Initiation of a Section 301 Investigation
of France's Digital Services Tax – Written Submission
[Docket No. USTR–2019–0009]

To the Honorable Members of the Section 301 Committee,

Brussels, August 18th 2019,

Madame, Sir,

Following the invitation published on July 16th 2019 by the Office of the U.S. Trade Representative for public input on the French Digital Service Tax (hereinafter referred to as the French DST or DST when not linked to France in particular), this submission is sent to you.

1. As a Belgian citizen I comment on this subject since effective trade sanctions between France and the U.S. following the introduction of the French DST would further dissolve the international trade network that was put in place after the ending of the Second World War. Where first applied within Europe as a free trade union on coal and steel, giving birth to the European Union as we know it today, the main purpose is and was to avoid a new war on the European Continent. That goal has been achieved for the western part of Europe. On the level of the world global trade was also applied to maintain peace and so far, no major conflict erupted. Policies on free trade are a vaccine against war or a medication that lower the temperature when tensions heat up. Effective trade sanctions should therefor remain an ultimate tool after giving negotiations conducted in good faith time to present an alternative.

By the submitted arguments I hope to enhance comprehension of the French DST. Under the angles of both international tax law and U.S. domestic tax law I hope to incite finding common grounds for fair apportionment of taxable income US companies obtain from digital activities that sort effects in a market jurisdiction such as France.

2. In summary, the submission considers that both countries have valid interests they seek to protect and presents options that may help in finding a middle-ground.

The **US** is rightfully concerned that when the French DST is applied as a model under the current criterions, it will be considered as a precedent for countries all over the world to start taxing US digital companies under DST's with criterions that only or mainly apply to these US based companies. In addition, the cumulated effect of all these future DST's may lead to over-taxation on these digital activities and so force certain US digital companies to no longer providing their services in certain territories.

The submission recognizes these concerns as legitimate and suggests criterions for guidelines as to avoid over-taxation that the US government can request when countries consider adopting DST's or digital permanent establishments. In exchange for respecting these U.S.

criterions, no investigation on trade sanction will be considered by the U.S. administration when these guidelines are applied in good faith by that country.

France seeks rightfully to amend tax distortion and/or location savings distortion through digital activities on its national territory that heavily rely in their business model on user-input and user-date of French tax residents. These digital activities had already a significant effect in France by supplanting existing business models (such as video stores, music shops, ordering clothes or other goods instead of buying them in shopping centers where they are exposed etc..) that provoked bankruptcies, unemployment and costs to form the unemployed again for skills in the digital era. While suffering in the meantime loss of corporate income tax from the supplanted business models, without being able to submit the profits of these new types of businesses to corporate income tax to amend for these costs and loss of income. This loss is suffered by the choice of these enterprises to avoid or not the simple lack of use of a physical presence. No permanent establishment exists so in France when conducting their business.

Digital enterprises that are resident in France or have a permanent establishment in France are taxed on profits they make out of their digital business in France at a CTR-rate of 31 % on profits that exceed 500.000 EUR and 28 % on the first 500.000 EUR reported profits. The French DST is a temporary measure while awaiting a solution on the international level for taxing intangible activities. It taxes turnover on allocated income at a 3 % rate. One could consider this effect as equal to a presumed profit margin of 10 % on turnover of digital business conducted in France at a CTR rate of 31 %.

The new sections III to V under article 177.A of the Code general des impôts (similar to the US Internal revenue code) organizes the obligation for the French government to monitor and report yearly to the French parliament the progress made on the international forum on closing this loophole. The French DST is so primary intended as to lessen the effects on the national budget of a loophole in corporate taxation through new types of businesses that no longer require a physical presence through their intangible nature. It singles out those activities that uses resources that are considered as national such as data and input of resident users. It exonerates certain types of activities when that type of activity is organized under European Union law and Member states such as French can no longer fully exert sovereign powers of taxation on them for various reasons.

3. The submission considers these concerns also as legitimate and points out that since October 2018 France has the possibility to adopt a digital permanent establishment and allocate profits to it. Under this angle the French DST can be considered as already outdated and a recognition of the U.S. administration of this new international law on the U.S.- French DTT (Double Tax Treaty) may set a worldwide standard on digital permanent establishments that allow digital companies to regain tax certainty in their financial planning. Logically, having so received a solution to that loophole in international taxation, the French DST would have to be lifted.

If this approach is considered by the U.S. administration, it may prove on the long run in the best interest of the **US digital companies** to benefit from the protection of double tax treaties rather than arbitrarily allocated gross income by various countries through DST's or digital permanent establishments. Adopting this approach also enhances qualifying DST as a direct income tax under Article 2 OECD MTC when criterions of *income* rather than size of the *digital activity* itself are considered for qualifying such DST taxpayers.

This may be a preferable scenario then decades of uncertainty while awaiting the outcome of litigations before national tax judges or WTO arbitration. It may avoid escalation of trade sanctions that may result over time in no substantial tax base that is left to fight over. **Maintaining the ability to make profit should be always prioritized in the best interest of the companies that are concerned over how to divide parts of that profit between countries.**

4. The submission will first point at recent case-law on both sides of the Atlantic Ocean that relates to the question if taxing turnover of digital activities without physical presence is to be considered as (un)reasonable under the angles of fairness or equity. This case law is also relevant for the question if the French DST is to be considered as discriminatory or not.

Before addressing the questions for public input, the submission will point out recent developments on the level of the United Nations that allow since October 2018 to define digital permanent establishments without the need for prior formal changes into the existing tax treaties.

A. Recent developments in taxing digital activities.

A.1. US Case-law on fairness in taxing business in general and without a physical presence in particular.

5. Considerations on equity on taxation of business in general were made in a ruling of the Supreme Court of the United States (hereinafter SCOTUS) of 18 may 2015 in the case *Comptroller of the Treasury of Maryland v. Wynne* [1]. This ruling pointed out **that corporations benefit from general services when conducting their business** (p. 13) :

> *"Attempting to explain why the dormant Commerce Clause should provide less protection for natural persons than for corporations, petitioner and the Solicitor General argue that States should have a free hand to tax their residents' out of state income because States provide their residents with many services. As the Solicitor General puts it, individuals "reap the benefits of local roads, local police and fire protection, local public schools, [and] local health and welfare benefits." Brief for United States as Amicus Curiae 30.*
>
> *This argument fails because corporations also benefit heavily from state and local services. Trucks hauling a corporation's supplies and goods, and vehicles transporting its employees, use local roads. Corporations call upon local police and fire departments to protect their facilities. Corporations rely on local schools to educate prospective employees, and the availability of good schools and other government services are features that may aid a corporation in attracting and retaining employees. Thus, disparate treatment of corporate and personal income cannot be justified based on the state services enjoyed by these two groups of taxpayers."*

These considerations considerably widen the notion of (horizontal) equity between both resident and non-resident enterprises gaining income in the same territory on the one hand

[1] http://www.supremecourt.gov/opinions/14pdf/13-485_o7jp.pdf

and national residents and enterprises on the other hand in sharing the costs for providing benefits to conduct business in that territory.

A non-resident company that sends goods uses public infrastructure. A non-resident company that offers digital services uses public or semi-public infrastructure that relates to electricity that is produced and transported to the user's home. Also, telecom operators are paid for by the user to have access to the internet and may use public infrastructure in the source country. When applying this ruling non-resident companies can be requested under the criterion of (horizontal) equity to participate in costs of several public services provided for by the source country.

