s-digital-services-tax-\(dst\)](https://www.comptia.org/newsroom/press-releases/2019/09/03/comptia-opposes-france-s-digital-services-tax-(dst))

⁴⁶ European Finance Ministers Should Focus on Global Tax Reform, Not Unilateral Actions: <https://www.cciagnet.org/2018/12/european-finance-ministers-should-focus-on-global-tax-reform-not-unilateral-actions/>

⁴⁷ CCIA Welcomes USTR Conclusion that French Digital Tax Discriminates Against U.S. Tech: <https://www.cciagnet.org/2019/12/ccia-welcomes-ustr-conclusion-that-french-digital-tax-discriminates-against-u-s-tech/>

⁴⁸ US companies fear trade fallout from DSTs : <https://www.internationaltaxreview.com/article/b1h4kvnqd6gc6g/us-companies-fear-trade-fallout-from-dsts>

⁴⁹ Section 301 Investigation Report on France's Digital Services Tax: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf

⁵⁰ US companies fear trade fallout from DSTs : <https://www.internationaltaxreview.com/article/b1h4kvnqd6gc6g/us-companies-fear-trade-fallout-from-dsts>

Treasury should be a welcome move from government perspective. This is also a much-needed mechanism for the government to recoup its revenue losses due to alien acts.

The French government would strongly oppose this proposal. It had refused to heed to reason all along the duration of the events leading to the imposition of the DST. It is also seen that the action of the French government had the backing of all parties of France across spectrum. This is evidenced by the fact that the lawmakers in National Assembly voted 88-7 in favor of the bill to while sending it to the Senate for approval and political consensus that was achieved in the Senate for the imposition of the DST^{51, 52}. France has also warned of a 'strong response' in response to the impending tariffs by US following the release of investigation report by USTR under section 301 of the Trade Act of 1974⁵³. This posturing by France derived further gravity by the reported solidarity of the European Union against imposition of any retaliatory tariffs and endorsing the rights of its member countries to exercise their sovereign right to impose digital taxation on companies in a fair way⁵⁴. Both the French government and the European Union are likely to exert pressure and oppose the move.

⁵¹ France Takes a Step Closer to Making 3 Percent Digital Tax Law:
<https://news.bloombergtax.com/daily-tax-report-international/france-takes-a-step-closer-to-making-3-percent-digital-tax-law>

⁵² France: Update on digital services tax; enactment anticipated:
<https://home.kpmg/us/en/home/insights/2019/06/tnf-france-update-on-digital-services-tax-enactment-anticipated.html>

⁵³ France vows "strong response" to threatened new U.S. tariffs on \$2.4 billion in goods :
<https://www.cbsnews.com/news/france-warns-donald-trump-tariffs-strong-response-european-union-trade-war-today-2019-12-03/>

⁵⁴ Tensions continue over French digital services tax, US tariff threats:
<https://www.taxathand.com/article/12761/European-Union/2020/Tensions-continue-over-French-digital-services-tax-US-tariff-threats>

French companies that do business in the US are another group that is likely to oppose the executive order. They have all along been actively encouraging negotiations to find a mutually acceptable solution⁵⁵. With the extra burden that is going to be placed on them, it is likely that they would resist the order. At the same time, this very group is an effective medium to communicate to the French government about the negative consequences of the unilateral DST. Their difficulties are a potential way of encouraging France to reconsider the decision to impose DST.

The overall sentiment on the unilateral measures by France has been generally negative as is noticed in the public hearings by the USTR with reference to the 301 investigations into the DST by France⁵⁶. The perception that has been conveyed by about 40 and odd witnesses that provided evidence or written submissions has been that such measures are discriminatory and anti competitive. They were also in favor of an appropriate response by United States to stem the tide of unilateral measures by other countries and not just France. Effective communication of the move as a measure to protect the revenue base of the country and also its employment generating companies would add to this support.

