Before the

Office of the United States Trade Representative

Washington, D.C.

In re: Initiation of Section 301 Investigations of Digital Services Taxes	Docket No. USTR-2020-0022

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Comments of Engine Advocacy

Engine Advocacy respectfully submits the following comments to the Office of the United States Trade Representative, pursuant to USTR's request for comments as published in the Federal Register at 85 Fed. Reg. 34709 on June 5, 2020.

I. Introduction

Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship. To that end, Engine welcomes U.S. scrutiny of international taxation regimes that have the potential to disproportionately affect U.S. digital firms—particularly startups. The patchwork of digital services taxes under review could harm the U.S. economy and lead to a downturn in startup activity and growth, potentially imposing additional costs on small businesses and presenting complex issues of compliance. Engine recognizes that the growth of the digital age has brought forth a need to reassess international tax frameworks as they pertain to the digital economy through a collaborative effort. But a country-by-country compilation of taxes that largely and discriminatorily target American companies is not the way to accomplish this goal, nor are the taxes generally consistent with prevailing international tax principles.

II. The Burden on the U.S. Economy and Startup Ecosystem from Digital Services Taxes

The digital services taxes (DSTs) from the jurisdictions under consideration (Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey, and the United Kingdom) will undoubtedly have a significant impact on the U.S economy, with a likely trickle-down effect on startups. Moreover, the jurisdictions under review represent just a fraction of those developing DSTs, as dozens of jurisdictions have proposed or implemented direct taxes on the digitalized economy.[1] Some of these DSTs are similar in nature to the French DST previously under 301 investigation, while others diverge in structure and scope of application.[2] The COVID-19 pandemic could further encourage jurisdictions to implement these taxes. Engine remains concerned that the current economic uncertainty will cause countries to lower the thresholds triggering DSTs, ensnaring a broader swath of American digital companies.

Small businesses and startups are the lifeblood of the American economy and are huge drivers of U.S. job growth.[3] While most of the DSTs under investigation—with certain exceptions—generally target high revenue companies, these taxes do not exist in a vacuum. The DSTs, discriminatorily geared at American companies, are likely to result in significant downstream costs on the small businesses and consumers that use digital services. Because these companies provide digital services important to nascent startups, like those that allow startups to reach new audiences and host critical computing tools in the cloud, startups will likely face rising

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[1] KPMG, Taxation of the Digitalized Economy (June 26, 2020), available at: https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.

[2] Id.

[3] U.S. Small Business Administration Office of Advocacy, 2019 Small Business Profile, available at: https://cdn.advocacy.sba.gov/wp-content/uploads/2019/04/23142719/2019-Small-Business-Profiles-US.pdf.

fees for the traditionally inexpensive tools they need to grow. Preliminary studies of the French DST indeed indicated that large digital companies will not primarily bear the impact of the tax—rather, the cost of the tax will be passed both to the consumer and to businesses operating in the digital marketplace.[4] As Engine previously indicated in comments to USTR, one study by Deloitte and Taj on the French DST determined that only five percent of the tax burden would impact the large firms directly subject to the tax; the rest of the burden will fall on consumers and businesses using their services at 55 percent and 40 percent respectively.[5] It only stands to reason that DSTs implemented by other jurisdictions will have a similar effect, but on a broader scale. Moreover, enacting more DSTs will not only cause an increase in the cost of services to offset the cost of taxes themselves, but the large patchwork of taxes will also result in an administrative burden that could further inflate the cost of services offered to consumers.

Upon completing the 301 investigation into the French Digital Services Tax, USTR found that the DST was in fact discriminatory, unreasonable, and burdensome.[6] With the exception of Indonesia and India, the jurisdictions currently under investigation have implemented—or are considering implementing—DSTs that closely resemble the tax implemented by the French government. The taxes themselves cover the provision of similar services by large digital companies, and effectively exclude domestic companies through carve outs or both global and in-country revenue thresholds that trigger the taxes. While some domestic companies that provide similar or identical services to the companies targeted may hit the in-country revenue threshold, it is less likely that these local companies will reach the global revenue threshold—thereby limiting taxation to mostly foreign companies. Moreover, the USTR report on the French DST further indicated that French officials referred to both the French DST and the EU proposal as a "GAFA tax" (Google, Apple, Facebook and Amazon)—highlighting the discriminatory intent of some DSTs. Because many of the DSTs under investigation closely resemble the French DST, and because officials from jurisdictions in these investigations have made similar statements indicating an intent to target U.S. companies, they too would share a discriminatory effect.

