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France's proposed digital tax leads to spat with the U.S.

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French President Emmanuel Macron is likely to sign into law a 3 percent tax on certain digital services. Referred to as the "GAFA" tax, it would affect large tech companies, like Google, Apple, Facebook and Amazon. France estimates the tax would raise about €500 million annually.

The U.S. has raised objections to the French proposal, alleging the tax would unfairly target U.S. companies. Shortly after the French Senate passed the tax law, the U.S. opened a Section 301 investigation into the tax at the Office of the U.S. Trade Representative. This is the same type of investigation used to set tariffs on Chinese goods.

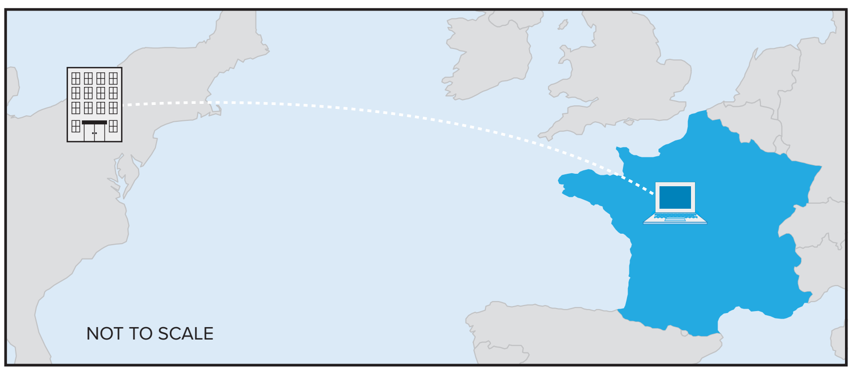
Critics: Taxing companies without physical presence 'contravenes' principle of permanent establishment

Article 5 of the OECD's Model Tax Convention outlines the principle of permanent establishment, which gives countries the right to tax businesses physically located within their borders. Digital taxes have been contentious because they often run counter to permanent establishment by taxing foreign companies that provide digital services without a physical presence in the country. Although the Convention is nonbinding, opponents of the French proposal argue France does not have a right to tax these companies; that right would instead belong to the countries where the company is headquartered.

The French proposal "contravenes the 'permanent establishment' principle," wrote Gary Clyde Hufbauer of the Peterson Institute for International Economics in a blog post, who added that the measure "will result in double taxation and discourage the spread of digital commerce."

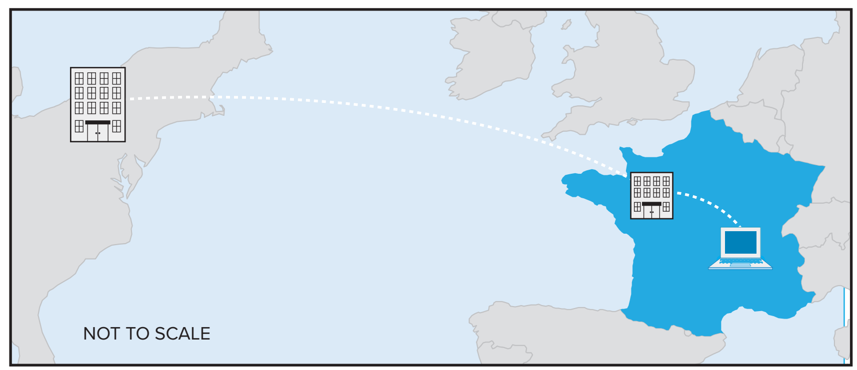
According to Article 5 of the OECD's Model Tax Convention on permanent establishment:

No physical presence where sale occurs: Not subject to income tax



A U.S. business completes a transaction, such as placing a targeted ad or selling data. Under the permanent establishment principle, the transaction **would not be taxable in France** because the company does not have a physical presence there.

Physical presence where sale occurs: Subject to tax

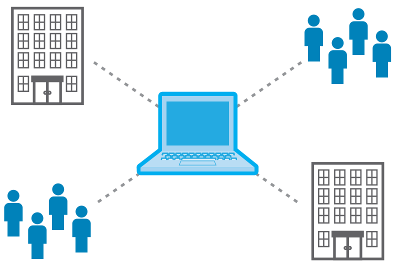


A French affiliate of a U.S. business provides the same service. Under the permanent establishment principle, the transaction **would be subject to French tax**, because there is a physical presence in France.

Sources: Government of France, USTR, OECD, European Commission, Tax Foundation, POLITICO staff reports, The New York Times, The Wall Street Journal, The Guardian, Forbes, Rödl & Partner, Ernst & Young, PwC, KPMG

The French law would tax three specific digital services:

Companies with more than €750 million in total annual revenue, and more than €25 million in annual revenue in France, would be subject to the tax.