6. Gross receipts can be a tax base between States of the United States under this ruling (p. 11 and 12 of the ruling : .. *The discarded distinction between taxes on gross receipts and net income was based on the notion, endorsed in some early cases, that a tax on gross receipts is an impermissible "direct and immediate burden" on interstate commerce, whereas a tax on net income is merely an "indirect and incidental" burden*. (..) *And we have now squarely rejected the argument that the Commerce Clause distinguishes between taxes on net and gross income.*).

Why do these consideration of equity between States of the United States cannot be invoked by third countries for addressing similar effects they suffer from digital activities occurring on their territory ? Where article 7 OECM MTC uses the criterion of profits a permanent establishment may be expected to make, formulary apportionment methods such as profit margins of the gross receipts are an accepted tool to allocated profits under article 7 OECD MTC to a permanent establishment.

7. In the SCOTUS ruling of 21 June 2018 in the case *State of South Dakota v. Wayfair*[2] it is considered that physical criterions of presence for granting rights to tax turnover of digital activities has become **unfair** between States of the United States :

- On the criterion of digital presence (p. 15 of the ruling) :

  "*But it is not clear why a single employee or a single warehouse should create a substantial nexus while "physical" aspects of pervasive modern technology should not. For example, a company with a website accessible in South Dakota may be said to have a physical presence in the State via the customers' computers. A website may* ***leave cookies saved to the customers' hard drives****, or customers may* ***download the company's app onto their phones****. Or a company may lease data storage that is permanently, or even occasionally, located in South Dakota. Cf. United States v. Microsoft Corp., 584 U. S.(2018) (per curiam)."*

- On considering fairness in taxing through a digital presence (p. 17 of the ruling) :

  "But there is nothing unfair about requiring companies that avail themselves of the States' benefits ***to bear an equal share of the burden of tax collection****.* ***Fairness dictates quite the opposite result****. Helping respondents' customers evade a lawful tax* ***unfairly shifts to those consumers*** *who buy from their competitors with a physical presence that satisfies Quill—even one warehouse or one salesperson—****an increased share of the taxes****. It is essential to public confidence in the tax system that the Court avoid creating inequitable exceptions. (..) In the name of federalism and free markets,*

[2] https://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf

*Quill does harm to both. The physical presence rule it defines has limited States' ability to seek longterm prosperity and has prevented market participants **<u>from competing on an even playing field</u>**."*

- Conclusions (p. 18 and 22 of the ruling) :

  "*If it becomes apparent that the Court's Commerce Clause decisions prohibit the States from exercising their lawful sovereign powers in our federal system, the Court should be vigilant in correcting the error. While it can be conceded that Congress has the authority to change the physical presence rule, Congress cannot change the constitutional default rule. It is inconsistent with the Court's proper role to ask Congress to address a false constitutional premise of this Court's own creation. (..) It is currently the Court, and not Congress, that is limiting the lawful prerogatives of the States*."
  (..)
  In the absence of Quill and Bellas Hess, the first prong of the Complete Auto test simply asks whether the tax applies to an activity with a substantial nexus with the taxing State. 430 U. S., at 279. "[S]uch a nexus is established when the taxpayer [or collector] 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."(Polar Tankers, Inc. v. City of Valdez, 557 U. S. 1, 11 (2009)). Here, the nexus is clearly sufficient based on both the economic and virtual contacts respondents have with the State."
  (..)
  *"That said, South Dakota's tax system includes several features that appear designed to prevent discrimination against or undue burdens upon interstate commerce. First, the Act applies **<u>a safe harbor to those who transact only limited business</u>** in South Dakota. Second, the Act ensures that **<u>no obligation to remit the sales tax may be applied retroactively</u>**. S. B. 106, § 5. Third, South Dakota is one of more than 20 States that have adopted the Streamlined Sales and Use Tax Agreement. This system standardizes taxes to reduce administrative and compliance costs: It requires a single, state level tax administration, uniform definitions of products and services, simplified tax rate structures, and other uniform rules*."

8. Several states of the United States have adopted or are adopting since taxes on business that is solely or partially conducted digitally in their territory. This ruling also had a major effect on the position of the United States' delegates in the OECD and allowed considerable progress in 2019. The main question within OECD is now no longer if but how to tax digital activities.

Logically, French digital companies that are not taxable under the criterions of the French DST will become subject to State DST's in those States of the United States that wish to adopt DST's when a certain threshold of income or size of activities is reached in each State.

This reciprocal effect is to be considered when a assessing the effects of the French DST in good faith.

9. This ruling applies horizontal equity (only resident companies still pay taxes, what disturbs the even playing field among competitors and states that can no longer finance themselves – consumers that buy local pay taxes other consumers avoid by ordering in another State) and vertical equity (requirement of a threshold of activity or income before digital activity can be taxed (save harbor)). **So only when the activity of a non-resident company is deemed to have a relevant size it becomes fair under this ruling to tax the gross income in the source state to contribute to the general budget and so the cost of providing public services**.

This ruling also specifically takes in account that fairness dictates that major loss of public finances must be addressed in an economy where up to 10 % of the commercial transactions has become digital (p. 22 ruling) :

> *"And, if some small businesses with only de minimis contacts seek relief from collection systems thought to be a burden, those entities may still do so under other theories. These issues are not before the Court in the instant case; but their potential to arise in some later case cannot justify retaining* ***this artificial, anachronistic rule that deprives States of vast revenues from major businesses****. For these reasons, the Court concludes* ***that the physical presence rule*** *of Quill* ***is unsound and incorrect****. The Court's decisions in Quill Corp. v. North Dakota, 504 U. S. 298 (1992), and National Bellas Hess, Inc. v. Department of Revenue of Ill., 386 U. S. 753 (1967),* ***should be, and now are, overruled****."*

10. Article 5 OECD MTC / Article 5 US – France DTT requires a 'fix base of business' and lists a set of physical criteria for purpose of a permanent establishment that grants the right to tax to the source state. It is obvious that the reasons considered by this ruling, when applied to that article, allow to consider digital permanent establishments in the relation between countries. But since the Commerce clause only exists between States of the United States another legal base must be considered for relations towards third countries that are organized under treaties.

That other legal base exists under the law of treaties. Since October 2018 the International law committee has considered that the rules of interpretation of treaties as laid down in articles 31 and 32 VCLT have become **customary international law** and apply as such immediately to all countries (see hereinafter point B). Including the 65 countries that did not join that Convention (such as the United States or France).

The State of South Dakota counts a small million inhabitants, it is fair to apply the criterions of size (200 contracts / 1 million inhabitants in a country) and the requirement of a save harbour by income (100.000 USD / 1 million inhabitants in a country) for the purpose of qualifying criterions for a digital permanent establishment that can be taxed by the source country under article 5 OECD MTC or for criterions of guidelines on DST criterions that can be considered as fair under U.S. law.

A.2. CJEU Case-law

11. On June 13th 2019, the Advocate-general with the Court of Justice of the European Union (hereinafter CJEU), Madame Kokott (German national), had to file here opinion to the CJEU on a Hungarian tax on telecom-operators that applies on both resident and non-resident enterprises[3]. That tax is calculated on the **turnover allocated in the Hungarian territory** and exonerates the first 500 million of Forints. The tax increases progressively until 6,5 % is levied on the national turnover that exceeds 5 billion of Forints (HUF).

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[3] OPINION OF ADVOCATE GENERAL KOKOTT delivered on 13 June 2019 (1) Case C‑75/18, Vodafone Magyarország Mobil Távközlési Zrt. V Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, ECLI:EU:C:2019:492 http://curia.europa.eu/juris/document/document.jsf?text=&docid=214959&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=9745343

The following considerations were made in that opinion that relate to the fairness of singling out a digital activity for tax purposes (§§ 81, 96, 99 and 112-114):

"..In other words, the criterion of turnover is not an intrinsically cross-border distinguishing criterion, but — as rightly noted by the Czech Republic in its written observations and the Federal Republic of Germany at the hearing — a neutral distinguishing criterion. ***Turnover is just as neutral as a basis of assessment for calculating a direct tax as, for example, profit (or wealth).*** *The fundamental freedoms favour neither one nor the other.*

..

