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Section 301 Investigations: Foreign Digital Services Taxes (DSTs)

Background

An international debate is occurring over the global taxing rights of revenues and profits earned by multinational corporations (MNCs) in certain "digital economy" sectors. This debate is driven by concerns that these MNCs are not adequately taxed and arguments that the right to tax some of their profits should be reallocated from the jurisdiction where the MNC claims residence to the jurisdiction where their customers are located.

Some countries have imposed unilateral digital services taxes (DSTs) on the gross revenues earned by digital economy MNCs. These taxes target certain MNC digital transactions with domestic businesses or online activities directed ultimately towards domestic users, even if the corporation does not have a physical presence in the country. The Trump Administration and others contend that, based on their design, many of these DSTs effectively target large U.S. MNCs disproportionately to other firms. In addition, some observers argue that the proliferation of such unilateral measures could undermine basic principles of the current international taxation system.

Meanwhile, at the international level, more than 130 countries, comprising both members and non-members of the Organisation for Economic Cooperation and Development (OECD), are negotiating policy recommendations in an attempt to develop an international digital tax framework. The OECD Secretariat announced its intent to conclude these negotiations by the end of 2020, although there are doubts about the feasibility of this timeline due to the Coronavirus Disease 2019 (COVID-19) pandemic.

Despite ongoing negotiations at the OECD, some countries, particularly in Europe and Asia, have proposed, announced, or implemented DSTs. France's DST—by far the most controversial—was the subject of a 2019 investigation by the U.S. Trade Representative (USTR), under Section 301 of the Trade Act of 1974. More recently, the USTR launched a new investigation into the implemented or proposed DSTs of 10 other U.S. trading partners.

Overview of Section 301

Title III of the Trade Act of 1974 (Sections 301-310, codified at 19 U.S.C. §§2411-2420), titled "Relief from Unfair Trade Practices," is often collectively referred to as "Section 301." It grants the USTR a range of responsibilities and authorities to impose trade sanctions on foreign countries that violate U.S. trade agreements or engage in acts that are "unjustifiable," "unreasonable," or "discriminatory" and burden U.S. commerce. Prior to 1995, the United States used Section 301 to unilaterally pressure other countries to eliminate trade barriers and open their markets to U.S. exports. The creation of an enforceable dispute settlement mechanism in the World Trade Organization (WTO), strongly supported at the time by the United States, significantly reduced the use of Section 301.

The United States retains the flexibility to determine whether to seek recourse for foreign unfair trade practices in the WTO or under Section 301. The Statement of Administrative Action (SAA)—which explained how U.S. agencies would implement the 1994 Uruguay Round Agreements Act (URAA or "WTO Agreements")—states that the USTR will invoke the dispute settlement procedures of the WTO Dispute Settlement Understanding (DSU) for investigations that involve an alleged violation of (or the impairment of U.S. benefits under) WTO Agreements. At the same time, the SAA makes clear that "[n]either section 301, nor the DSU will require the" USTR to do so if it "does not consider that a matter involves" WTO Agreements. Such a determination appears to be solely at the USTR's discretion. However, the USTR's decision to bypass WTO dispute settlement and impose retaliatory measures (if any) in response to a Section 301 investigation, may be challenged at the WTO.

France's Digital Services Tax

France enacted a DST formally on July 24, 2019. The DST applies retroactively to digital services revenue as of January 1, 2019, and is a 3% levy on gross revenues derived from two digital activities of which French "users" are deemed to play a major role in value creation: (1) intermediary services, and (2) advertising services based on users' data. The law excludes certain services, including digital interfaces for the delivery of "digital content." The DST applies only to companies with annual revenues from the covered services of at least €750 million ($847 million) globally and €25 million ($28 million) in France. Covered companies are required to calculate revenues attributable to France (and, therefore, covered by the DST) using formulas specified in the law.

Section 301 Investigation

In its investigation, initiated on July 10 and completed on December 2, 2019, the USTR ultimately concluded that France's DST discriminates against major U.S. digital companies and is inconsistent with prevailing international tax policy principles. On December 6, 2019, the USTR issued a preliminary list of products from France, with an estimated 2018 import value of $2.4 billion, on which to impose additional tariffs of up to 100%. The agency sought comments on the proposed action, convened a hearing, and accepted post-hearing rebuttal comments, after which it would be generally required to make a final determination.

At the end of January 2020, France suspended its DST for the remainder of 2020 and agreed to continue working with the United States at the OECD to reach a compromise on international digital taxation. News outlets have reported that Section 301 tariffs will not be imposed on U.S. imports from France while countries work on the deal, but the

USTR has not made any official announcements. There are specific timelines to take action under Section 301, but waivers provide flexibility, especially if the USTR determines that substantial progress is being made, or that a delay is necessary or desirable to obtain a satisfactory solution to the issue.