While implementing a discriminatory tax on large American companies in itself poses the possibility of significant harm to the United States, DST proponents neglect to acknowledge the potential impact these taxes will have on small- and mid-sized companies. As Engine noted in its comments to USTR on its investigation into the French DST, "many of the companies Engine works with launch with thin margins and almost insurmountable challenges, beginning with accessing enough capital to get off the ground, providing and expanding services to consumers, and finding new revenues and funding to grow their business in the process."[7] These companies rely heavily on the low-cost services provided by large, American digital companies—the exact companies that were targeted by the French DST and are similarly being targeted by the jurisdictions under the current 301 investigation. For example, services that allow startups to connect with consumers are integral to their success and generate a lot of value for companies

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[4] Deloitte, Taj, *The French Digital Services Tax: An Economic Impact Assessment* (2019), available at: https://taj-strategie.fr/content/uploads/2020/03/dst-impact-assessment-march-2019.pdf.
[5] Id.
[6] Office of the U.S. Trade Representative, Report on France's Digital Services Tax (December 2, 2019), available at: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf.
[7] See Engine's comments to the USTR regarding their 301 Investigation of the proposed French Digital Services Tax, available at: http://engine.is/s/Engine-Comments-USTR-France-DST.pdf.

with thin margins or small bank accounts. The added cost of the tax, which will be passed onto the consumers of covered services, could eliminate startups' ability to use covered services at all, and could serve to limit competition and hamper innovation.

Other taxes currently under investigation, like India's expansion to its equalization levy, pose different potential risks to American startups. The equalization levy applies to the sale of goods and services to individuals in India, or with Indian ISPs, by non-resident e-commerce operators.[8] The Indian levy targets companies with a much lower revenue threshold—around $267,000. Many small- and mid-sized startups could be exposed to liability under the levy because of this threshold. Moreover, as the lower revenue threshold exposes a greater number of small American companies to the levy, many of these startups will have to undertake costly tax planning to determine if they in fact owe tax, what their tax burden is, how to remit the tax.[9] And, because DSTs are not income tax, it could result in companies not receiving credit for payment of the tax in their home countries.[10] Indonesia, on the other hand, has instituted measures shielding domestic companies—including an electronic transaction tax on e-commerce activities carried out by non-resident companies or individuals[11] with a significant economic presence in Indonesia. Significant economic presence will be determined by a number of factors, including "gross circulated product, sales and/or active users in Indonesia," and could ensnare a number of U.S. companies.[12] Alternatively, the Austrian DST—while similar in nature to that of France—goes one step further in favoring domestic companies by funneling 15 million Euros generated by the tax to Austrian media companies—effectively the competitors of taxed companies.[13]

III. The DSTs are Discriminatory, Overly Burdensome, and Run Afoul of Prevailing International Taxation Principles

Like USTR determined in its investigation of the French DST, the design of the DSTs similar to that enacted by France, and those of Indonesia and India, are discriminatory in nature. As previously stated, the revenue thresholds for covered activities of many of the taxes are designed to specifically exclude most domestic companies—those of India and Indonesia expressly apply to non-resident companies and are facially discriminatory. These discriminatory frameworks create the potential for domestic businesses to grow and thrive at the expense of American companies, including startups. Though many American startups do not currently fall

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[8] KPMG, *India: Digital taxation, enlarging the scope of "equalisation levy,"* (March 24, 2020), available at: https://home.kpmg/us/en/home/insights/2020/03/tnf-india-digital-taxation-enlarging-the-scope-of-equalisation-levy.html.

[9] Surabhi Agarwal, Big Tech takes Equalization Levy Row to U.S. Govt (April 1, 2020) available at: https://economictimes.indiatimes.com/tech/internet/big-tech-takes-equalisation-levy-row-to-us-govt/articleshow/74922783.cms?from=mdr.

[10] Id.

[11] Eisya A. Eloksari, Indonesia taxes tech companies through new regulation (April 1, 2020), available at: https://www.thejakartapost.com/news/2020/04/01/indonesia-taxes-tech-companies-through-new-regulation.html and KPMG, Taxation of the Digitalized Economy, *supra* note 1.

[12] Elokasari, *supra* note 11.

[13] KPMG, *Austria: Legislation introducing digital services tax* (Oct. 29, 2019), available at: https://home.kpmg/us/en/home/insights/2019/10/tnf-austria-legislation-introducing-digital-services-tax.html.

within the revenue scopes outlined within the DSTs, the taxes do not operate in isolation—these taxes are anti-growth and will likely "increase costs on some of our country's fastest-growing and most innovative companies."[14] Moreover, the revenue thresholds themselves serve as a cliff, possibly disincentivizing growth for those startups nearing the thresholds. Companies may be reluctant to pass the revenue thresholds to avoid the need to completely overhaul their tax systems in order to comply with a convoluted web of foreign digital services taxes.