In broad terms, the parliamentary debate concerned the problem whereby large multinational groups are able to minimise their profits in Hungary with the result that the tax burden falls mainly to small and medium-sized undertakings, a situation which the Law on the special tax is intended to prevent to some extent. ***The primary focus was on multinational undertakings whose tax practices were also one of the main reasons for the BEPS debate.***

..

That tax too is an attempt ***to obtain a greater contribution to public costs from multinational undertakings (in that case primarily from certain non-member countries) if they generate profits within the EU which are not, however, subject to income tax there****. This cannot form a basis for an allegation of an abuse of rights against Hungary.*

..

Furthermore, the limit of HUF 500 million for the first tax band does not cover only foreign undertakings. ***Any new domestic or foreign undertaking operating on the Hungarian telecommunications market would also benefit from the allowance****. In this regard, the chosen tax rate structure primarily favours smaller undertakings, in particular start-ups, compared with larger undertakings that are already firmly established on the market. Whether the limit of HUF 5 000 million turnover is the 'best' limit or another amount would not have been 'better' is a decision for the national legislature which cannot be reviewed by either the Court or the Commission, unless there is abuse.*

..

In addition, ***focusing on turnover gives less scope for organisational models of multinational undertakings, which has been one of the main points of the BEPS debate*** *over the last decade and was also a key element of the Hungarian parliamentary debate. The Commission is also proposing a turnover-based digital services tax for certain high-turnover undertakings in the digital sector. In recital 23 this taxation technique is expressly explained by the fact that 'the opportunity of engaging in aggressive tax planning lies with larger companies'.*

..

The underlying reason is generally, in a welfare state at least, to relieve the burden on the weaker parts of society and thus partially to redistribute the to some extent unequally distributed funds by means of taxation law. In principle, this welfare state objective also justifies a certain degree of unequal treatment based on a progressive tax rate.

113. As under the second subparagraph of Article 3(3), the Union is not only to establish an internal market, but also to promote social justice, these reasons relating to the welfare state, as Poland argued at the hearing, may also justify a progressive tax rate in EU law. This holds in any case for a tax covering not only undertakings, but also natural persons, as is the case under Paragraph 3(1) and (2) of the Law on the special tax.

114. Consequently, ***the justification of taxation according to financial capacity in conjunction with the principle of the welfare state can justify a restriction of the fundamental freedoms****."*

In this rendered opinion on a national tax on a single type of digital activity, there are so arguments that relate to both vertical equity (save harbor under 500 million HUF, ability to pay, ability to tax engineer) and horizontal equity (participating to financing of public costs and even social welfare on national turnover as resident enterprises are required to do). Similar considerations could be made for the digital activities considered under the French DST. The legal bases applied may be different from those under the SCOTUS rulings but the principles considered by both the opinion and the SCOTURS rulings seem fairly similar and can be considered to support the sovereign choice of France for the purpose of the French DST and the chosen criterions such as allocated turnover as a tax base.

12. Under the rulings of the CJEU, the need for financing the general budget by addressing abuses and/or loopholes in the nation tax system of a Member State is accepted as a general restriction of the freedoms granted by Union law. Provided that the tax base that is considered under such tax laws <u>is proportionate to the business conducted</u> in that Member State and <u>does not discriminate</u> in a <u>disproportional way</u> between resident and non-resident companies[4]. This rule of law that applies between Member states of the European Union is relevant when assessing the purpose of the French legislator when adopting the French DST and its effects.

The Hungarian progressive tax on turnover that was examined in the cited opinion of Advocate-general Kokott was modified in 2013. New criterions were adopted with the same threshold of 500 million HUF, **<u>progressives tax rates on turnover</u>** were introduced and a new reduction of 50 % of the tax if the company did not make profits that applied for just the year 2013. The European Commission considered these criterions as prohibited State aid. By reasons that can be identified as relating to horizontal and vertical equity, the Court of Justice of the European Union ruled on June 27th 2019 otherwise (§ 87, 89, 103 and 104, 122)[5] :

A consideration that relates to horizontal equity :

- *..a progressive structure of a tax rate cannot as such be contrary to the objective of collecting budgetary revenue. Similarly, the objective of promoting public burden sharing is very general and could be put forward for most taxes...(..).. it cannot be excluded that a redistributive purpose may also justify the progressivity of a turnover tax, as the Government of Hungary rightly maintains in the present case*.

Considerations that relate to the ability to pay principle and progressive tax rates / exemptions and save harbor :

- *It may reasonably be presumed that an undertaking which achieves a high turnover may, because of various economies of scale, have proportionately lower costs than an undertaking with a smaller turnover — because fixed unit costs (buildings, property taxes, plant, staff costs*

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[4] CJEU, 5 July 2005, case C-376/03, *D. v. Inspecteur*, ECLI:EU:C:2005:424 (Member states are free under Union law to choose the criterions of tax bases under double tax treaties) ; CJEU, 13 December 2005,case C-446/03, *Marks & Spencer plc v David Halsey*, ECLI:EU:C:2005:763) and CJEU, 15 May 2008, case C 414/06, Lidl Belgium Gmbh & Co K v. Finanzamt Heilbronn, ECLI:EU:C:2008:278 (double taxation is allowed between Member states, provided that the Source State determines a tax base that is proportionate to the activities on its territory)

[5] CJEU, 27 June 2019, T-20/2019, European Commission v. Hungary, ECLI:EU:T:2019:448

*for example) and variable unit costs (raw material supplies for example) decrease with levels of activity — and that it may, therefore, have proportionately greater disposable revenue which makes it capable of paying proportionately more in terms of turnover t*ax.

- *The distinguishing criterion chosen by the Hungarian authorities of not having generated profits in 2013 is objective. It is whether the undertakings concerned met that criterion which is random. Lastly, in the light of the Hungarian legislature's objective of introducing sectoral taxation with a redistributive purpose, that criterion, which is intended to ensure in the first year of the advertisement tax's introduction a moderate tax burden for taxable persons in an unfavourable situation, establishes a difference in treatment between undertakings not in a similar situation: the profit-making undertakings in 2013 and undertakings not having made profits that year*.

- *A redistributive purpose may indeed even justify a total exemption for some undertakings (..) Consequently, as regards a turnover tax, a variation criterion taking the form of progressive taxation above a certain threshold — even if that threshold is a high one — which may reflect the wish to tax an undertaking's activity only when that activity reaches a certain level, does not in itself imply the existence of a selective advantage*.

A.3. Findings

13. The cited considerations under both US-law and European Union-law apply principles of both horizontal and vertical equity for judging criterions of the right to tax directly turnover of non-resident companies. **They leave no room for further discussion that not taxing business for lack of physical presence in a jurisdiction is unfair and violates equity in the present times.** Progressive tax rates and thresholds may also be determined by other considerations than presumed profit. **Turnover is recognised as a valid tax base**. The capacity to contribute more or less to financing the general budget of the source country is considered as a valid criterion.

It should however be noted that neither the opinion of Advocate general Kokott nor the CJEU ruling nor the SCOTUS rulings had to take in account the effects of double tax treaties under Union law on these principles. So these considerations do not consider the question on how taxing <u>turnover of digital activities</u> could be compliant with the Articles 5 and 7 of the OECD MTC / the Articles 5 and 7 of the US – France DTT. That question is addressed hereinafter under point B.