New Section 301 Investigation

On June 2, 2020, the USTR launched a new Section 301 investigation into the DSTs adopted or under consideration by Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey, and the United Kingdom (see **textbox**). The USTR also requested consultations with the governments of these jurisdictions.

As part of the investigation, the agency may seek to address several issues, including:

- Are the taxes discriminatory and do they burden or restrict U.S. commerce? Are these jurisdictions unfairly targeting the taxes at certain U.S. firms?
- What are the implications of applying the taxes retroactively? Some taxes are (or will be) applied retroactively, raising administrative and legal questions as to how firms will be able to calculate their potential liabilities.
- Is the tax policy "unreasonable"? The USTR has indicated that these DSTs appears to diverge from norms reflected in U.S. and international tax systems, particularly because of their extraterritorial scope and their taxing of revenue instead of income.
- Are the DSTs inconsistent with international commitments and obligations under the WTO or other agreements?
- Does the WTO General Agreement on Trade in Services (GATS) cover digital trade? If so, the USTR may invoke the dispute settlement procedures of the WTO DSU.

Outlook

If an agreement is not reached at the OECD in the near term, and the USTR determines that the DST of any countries under investigation is unreasonable or discriminatory and burdens or restricts U.S. commerce, the USTR could seek to negotiate and enter into a binding agreement that commits these trading partners to eliminate the tax policy or that provides compensation to the United States. Absent mutual resolution, some analysts have indicated that the most likely scenario would be the imposition of tariffs and the escalation of tensions in U.S. economic relations with these trading partners. Should the United States impose retaliatory trade measures, the affected parties could pursue WTO dispute settlement or retaliate by targeting U.S. exports.

CRS Resources

- CRS In Focus IF11346, *Section 301 of the Trade Act of 1974*, by Andres B. Schwarzenberg.
- CRS Report R45532, *Digital Services Taxes (DSTs): Policy and Economic Analysis*, by Sean Lowry.
- CRS In Focus IF10770, *Digital Trade*, by Rachel F. Fefer.

DSTs Under Investigation

Adopted

Austria. Adopted a 5% tax on revenues from online advertising services. It applies to companies with at least €750 million ($847 million) in annual global revenues for all services and €25 million ($28 million) in in-country revenues for covered services.

India. Adopted a 2% tax that only applies to nonresident companies, and covers online sales of goods and services to, or aimed at, persons in India. The tax applies to companies with annual revenues in excess of approximately INR 20 million ($265,000).

Indonesia. Adopted a 10% value-added tax on digital products and services provided by non-resident companies with a "significant economic presence" in the Indonesian market, including music and video streaming services, applications, and digital games. It will be effective July 1, 2020.

Italy. Adopted a 3% tax on revenues from targeted advertising and digital interface services. The tax applies to companies generating at least €750 million ($847 million) in global revenues for all services and €5.5 million ($6 million) in in-country revenues for covered services.

Turkey. Adopted a 7.5% tax on revenues from targeted advertising, social media, and digital interface services. The tax applies to companies generating €750 million ($847 million) in global revenues from covered digital services and TRY 20 million ($3 million) in in-country revenues from covered digital services. The Turkish President has authority to increase the tax rate up to 15%.

Under Consideration

Brazil. Considering a 1% to 5% tax (to be levied progressively) on revenues from targeted advertising and digital interface services. It would apply to companies generating at least BRL 3 billion in annual global revenues and at least BRL 100 million ($21 million) in in-country revenues for covered digital services.

Czech Republic. Considering a 7% tax on revenues from targeted advertising and digital interface services. It would apply to companies generating €750 million ($847 million) in annual global revenues for all services and CZK 50 million ($2 million) in in-country revenues for covered services.

European Union. Considering a DST as part of the financing package for its proposed COVID-19 recovery plan. It is based on a 2018 DST proposal that: (1) included a 3% tax on revenues from targeted advertising and digital interface services, and (2) would have applied only to companies generating at least €750 million ($847 million) in global revenues from covered digital services and at least €50 million ($56 million) in EU-wide revenues for covered services.

Spain. Considering a 3% tax on revenues from targeted advertising and digital interface services that would apply to companies generating at least €750 million (847 million) in global revenues for all services and €3 million ($3 million) in in-country revenues for covered services.

United Kingdom. Considering a DST proposal as part of its Finance Bill 2020. It would be a 2% tax on revenues above £25 million to internet search engines, social media, and online marketplaces. The tax would apply to companies generating at least £500 million ($640 million) in global revenues from covered digital services and £25 million ($32 million) in in-country revenues from covered services.

Source: Adapted from Office of the USTR, 85 FR 34709 (June 6, 2020).

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