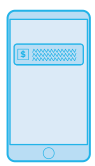
Intermediation services that connect businesses with consumers, businesses with businesses or consumers with consumers

Targeted advertising and advertising placement that is directed to users in France

Sales of data on users located in France

Digital services that would not be subject to the French tax:

Online sales of goods and services



Messaging and payment services

Advertising that is based on site content and that is identical for all internet users

Sales of data not collected via the internet, or for purposes besides ads

Regulated financial services

Sources: Government of France, USTR, OECD, European Commission, Tax Foundation, POLITICO staff reports, The New York Times, The Wall Street Journal, The Guardian, Forbes, Rödl & Partner, Ernst & Young, PwC, KPMG

USTR investigation will assess if tax discriminates against U.S. companies

In a press release announcing the Section 301 investigation, USTR Robert Lighthizer said the U.S. was “very concerned” that the tax “unfairly targets American companies.” Section 301 investigations assess whether a trade practice by a foreign country is unfair or unfairly targets U.S. businesses. According to the Forbes Global 2000, a Forbes report on the largest publicly traded companies in 2019, nine of the 12 largest tech companies in the world are headquartered in the U.S. Several of these companies would be affected by the proposed tax.

According to Hufbauer, a separate part of the French measure adds weight to the charge that the tax would discriminate against U.S. firms: Criteo, a French firm that provides services that would be taxed under the new law, would be exempted from the tax. “With this amendment, the tax is discriminatory on its face, flatly contradicting France’s obligation to ensure national treatment of foreign digital firms” under the WTO agreement on trade in services, Hufbauer wrote.

Largest publicly-traded tech companies, Forbes 2000

OVERALL RANK AND COMPANY	HQ	MARKET VALUE, U.S. DOLLARS
6. Apple	**U.S.**	**$961B**
13. Samsung	S. KOREA	$272B
16. Microsoft	**U.S.**	**$947B**
17. Alphabet	**U.S.**	**$863B**
28. Amazon	**U.S.**	**$916B**
44. Intel	**U.S.**	**$263B**
59. Alibaba	CHINA	$481B
60. IBM	**U.S.**	**$125B**
63. Facebook	**U.S.**	**$512B**
74. Cisco	**U.S.**	**$248B**
74. Tencent	CHINA	$472B
92. Oracle	**U.S.**	**$186B**

Forbes’ ranking is based on a composite score of revenue, profits, assets and market value. Note that Forbes categorizes Amazon and Alibaba in the retail sector, but are included here. Cisco and Tencent are tied at 74.

Sources: Government of France, USTR, OECD, European Commission, Tax Foundation, POLITICO staff reports, The New York Times, The Wall Street Journal, The Guardian, Forbes, Rödl & Partner, Ernst & Young, PwC, KPMG

What's next: Without international reform, 'other nations are likely to follow suit'

At the July meeting of G-7 finance ministers in Chantilly, France, the G-7 announced a plan to develop a blueprint for digital taxes and a global minimum corporate rate. The OECD, which comprises a larger group of countries, will now work to develop the blueprint.

In the interim, it appears France may move forward with its digital tax. At a G-7 press conference, French Finance Minister Bruno Le Maire said "the French position is that France will withdraw its digital taxation if there is an international decision by the end of 2020, as soon as there will be a credible international decision, then France will drop its French digital taxation."

This is in line with France's position at the start of the meeting: at that time, Le Maire told the Guardian that France would only back down if there was an international consensus on a digital tax.

The July announcement follows a similar May announcement from the OECD. The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting working group agreed to a road map to address the same issues as the G-7 plan.

Meanwhile, support has risen across Europe to set a digital tax. On July 16, European Commission President Ursula von der Leyen — then a nominee — said that if digital firms "want to benefit" from public services, "they have to share the burden." Countries including the U.K., are also considering their own digital taxes.

International coordination on a digital tax could reduce tax avoidance, while discord could make it easier to shield income from taxes. It could also increase the cost of complying with international tax law.

"France's planned tax is a clear warning: Unless a broad consensus can be reached on reforming the international tax system, other nations are likely to follow suit, and American companies will face a cascade of different taxes from dozens of nations that will prove onerous and costly," wrote Professor Lilian Faulhaber of Georgetown University Law Center, in The New York Times.

Sources: Government of France, USTR, OECD, European Commission, Tax Foundation, POLITICO staff reports, The New York Times, The Wall Street Journal, The Guardian, Forbes, Rödl & Partner, Ernst & Young, PwC, KPMG