14. On the notions of horizontal and vertical equity as tools for fairness in international taxation, the Belgian Professor DEBELVA has published in October 2018 an article[6]. His findings point out that debates on fairness in international taxation occurred over time on two levels : horizontal equity (benefits justify taxes) and vertical equity (taxpayers with different amounts of income should pay different amounts of tax or the ability to pay). These levels play not only in a domestic context but also on the level of nations.

When tax treaties were conceived in 1927 they wished to achieve inter-nation equity along the idea of 'The same income is taxed once, and only once'. These treaties used Capital-export

[6] Prof. F. DEBELVA, 'Fairness and International Taxation : Star-Crossed Lovers ?', World Tax Journal, 2018, (volume 10) N° 4, published on 9 October 2018

neutrality that requires that an investor that invests abroad pays the same taxes as if he did that investment in his home nation (worldwide taxation with foreign tax credit) and/or Capital-import neutrality that requires that in the place of investment all capitals are treated equally, independent of their origin (source-base taxation with exemption).

Applied on digital activities, these new technologies allow providers of digital goods and services to remain untaxed, what creates an inter-nation horizontal equity problem according to DEBELVA. Tax bases are not adequately shared between the States and it may provoke tax migration. It creates also an inter-personal vertical equity problem. Multinational enterprises can best use these new technologies to pay less taxes than domestic taxpayers.

B. Recent developments in international tax law.

15. Since October 2018 a hard law base is recognised under the law of treaties that can be applied immediately, that is without formal changes to the tax treaties, and worldwide, that is on each existing tax treaty, for defining under national tax law digital permanent establishments and allocating expected profits to them.

The International Law Committee (hereinafter ILC) has adopted in October 2018 the draft conclusions of ten years of work on identifying customary international law[7] and presented these conclusions to the sixth committee of the General Assembly of the United Nations.

Three drafts of resolution were adopted by the sixth committee on November 7th 2018 :

- Draft Resolution A/C.6/73/L.22 *Report of the International Law Commission on the work of its seventieth session*[8]*,*
- Draft Resolution A/C.6/73/L.23 *Subsequent agreements and subsequent practice in relation to the interpretation of treaties*[9]*,*
- Draft resolution A/C.6/73/L.24 *Identification of customary international law* [10].

The third draft Resolution was adopted by the General assembly of the United Nations on December 20th 2018[11]. This Resolution states under its decision # 4 :

> *"Also takes note of the conclusions on identification of customary international law, the text of which is annexed to the present resolution, with the commentaries thereto, brings them to the attention of States and all who may be called upon to identify rules of customary international law, and encourages their widest possible dissemination;"*

And considers under the conclusions 12 and 13 attached to that Resolution :

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[7] http://legal.un.org/ilc/texts/instruments/english/commentaries/1_13_2018.pdf

[8] https://undocs.org/A/C.6/73/L.22

[9] https://undocs.org/A/C.6/73/L.23

[10] https://undocs.org/A/C.6/73/L.24

[11] http://legal.un.org/docs/?symbol=A/RES/73/203

"Conclusion 12
Resolutions of international organizations and intergovernmental conferences

1. A resolution adopted by an international organization or at an intergovernmental conference cannot, of itself, create a rule of customary international law.

2. A resolution adopted by an international organization or at an intergovernmental conference may provide evidence for determining the existence and content of a rule of customary international law, or contribute to its development.

3. A provision in a resolution adopted by an international organization or at an intergovernmental conference may reflect a rule of customary international law if it is established that the provision corresponds to a general practice that is accepted as law (opinio juris).

Conclusion 13
Decisions of courts and tribunals

1. Decisions of international courts and tribunals, in particular of the International Court of Justice, concerning the existence and content of rules of customary international law are a subsidiary means for the determination of such rules.

2. Regard may be had, as appropriate, to decisions of national courts concerning the existence and content of rules of customary international law, as a subsidiary means for the determination of such rules."

Under conclusion 12 it is so clearly stated that resolutions do not create customary international law but only acknowledge its prior existence. So as soon as customary international law is identified as such it can be applied on interpreting tax treaties. **The hard law base of that effect can be found in Article 38, paragraph 1 (b) and (d) of the Statute of the International Court of Justice**, according to which international law is also 'international custom, as evidence of a general practise accepted as law' and 'judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law'.

16. The second Draft of Resolution A/C.6/73/L.23 on *Subsequent agreements and subsequent practice in relation to the interpretation of treaties* concludes :

"Conclusion 2 - General rule and means of treaty interpretation

1. Articles 31 and 32 of the Vienna Convention on the Law of Treaties set forth, respectively, the general rule of interpretation and the recourse to supplementary means of interpretation. ***<u>These rules also apply as customary international law</u>****.*

2. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in the light of its object and purpose, as provided in article 31, paragraph 1.

3. Article 31, paragraph 3, provides, inter alia, that there shall be taken into account, together with the context,

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; and
(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation.

4. Recourse may be had to other subsequent practice in the application of the treaty as a supplementary means of interpretation under article 32.

5. The interpretation of a treaty consists of a single combined operation, which places appropriate emphasis on the various means of interpretation indicated, respectively, in articles 31 and 32."

"Conclusion 8 - Interpretation of treaty terms as capable of evolving over time

Subsequent agreements and subsequent practice under articles 31 and 32 may assist in determining whether or not the presumed intention of the parties upon the conclusion of the treaty was to give a term used a meaning which is capable of evolving over time."

By adopting the draft of conclusions in October 2018, the International law committee has identified that the rules of interpreting treaties as described under Articles 31 and 32 VCLT[12] have evolved over time to customary international law. These rules of interpretation so apply immediately on all existing treaties in compliance with Article 38, paragraph 1 (b) of the Statute of the International Court of Justice.

It is not required that the General Assembly of the United Nations votes this draft of this second resolution to resort effect, since the Resolution voted on December 20th 2018 already states that customary international law does not require a resolution. It suffices it is recognized as such to become hard law.

17. In a ruling of February 26th 2019 the CJEU described article 31 VCLT as (§ 35) [13] :

"As a preliminary point, since the AFMP is an international treaty, it must be interpreted, in accordance with Article 31 of the Vienna Convention on the Law of Treaties of 23 May 1969 (United Nations Treaty Series, vol. 1155, p. 331), in good faith, in accordance with the ordinary meaning to be given to its terms in their context and in the light of its object and purpose (judgments of 2 March 1999, Eddline El-Yassini, C‑416/96, EU:C:1999:107, paragraph 47, and of 24 November 2016, SECIL, C‑464/14, EU:C:2016:896, paragraph 94 and the case-law cited). Further, it follows from that provision that a term will be understood to have a special meaning if it is shown that that was the intention of the parties (see, to that effect, judgment of 27 February 2018, Western Sahara Campaign UK, C‑266/16, EU:C:2018:118, paragraph 70)."

In the context of a litigation between Germany and Austria on their double tax treaty, the CJEU also applied in a ruling of September 12th 2017 article 31 VCLT (§§ 39 to 41) [14] :

"39. In that regard, it should be borne in mind that it follows from the provisions of the Vienna Convention, to which both the Republic of Austria and the Federal Republic of Germany are

[12] https://treaties.un.org/doc/Publication/UNTS/Volume%201155/volume-1155-I-18232-English.pdf
[13] CJEU, 26 February 2019, case C-581/17, *Wächtler v. Finanzamt Konstanz*, ECLI:EU:C:2019:138
[14] CJEU, 12 September 2017, case C-648/15, *Austria v. Germany*, ECLI:EU:C:2017:664

parties, that a treaty must be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in the light of its object and purpose, taking into account any relevant rules of international law applicable in the relations between the parties to that treaty (see, to that effect, judgment of 25 February 2010, Brita, C‑386/08, EU:C:2010:91, paragraph 43).