Furthermore, the DSTs run afoul of prevailing international tax principles on multiple fronts. Not only will the DSTs likely result in countries passing the tax burden on to their users through increased costs for services, but taxing revenue as opposed to profit disregards prevailing international tax principles,[15] and threatens to ensnare companies that have high revenues but low profit margins. One study found that a three percent tax on the revenue of a company with a five percent profit margin amounted to a corporate tax rate of 60 percent.[16] Companies with high revenue but low profit will be forced to pass an even greater percentage of the tax on to their consumers, limiting their competitiveness in the marketplace,[17] and possibly forcing companies to shutter their doors completely. Moreover, these taxes compound existing tax liabilities that targeted companies already face within the jurisdictions in question. Some aspects of the DSTs under investigation also run afoul of prevailing international tax principles because they are retroactive. Like the French DST, the Italian and UK DSTs are retroactive. Retroactivity presents a huge administrative and compliance burden, and limits the ability of affected companies to effectively plan and prepare for a levy. Many affected companies were likely not tracking the revenues to calculate their new tax burden prior to implementation, and all businesses will have to determine which revenue falls within the scope of the tax. This is further complicated by the tax's retroactivity.[18] Moreover, as Engine previously noted in its comments to USTR concerning the French DST, "even in instances where tax is owed, that liability could still be dwarfed by the cost of determining the liability itself. Furthermore, it would be irresponsible not to consider the fact that if the large companies targeted by the tax pass the tax through to its customers and consumers, they will do the same thing with the tax's compliance burden."[19] This would further limit market entry and make it even more difficult for startups to expand their customer base.

The DSTs under investigation are also unduly burdensome—not just for firms that clearly fall within the scope of the taxes, but for those firms that are uncertain as to whether they are subject to the taxes. The growing number of jurisdictions implementing DSTs means that companies will have an enormous administrative burden in determining liability in multiple jurisdictions. The same companies may face similar liability across DSTs, with the same revenue taxed at different rates across many jurisdictions. While Engine recognizes that we are living in an increasingly digital world and international taxation frameworks should be re-examined in

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[14] Engine, *supra* note 7.
[15] Office of the U.S. Trade Representative, Report on France's Digital Services Tax (December 2, 2019), available at: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf.
[16] Matthias Bauer, European Center for International Political Economy, *Five Questions about the Digital Services Tax to Pierre Moscovi* (June 2018), available at:
https://ecipe.org/publications/five-questions-about-the-digital-services-tax/
[17] Id.
[18] Daniel Bunn, The Tax Foundation, *France's Digital Services Tax: Facts and Analysis* (March 11, 2019), available at: https://taxfoundation.org/france-digital-services-tax/
[19] Engine, *supra* note 7.

light of the digital economy, a patchwork approach will only benefit other nations' treasuries and push steep, unforeseen costs onto the U.S. startup ecosystem. Any approach taken to tax the digital economy should conform to prevailing international tax principles and most certainly should be nondiscriminatory.

Finally, while much is said about how DSTs are generally unfair to large American firms, we should also consider the potential long-term effects of these taxes on small businesses. For example, as the COVID-19 pandemic continues to wreak havoc on economies across the globe, will countries begin to push lower revenue thresholds for their DSTs? How will the taxes affect American companies that are too small to be captured now, but might be subject to the taxes in the future? What about mergers and acquisitions? Startups are inherently risky ventures that often generate little profit in their early stages, when founders choose to invest all or most of their revenues back into the company. Mergers and acquisitions represent a promising exit strategy to help offset some of the risks inherent to funding a startup. The merger of two startups, however, could take a company over the threshold and subject it to DSTs. Is this potential burden enough to dissuade larger companies from engaging in mergers or acquisitions? As Engine previously argued to USTR, "it is not irresponsible to assume that, like the U.S.'s corporate Alternative Minimum Tax did, and the estate tax does now, it will force businesses into complicated, burdensome, and expensive tax planning in order to avoid the tax. That could further distort incentives and divert capital away from research and other growth opportunities to tax planning. Taxes are powerful disincentives and negative motivators."[20]

II. Conclusion

Engine thanks the Office of the United States Trade Representative for their efforts to address discriminatory digital services taxes. We thank USTR for the opportunity to submit these comments pertaining to the economic impact of digital services taxes, and—specifically—to provide insight into their potential effect on America's startups. If there are any further questions, please contact Engine at the address below.

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[20] Id.