Congress, though having no statutory role in the executive order process, could be a necessary player in providing a strong legal support to the order. In theory, the US Congress can always pass a law to override the executive order. However, legislators in both parties in the Senate and House of Representatives have been categorical in condemning the unilateral action by France and expressing concern

⁵⁵ French Companies Urge U.S. to Stop Trade Probe on Digital Tax:
<https://news.bloombergtax.com/daily-tax-report-international/french-companies-urge-u-s-to-stop-trade-probe-on-digital-tax>

⁵⁶ Section-II (B)(3) of the report titled- Inputs from the Public:
https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf

over its adverse impact on US⁵⁷. They have also called for immediate retaliatory action against France if it proceeds to collect the tax from US companies⁵⁸. It is therefore likely that the Congress would support the executive order. In fact, it would be a worthwhile idea to explore the possibility of the passage of an affirming statute by the US congress to reauthorize the President to invoke the Section 891 provisions for protecting US industry from discriminatory treatment. This would provide protection to the Executive Order from the legal scrutiny as to its validity (as mentioned in the policy analysis).

Several options have been put forward by different stakeholders as the possible way(s) for US to respond to the French action⁵⁹. They are as below:

1. Expedite the arrival of a consensus based solution through the OECD;
2. Filing of complaint with WTO;
3. Imposition of retaliatory tariffs;
4. Invoking provisions of Section 891 of the U.S. tax code;

Of these, invoking Section 891 is the best option. Attempting to find a consensus solution through the OECD creates an uncertain future for several of the US taxpayers. The retaliatory tariff option exposes US exports to France to similar response and thus opens up a new area of pain and does not immediately address the issue. It would also have an adverse effect on the US businesses and customers that are dependent on French imports. The WTO dispute path is a long process with no

⁵⁷ LaHood, DelBene Urge Mnuchin and Lighthizer to Protect U.S. Digital Trade Interests: <https://lahood.house.gov/media-center/press-releases/lahood-delbene-urge-mnuchin-and-lighthizer-protect-us-digital-trade>

⁵⁸ Grassley, Wyden Press Mnuchin Over French Government's Proposed Digital Services Tax: <https://www.finance.senate.gov/chairmans-news/grassley-wyden-press-mnuchin-over-french-governments-proposed-digital-services-tax>

⁵⁹ France's digital tax: all about leverage?: <https://www.atlanticcouncil.org/blogs/new-atlanticist/france-s-digital-tax-all-about-leverage/>

certain outcome, while the US companies continue to be subjected to unfair discriminatory tax treatment. In case of almost all these paths, the outcome is contingent upon the decisions of others while the impact is solely on US companies and thus US revenue.

The invocation of Section 891 of the tax code, on the other hand, retains the decision-making authority in the hands of the United States. It also serves as a ready template for action by the government when any country seeks to target US companies unfairly. The basis is already available in the form of investigation by the USTR. There are no provisions similar to section 891 in French Tax Code. This approach would therefore avoid immediate adverse effect on the US businesses.

The proposed executive order would be a perfect showpiece to the policy of the Government that puts America first while also acknowledging its role in the world. It exemplifies the determination of the Government to take tough decisions for the greater interests of the Nation. This would resonate well with the large section of the Republican voter base. This is the key political benefit of this decision. The proposed policy would also ring fence the American MNCs not just from digital economy but in all other sectors also. This would virtually portray a sovereign backing to the industry and would be huge fillip to the confidence of the industry. The industry would therefore welcome the proposal emphatically. This is the primary benefit of the proposed executive order. On the international level the continued threat of retaliation by US would encourage all the countries presently engaged in protracted negotiation under the Inclusive Frame Work of the OECD to quickly arrive at a global consensus solution for tax challenges to the digital economy.

The flip side would be subdued activity by the French Industries in US as well as the FDI from France into US. With \$326.4(2018) billion invested, France is the 6th

largest investor in the US, according to the U.S. Bureau of Economic Analysis (BEA).⁶⁰ The executive order would have a dampening effect on these flows. The Foreign (French) domestic corporations pay taxes to the tune of \$3459 million (2018) to the US treasury. The executive order would increase the rates and thus the gross collections from these companies. However, the subdued economic activity would blunt the growth.