*40 As regards, first of all, the ordinary meaning to be given to the terms 'participation in profits', **both everyday language** and the most commonly accepted accounting conventions refer to (..).*

*41 Furthermore, the phrase 'participation in profits' **is normally associated** with the inherent variability and unpredictability of the annual income of any high-risk economic activity (..)"*

18. Those rules of interpretation under Articles 31 and 32 VCLT are described by the ILC (Chapter IV Yearbook 2018 ILC[15]) as rules of evolving interpretation of treaties :

- p. 8 and 9 :

*« The second sentence of paragraph 1 of draft conclusion 2 confirms that the rules set forth in articles 31 and 32 reflect customary international law. International courts and tribunals have acknowledged the customary character of these rules. (..) Hence, the rules contained in articles 31 and 32 apply as treaty law in relation to those States that are parties to the 1969 Vienna Convention, **and as customary international law between all States**, including to treaties which were concluded before the entry into force of the Vienna Convention for the States parties concerned. »*

- p. 10 :

"Article 31, paragraph 1, is the point of departure for any treaty interpretation according to the general rule contained in article 31 as a whole. (..) All means of interpretation in article 31, including the elements of context mentioned in paragraph 2, are part of a single integrated rule.
(..)
Article 32 includes a non-exhaustive list of supplementary means of interpretation. Paragraph 4 borrows the language "recourse may be had" from article 32 to maintain the distinction between the mandatory character of the taking into account of the means of interpretation, which are referred to in article 31, and the discretionary nature of the use of the supplementary means of interpretation under article 32."

- p. 55 – 57 :

"Draft conclusion 8 rather emphasizes that subsequent agreements and subsequent practice, as any other means of treaty interpretation, can support both a contemporaneous and an evolutive interpretation (or, as it is often called, evolutionary interpretation), where appropriate. The Commission, therefore, concluded that these means of treaty interpretation "may assist in determining whether or not" an evolutive interpretation is appropriate with regard to a particular treaty term. (..)

The "generic" nature of a particular term in a treaty and the fact that the treaty is designed to be "of continuing duration" may also give rise to an evolving meaning. (..) Any evolutive interpretation

[15] http://legal.un.org/docs/?path=../ilc/reports/2018/english/chp4.pdf&lang=EFSRAC

of the meaning of a term over time must therefore result from the ordinary process of treaty interpretation (..)

The interpreter thus has to answer the question of whether parties can be presumed to have intended, upon the conclusion of the treaty, to give a term used a meaning that is capable of evolving over time."

19. Article 31 demands the contracting parties to apply treaties in good faith in an evolving context. Article 32 demands that if an interpretation under Article 31 would lead to a situation that is manifestly absurd or unreasonable, an interpretation must be given to the treaty by searching the original goal of the contracting parties and apply this will while in the present.

These rules of interpretation provide as customary international law a worldwide hard law base for the interpretation of **article 5 OECD MTC / Article 5 US-France DTT** that can be used immediately by either party when adopting national tax law :

- ..business.. => interpretation in good faith in an evolved context of the general term 'business' = also *digital* business included,
- .. a fixed base.. => interpretation in good faith in an evolved context of 'fixed base' = a form of *frequent activity on the territory* through the quantity of users, forms of data or connexions that qualify to constitute a frequent (= weekly) / constant (= daily) use of servers outside the national territory, activated by demands made on tools of digital connection located at that time in the national territory, contracts concluded or resident users in the national territory,
- the list of criterions of physical presence cited by article 5 OECD MTC / Article 5 US-France DTT is exemplary,
- if this list of criterions of physical presence were to be considered as exclusive, this would lead to a situation which has become overtime manifestly absurd or unreasonable (Article 32 test that confirms the interpretation under Article 31 in accordance with the intent of the double tax treaty to tax profit obtained from activities in the national territory). See also the SCOTUS ruling of June 21st 2018 that finds that physical presence criterions for taxation have become an "*artificial, anachronistic rule that deprives States of vast revenues from major businesses*" in an economy that has over 10 % of business conducted digitally.

20. These rules of interpretation provide a hard law base for an interpretation of **article 7 OECD MTC / Article 7.1 US-France DTT** that applies immediately and worldwide. When reading article 7 OECD MTC, the first sentence indicates that a PE opens the right to tax 'the **<u>profits</u>** it might be **<u>expected to make'</u>**. By lack of a physical presence these general terms require interpretation.

There is no legal base under Article 7 OECD MTC or Article 7.1 US/France DTT to justify the European Commission's (however cautious) recommended method in March 2018 when suggesting draft of directives to the European Council that the profit must be determined 'as if a separate and independent enterprise' is present, by criterions such as functions, assets used or risks assumed. This method requires first of all under article 7 OECD MTC 'dealings with <u>other parts</u> of the enterprise' before it can be applied :

1° As all dealings will occur on the same server of the non-resident enterprise, a digital PE has by definition or in most cases no dealings with separate parts of that enterprise. So there is no legal ground under the OECD MTC to refer to the subsequent method as the method to determine the profits the PE might be expected to make.

2° Even when applying such method, by lack of any physical presence, there is no asset used, no risk assumed and no function on the national territory. Allocating parts of the non-resident enterprise that are located physically outside the national territory cannot be considered as an interpretation in good faith of article 7 OECD MTC that may have occurred under the original intent of the contracting parties when they stipulated these definitions.

This question however is not raised under Article 7 US-France DTT that only refers to the 'expected profit' criterion. So only that phrase needs interpretation in good faith.

21. How to interpret then the right granted under Article 7 US-France DTT to tax 'the profits it might be expected to make' under Articles 31 and 32 VCLT ? The word 'expected' indicates that legal fictions of profit are possible. This is basically what the already generally accepted CFC's and arm's length approaches do when they seek to address BEPS practises.

Profits are derived from a tax base. A tax base is the result of turnover and gains on assets. An 'expected profit' will therefor by definition be a portion of the turnover or gain on asset that is allocated to the digital permanent establishment. Such method qualifies under the fractional appointment approach.

The taxable profits of a digital permanent establishment must therefore be the combined result of an allocated national turnover and an 'expected' profit as a margin of that tax base. An approach that taxes the entire turnover of digital activities allocated to the national territory through a digital permanent establishment violates article 7 US-France DTT. The wordings of article 2 US-France DTT leave no doubt that all national French taxes on 'total income' are considered under the scope of the DTT. However, by using a flat tax rate of 3 % instead of 28 % or 31 %, the French DST resorts the same effect as taxing a presumed profit margin of 10 % on the allocated turnover from the digital activity.

22. The criterion of size of activity under the French DST is consistent with a constant form of activity on the national territory that may be considered as 'a fixed base'.

Digital activities have become part of most businesses and therefor most business models are eligible for digital criteria of taxation. Some digital activities imply the participation of the consumer, who becomes both a factor of production and consumption (prosumption)[16],

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[16] Prof. HOYOS, Catalina (2019). *La tributación en medio de la revolución digital.* Ponencia para las 43 Jornadas Colombianas de Derecho Tributario, Instituto Colombiano de Derecho Tributario (ICDT), Cartagena de Indias, Colombia, 2019), with references to : on the notion of digital permanent establishments (notes 245 and 246 : Brauner, Yariv y Pistone, Pasquale (2017), 'Adapting current international taxation to new business models ; two proposals for the European Union.', *Bulletin for international taxation*, December 2017, IBFD journals and Brauner, Yariv, Pistone, Pasquale (2018), 'Somme comments on the Attribution of Profits to the Digital Permanent Establishment', *Bulletin for International taxation*, Journals IBFD ED 74 (4a) ; on the need to find other criterions of taxation such a connexion (notes n° 123 and n° 243 : Vanistendael, F., « Digital Disruption in International Taxation », TNI, January 8, 2018 and Valente, Piergirogio, 'Digital revolution. Tax revolution ?',

confronting countries with a third type of location nexus in digital activities, the place of CONNEXION. That location is part source nation, next to the country of residence of the USER. So instead of a dual, a triangular international taxation nexus could be considered.

It can so be considered consistent that when part of the production process of the digital activity occurs in the national French territory through input or payments from French tax residents to single out business models through digital activities that rely on merchandising input of users and sales to users.

23. When applying these rules of interpretation as customary international law, two questions must be addressed.

The first questions considers the size of the digital activity qualify as sufficient frequent to be considered as constant? The amount of collected income is not a valid criterion without sufficient digital activity.

The second question is how to divide taxing rights through expected profits that activity triggers ? Besides directly collected income in the source country, other income may have been obtained worldwide. By lack of books that allow to link digital activities in a country with income, expected profits may have to be presumed as a fraction (margin) of that tax base.

Guidelines for fair and equal fractions that can apply for both DST and expectable profits by digital PE could then. be considered. Such guidelines have regard for investments and return of investments for the digital enterprise. It seems logic to require that 50 % of the tax base is to remain in the production jurisdiction to set-off deductable costs and 25 % of the remaining tax base as profit allocated to the production jurisdiction.

- 50 % is to set off costs of servers, staff, buildings, R&D etc..,
- 25 % is ten half the expected ‘profit’ to maintain a reasonable tax base in the production jurisdiction (typically the US).

Up to 25 % of that tax base on allocated turnover can then be ‘expected profit’ for the source country / market jurisdiction through the type of digital activity conducted in the source country. As the national tax authority for U.S . based companies, the U.S. administration is the best qualified to have access to data that allow to determine the average profit margins per type of digital activity conducted by U.S. based companies when establishing such guidelines.

For motives of fairness that margin can otherwise be set between 10 and 25 % by three factors : expected profits (ability-to-pay), dislocation of profits (BEPS risks) and provoking costs to the source country. Avoiding proportionate sharing in increased costs of public services as resident companies or civilians do is but an indirect way of increasing the expected profit. Also under these criterions the French DST has a similar effect as a 10 % profit allocation that can be considered as compliant with Article 7 US-France DTT as ‘expected profit’ in turnover.

Bulletin for international taxation, 2018 (volume 72), n° 4) ; or on the difficulties related to taxing digital bartering (note n° 138 : Tardivon-Lorizon, E & A.Z Quenette (2018) *Indirect taxation of E-Commerce – Significant Recent Changes in the United States and the European Union*, 29 intl. VAT Monitor 6, journal IBFD).

24. An extensive submission on how to determine profit margins by various types of digital activities was sent in July 2019 to the Government of New-Zealand following the request for public input on a considered DST. In that submission is referred to the United Nation Committee of Experts on International Cooperation in Tax Matters that formed a Subcommittee on Tax Challenges Related to the Digitalization of the Economy. `

This Subcommittee presented on April 18th 2019 a report on Tax Issues related to the Digitalization of the Economy [17]. The mission of that Subcommittee is next to identifying those issues also to present solutions that take in account the following objectives :

- Avoiding both double taxation and non-taxation;
- Preferring taxation of income on a net basis where practicable; and
- Seeking simplicity and administrability.

The findings of that Committee may hold further arguments for finding common grounds between the US and France on how to best find a balanced compromise rather than trade sanctions.

C. Discriminatory?

25. By singling out digital activities by type, then exonerating some of the selected activities, and setting a double high threshold of income, the French DST may be perceived as designed for resorting effects that mainly or only affect US tech companies.

A perception of discrimination formed on the base of effects only can be considered as a subjective conclusion. Through the understanding of why and how the French DST was adopted objective elements come into the assessment. Discrimination occurs when :

- Taxpayers that are in comparable situations are treated differently without just cause or proportionate measures under the purpose of the tax law.

- Taxpayers that are not in comparable conditions are treated equally without just cause or proportionate measures under the purpose of the tax law.

As to the just cause of the tax law, it has already been pointed at the *purpose* to tax business that does not require a physical presence on a national territory can be considered as both fair and equitable in present times (see section A). It has also been pointed out that the French DST is conceived as a temporary measure to address a loophole in international taxation while awaiting a solution on the international level.

The assessment of discrimination can so be narrowed down to the question if the chosen criterions for the French DST can be considered as proportionate measures for such purposes.

[17] https://www.un.org/esa/ffd/wp-content/uploads/2019/04/18STM_CRP12-Work-on-taxation-issues-digitalization.pdf

C.1. A double high threshold.

26. The criterion of 750 million euro worldwide turnover for a group is a standard criterion for qualifying MNE's. MNE's can be considered to form a separate group of enterprises that by their size and nature can resort to BEPS and have the necessary tools at their disposal to engage on equal terms with tax administrations.

They are as such a separate category of enterprises that can be treated differently than other enterprises for the purpose of a tax that requires complex tracking of income and digital business conducted with users on a national territory.

27. The economic effect of the large threshold of 25 million euro in order to be considered as a taxpayer under the French DST exceeds by far the 'Wayfar' test of 100.000 USD turnover / million inhabitants. France has about 67 million inhabitants, so a lower threshold that tends towards 6,5 – 7 million EUR could be considered as a legitimate request from the US to France to address a disproportionate measure.

On the other hand, since this is a new type of tax that may require important accounting and new forms of technical tracing and recording of connexions, it is in a way logical to single out taxpayers that may be considered to dispose of the necessary resources to engage in discussions with the French tax administration on equal strength and then be able to apply the agreed process of recording digital activities that can be considered to occur on the French national soil and income attached to them.

A significant higher threshold for business conducted between countries has also objective arguments then a threshold that applies between States of the United States. On that point : how are the various taxes on digital activities that are currently adopted by the States of the United States following the Wayfair-case going to affect digital business conducted *by* French companies *in* these States ? Will they complain when subjected to a similar indirect tax on their turnover in these States as resident companies in the United States ?

It may be considered logical to limit down the scope of a tax that is considered as temporarily until a solution is found on the international level to close a loophole in international taxation. Why submit the largest number of possible companies to such a tax ? It may disturb business and is not needed since companies that are resident in France pay corporate income tax on their turnover.

A French tech company that has no 25 million euro national turnover from that type of digital activity may be exonerated, but will be taxed at 28 % on the first 500.000 EUR profit and 31 % on what exceeds that on profit on reported income for digital activities conducted in France. The French DST taxes at 3 % competing activities that not have a permanent establishment and submits then so at a similar tax on 10 % of their turnover that is collected from activities requiring input from French tax residents. Given that purpose, effect and nature of the tax and the sort of obligations required from eligible taxpayers, there is ground to consider that the high threshold is not discriminatory since both French companies that no qualify and US companies that qualify are now subject to similar treatments.

C.2. Type of activity & exonerated activities.

28. France has singled out specific types of digital activities to be subject to the DST.

The draft of Bill presented on March 6th 2019 by the French government states on page 3 that targeted advertising activities and go-between digital service activities are singled out because these types of activities typically make high profits (1) through monetizing user input (2) and evolve towards (quasi-) monopolies for certain types of services (3).

It can be considered proportionate to narrow down the scope of a temporary solution for effects on the national budget to the type of digital activity that presents high contribution capacities through typical (1) high profits and (3) evolution to quasi monopolies. Under the case-law cited in section A, the ability-to pay is a valid criterion for taxation under vertical equity.