One of the criticisms to the Digital Service Tax has been that it violates the international principles of trade and tariffs as agreed at World Trade Organization (WTO) namely- bound duties, most favored nation (MFN) duties, and non-discriminatory national treatment⁶¹. The proposed executive order is also vulnerable to such allegations. However, without a forceful response, US tech firms, their shareholders, and the US Treasury all would lose out at the expense of foreign countries⁶². This would be a necessary trade off inherent in the order.

Recommendation

A response to the unilateral imposition of DST is necessary to not just put France on notice but also send out a message to all countries that are considering similar legislation. It would also be necessary to ensure that the US taxpayers and US Treasury do not lose out because of unfair tax practices of other countries.

⁶⁰ The United States & France 2019 Economic Report:
https://frenchtreasuryintheus.org/wp-content/uploads/2019/09/2019-France-U.S.-economic_full-report.pdf

⁶¹ How Congress Can Help Overturn the French Digital Tax:
<https://www.piie.com/blogs/realtime-economic-issues-watch/how-congress-can-help-overturn-french-digital-tax>

⁶² How Congress Can Help Overturn the French Digital Tax:
<https://www.piie.com/blogs/realtime-economic-issues-watch/how-congress-can-help-overturn-french-digital-tax>

Issuing an executive order to invoke the provisions of section 891 is a sufficiently forceful and effective response to the French DST. Compared to the alternatives of raising a dispute with WTO or imposing retaliatory tariffs, this path would have faster impact with lesser potential for retaliation both legally as well as under arbitration mechanism under the existing treaties. It also has a positive impact on the pace of discussions at OECD for arriving at a global consensus.

It is easy to issue and also implement. US Treasury can be delegated the responsibility of administering the order through US IRS. With minor changes to tax returns, the IRS would be in a position to implement the decision at low costs. The order would be up for review when there is any change in the French position with regards to DST. Upon a determination by US Treasury of cessation of the discriminatory treatment, the order can be rescinded. The order would raise the stakes for France in proceeding with the DST. Until the time France amends the ways, it would also recoup the losses to US treasury. It is thus a relatively simple yet effective response.

The one likely problem I find with the proposal is the legal challenge to it on the basis that the section 891 is old and the tax treaty with France is new. But I do not think that this challenge would be a difficult one to defend. The provisions of Section 891 empower the President to invoke temporary measures to respond to an unfair situation. It in no way fundamentally alters the equal treatment envisaged in the treaties in a recurring manner. It should therefore succeed in judicial scrutiny. Further, in case such situation is likely to arise, the bipartisan support expressed for a strong response to the French action could be utilized to enact an affirming statute by Congress and preclude the technical challenge.

I also think that the order would resonate well with the consistent stand of the administration in putting America first in its actions. It would reaffirm the determination of the President to take tough actions in all situations that threaten Americans or American interests. As the step is directly related to protecting the US companies and the jobs that they generate by ensuring their profitability, the move would have a positive impact on the companies as well as their large employee base. Given the bipartisan concern expressed against the unilateral actions by France and other countries, the issuance of executive order would also go down well with the US congress too.

Given the urgency to respond and the political considerations surrounding the action proposed, I recommend you to issue an executive order to invoke the provisions of the section 891 of the Tax Code-26 against countries that subject United States citizens or their companies to discriminatory taxes and subject the companies and citizens of such countries to taxation at double the rate applicable for others.

Curriculum Vitae

Neelam Shukla a master's graduate in Economics, is an officer of the Indian Revenue Service with over 19 years of experience of working in the Indian Government in various capacities of tax administration across India. Before moving to Washington DC on leave for study, Neelam's work profile as an Additional Commissioner of Income Tax included performing supervisory role of various statutory and administrative functions. In 2015, Neelam also attended a short-term training course on International Taxation at I.B.F.D Netherland.