It can also be considered as proportionate to single out activities that use the input of user residing in the national territory (2).

29. In the report presented on March 29th 2019 on behalf of the Commission of economic matters, the singled-out activities are further motivated (p. 7 and 8) by the fact that the digital service requires input of users on the national territory, so part of the digital service can be considered to have been produced by the user (see the cited 'prosumption' doctrine as. referred to under point A.3).

That report further motivates more in detail the other two effects of quasi-monopoly and high profits for singling out these types of activities, next to the increased access to BEPS for such types of digital activities to avoid direct taxation (p. 8). This leads to quantifying the number of users on the French soil and the income that is collected worldwide from data of these users and activities with a link to France as the tax base (p. 12).

30. The following types of digital activities are excluded :

Under Article 299-II, 1°, a) :

- Those who mainly send 'digital content'.
- Those who relate to 'communication services'.
- Those who relate to 'payment services'.

Under Article 299-II, 1° b) :

- Those who relate to delivery of financial instruments or interbank operations,
- Those who relate to trading financial instruments,
- Those who relate to 'crowd funding'.
- Those who relate to 'regulated financial operations' by licensed organisations by the national supervisor on financial operations.

Under Article 299-II, 1° c) :

- Those who relate to 'intergroup activities'.

France already has an indirect tax on turnover on the activity of providing movies into France. Eligible taxpayers under that other indirect tax must so be exonerated to avoid double taxation.

As for communication services, payment services and regulated financial operations ; they are activities that are specifically organized under European Union law that requires national supervision. This supervision generally requires a form of physical presence of the service provider in the national territory. There is so no need to address the absence of physical presence for these types activities. Given the purpose of the French DST as a temporary measure while awaiting a solution for absence of physical presence, it is for this reason alone logical to exempt these types of activities of the scope of the DST.

Only for some of the exempted 'payment services' it is possible through new technologies that some digital companies are operating without a physical presence in France. Such payment services are defined under European Union Law[18] and the exemption must be first of all understood for enterprises that fall under the scope of that European Union law. Also, payment services require few input of users. Their main input was already given when choosing the service or goods they wish to pay for as organized by another provider of digital services that may fall under the scope of the French DST.

For logical reasons, intergroup activities cannot not qualify as 'user' activity linked to the French territory.

Objective arguments for qualifying the singled-out activities and their exemptions can be provided. The type of taxed activities is proportionate to the purpose and the exempted activities cannot be considered as comparable to the taxed activities. They can so be treated differently without giving cause to discrimination.

D. Retroactivity?

31. An input is requested on retroactive effects of the French DST.

Article 299-III considers *yearly collected income* for both thresholds of 750 million euro for worldwide provided digital services on the group level and 25 million euro for specific digital services provided in France by a company that forms part of such a group.

Article 299-ter states that the tax is triggered by *the end of the civil year* during which such income was collected. It becomes due at that same moment. This is on January 1st at 0.00 hours when the next civil year starts.

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[18] DIRECTIVE (EU) 2015/2366 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, *OJ*, L 337/35, 23 December 2015.

Article 299-quarter I and II levies 3 % on the gross turnover of *collected* income, VAT excluded when applicable. Are exempted the collected payments that relate to digital services for goods subject to excise duties as organized under European Union law[19] and in as far as the price for that digital service is calculated proportionate to the price of these goods. Again European Union law objectively motivates this different treatment. Member States have passed to the European Union their sovereign right to tax by excise duties.

Article 300 organizes payment :

- At the same time as the first quarterly VAT report in the following civil year or the VAT report for the month March when reporting on a monthly basis.
- At the same time as the annual filing for special regimes under VAT.
- When no VAT reporting applies ; when filing the report of this tax by April 25th at the latest.

For that third type of taxpayers only, Article 1693 quarter organizes two moments of down payments. When filing the report that relates to the year before and can be no less then 50 % of the tax due (so the first filing will trigger two payments of minimum 4,5 % levied on collected income in the past civil year). And the second moment is set at October 25th of the ongoing civil year.

A taxpayer is granted the right not to pay down payments in as far as it is considered they will exceed payable taxes. When filing the payable tax is determined and down payments will be deduced of the payable amount.

Next to that general regime, Article 177 A quarter- III organizes a down payment by November 25th or the VAT filing for the month of October 2019 for the tax that will be due on income collected during the civil year 2019. The tax base is the collected worldwide income during the civil year 2018. The portion of that income that can be linked to taxable digital activities in France is determined by the fraction of such income linked to France that is retrieved between the publication of the French DST and October 31st 2019 in the worldwide income of that same period.

That down payment so basically covers a tax due on a full year of such income and can be deduced in 2020 when the tax for 2019 becomes due after filing the report under Article 300.

32. The French DST considers so yearly gross income that can be allocated to taxable digital activities in France. The collected income during 2019 is formally taxed on January 1st 2020, at 0.00 hours. Strictly legally speaking, the indirect tax is so levied in 2020. But through the unique down payment a first payment occurs in 2019, so there is a base for discussion it a formal retroactive element is present or not.

Economically and for financial planning purposes, the French DST has similar material effects as a corporate income tax that is levied on a fraction of yearly gross income.

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[19] COUNCIL DIRECTIVE 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, OJ, L 9/12, 14 January 2019

33. When considering the French DST as similar to a direct income tax that falls within the scope of Article 2 US – France DTT, retroactive effects are generally accepted in direct income taxes that relate to a civil year income. Since that yearly income is reported the next civil year all changes during the civil year affect reporting obligations and payable taxes for that year.

One could so argue that the French DST, next to qualifying income and not size of activity, holds a second feature under yearly income to be considered as a direct income tax and must therefore be assessed if unreasonable under direct income tax rules. Under the angle of direct income tax rules, no formal retroactivity is present.

The remaining point of discussion is then limited to the exceptional down payment organised three to four months after publishing the tax law. The French DST is unclear if the sanctions for lack of down payments as organised under Article 300 also for down payments under article 177 A quarter-III. If no sanction would apply, the exceptional down payment would then be left to the discretion of the tax payer. It would be important to sort a.s.a.p. this point out with the French authorities and in any event before considering trade sanctions.

Even when that exceptional down payment would be subject to sanctions and so be compulsory, the fact remains that the first payment becomes due after the law was published. By lack of data it can be considered proportionate to fall back on the latest completed civil year and compare it with the most recent data on collected income *after the law was published.* The outcome of a discussion if a formal retroactive effect is present remains uncertain. Uncertainty cannot objectively provide a just cause for unilateral trade sanctions.

It is recommendable to wait for assessment under a contradictory procedure before imposing trade sanction motivated by a retroactive aspect. Also, this is related to a single payment so the proportionality of a sanction, even when a formal retroactive element is found to be present, would be questionable.

34. When considering the French DST as an indirect tax, no formal retroactivity occurs since the first payments are organised three to four months after publishing the tax law. Only in 2020 a first tax is triggered, based on reported yearly income for 2019 and taxes that were paid in 2019 can be deduced of the due tax.

Such effects, when challenged by the concerned U.S. companies before the French Courts, would find it hard to be considered as retroactive. Again, uncertainty remains if a formal retroactive effect is present in the way the French DST is organised.

The same conclusion applies that it is then preferable to wait the outcome of litigations before considering trade sanctions.

E. Unreasonable?

35. Under European continental law the assessment if the tax law serves a just purpose and if the chosen criterions are proportionate to that purpose covers the (un)reasonable effects.

The request for public input states the following criterions under section 301 :

> *"An act, policy, or practice is unreasonable if the act, policy, or practice, while not necessarily in violation of, or inconsistent with, the international legal rights of the United States, is otherwise unfair and inequitable*."

And questions in particular :

> *"These apparent departures include: Extraterritoriality; taxing revenue not income; and a purpose penalizing particular technology companies for their commercial success."*

36. Section A motivates why singling out tax payers on their ability to pay (commercial success) is not considered under both SCOTUS and CJEU case-law as unfair. A penalizing effect of the French DST can so be questioned. Especially when taking in account that :

- French tech companies may qualify under State DST's of States of the USA ; a reciprocal effect to French DST may so apply to resident French enterprises,
- French enterprises pay corporate income tax on profits of similar activities were US companies that only are present to intangible digital activities do not ; the level of the French DST has the same effect as applying the French CTR of approximately 30 % on a fraction of 10 % of gross income, evening the playing field by reducing tax distortion.

As to the tool of taxing gross revenue and not profits, both SCOTUS and CJEU case-law find in equitable to proceed on taxing through revenue when no physical presence is involved that submits the company to taxes resident companies pay on similar activities and even activities in general that are conducted in that jurisdiction.

37. Section B of the submission explains why the effects of the French DST are not inconsistent with the US-France DTT when interpreting it under customary international law.

The fact that the French DST does not qualify tax payers by the size of the taxed digital activity but by income may form an argument of inconsistency when interpreting Article 5 US-France DTT. However, given the size of the threshold of 25 million euro, one cannot say that such an income would require a constant form of activity in the jurisdiction of France.

38. The remaining criterion of (un)reasonable effects relates to applying GATT or GATS on the taxed types of digital services and if a breach or inconsistency could be found under these treaties ? Since the French DST only considers digital services that relate to either targeted advertising or monetising user input, GATS would be the applicable treaty.

For companies with business models such as AMAZON there may be grounds to discuss if GATT is not the applicable treaty since selling goods is the primary objective of the offered service. If the digital service relates to ordering goods that are not owned but the service provider at that moment, GATS may be considered to govern the predominant characteristic of the transaction. When such digital services relate to selling goods that are the property of the digital service provider when offered, France could oppose to GATT requirements that the DST does not tax importing goods but the way goods are sold, regardless the fact if they are already present or not in the French territory when sold. So no different treatment would be present for further consideration under GATT.

39. The following sections of GATS relate to digital services[20] :

"*Article I - Scope and Definition*

1. This Agreement applies to measures by Members affecting trade in services.

2. For the purposes of this Agreement, trade in services is defined as the supply of a service :

(a) from the territory of one Member into the territory of any other Member;
(b) in the territory of one Member to the service consumer of any other Member;
(c) by a service supplier of one Member, through commercial presence in the territory of any other Member;
(d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.

3. For the purposes of this Agreement:

(a) "measures by Members" means measures taken by: (i) central, regional or local governments and authorities; and (ii) non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities; In fulfilling its obligations and commitments under the Agreement, each Member shall take such reasonable measures as may be available to it to ensure their observance by regional and local governments and authorities and non-governmental bodies within its territory;
(b) "services" includes any service in any sector except services supplied in the exercise of governmental authority;
(c) "a service supplied in the exercise of governmental authority" means any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers.

Article XXVIII - Definitions

(b) "supply of a service" includes the production, distribution, marketing, sale and delivery of a service;

(d) "commercial presence" means any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service;

(f) "service of another Member" means a service which is supplied, (i) from or in the territory of that other Member, or in the case of maritime transport, by a vessel registered under the laws of that other Member, or by a person of that other Member which supplies the service through the operation of a vessel and/or its use in whole or in part; or (ii) in the case of the supply of a

[20] General Agreement on Trade and Services, https://www.wto.org/english/docs_e/legal_e/26-gats.pdf

service through commercial presence or through the presence of natural persons, by a service supplier of that other Member;

(g) "service supplier" means any person that supplies a service (footnote # 12) Where the service is not supplied directly by a juridical person but through other forms of commercial presence such as a branch or a representative office, the service supplier (i.e. the juridical person) shall, nonetheless, through such presence be accorded the treatment provided for service suppliers under the Agreement. Such treatment shall be extended to the presence through which the service is supplied and need not be extended to any other parts of the supplier located outside the territory where the service is supplied.

(o) "direct taxes" comprise all taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

Digital services fall clearly within the scope of GATS.

40. Member States under GATS must observe :

"Article II - Most-Favoured-Nation Treatment

1. With respect to any measure covered by this Agreement, ***each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country****.*

2. ***A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions****.*

3. The provisions of this Agreement shall not be so construed as to prevent any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.

Article XVII - National Treatment

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

Article XIV - General Exceptions

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures : (..)

(d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;

*(e) inconsistent with Article II, **provided that the difference in treatment is the result of an agreement on the avoidance of double taxation** or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound."*

Footnote # 6 :

Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:

*(i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined **<u>with respect to taxable items sourced or located in the Member's territory</u>**; or*
(ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
(iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
(iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
*(v) **<u>distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers</u>**, in recognition of the difference in the nature of the tax base between them; or*
*(vi) **<u>determine, allocate or apportion income, profit</u>**, gain, loss, deduction or credit **<u>of resident persons or branches</u>**, or between related persons or branches of the same person, **<u>in order to safeguard the Member's tax base</u>**.*

Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure."

There will be breach under GATS if the criterions of taxation are deemed arbitrary, unjustifiable discriminations or disguised restrictions on trade in services.

As pointed out, the French DST has the effect to even the playing field between competing companies by addressing effects of tax distortion. Under sections A and C no unjustified different treatment was found, nor any arbitrary choice of criterions of taxation.

To the extent that French tech companies and foreign companies with a permanent establishment are submitted to a corporate income tax of 30 % on their profits made from the taxed digital activities in France, the French DST can be considered to not subject US companies to a less favourite treatment in France then national or foreign companies.

In as far as a different treatment would be considered, the French DST states explicitly to address temporally a loophole in international taxation for preserving a tax base in France. As such it can qualify as a general exception under GATS.

41. It is so strongly debatable there are inconsistencies under the international obligations of France to the USA. Even when found, the purpose of the French DST would have a strong case to be considered fair and equitable.

F. Conclusions.

42. Trade sanctions have proven often more than not questionable effectiveness. In this case the purpose is the force a Member state of the European Union to abandon domestic tax law that seeks to amend for a loophole in international taxation for tax bases of digital activities that not require a physical presence to conduct business.

More and more countries are considering to adopt unilateral measures in addressing loss of tax base through digital activities on their territories. Be it by lack of a permanent establishment or increased effects of BEPS through digital activities.

Several States within the United States are adopting domestic tax laws that seeks to tackle the same problems with their tax bases. The purpose of the French DST is consistent with case-law of both SCOTUS and CJEU on fairness in taxing in general and taxing digital activities without a physical presence in particular. It is so fairly uncertain if litigation will find the French DST to be inconsistent with the international obligations of France towards the USA.

Adopting trade sanction seems so a poor choice for protecting the interests of the US companies and of US treasury against DST's on the long run and exposes them to uncertain financial planning for a long period of time. Not knowing what taxes you will pay in the end on conducted business can be considered as more damaging for investment- and commercial policies then paying taxes.

43. The submission suggests it may be a more effective to recognize the valid purpose of the French DST and focus on determining a trade policy to protect the interest of US digital enterprises and the US treasury on the long run. The US government can establish unilaterally criterions for allocating turnover and determine profit margins that are considered fair to apply for various types of digital business conducted outside the United States.

This may prove to be a more objective base to engage into discussion with third countries over criterions of their domestic tax policies and interpreting tax treaties that may affect US digital enterprises less and yield more results in the long run for the US companies the French DST relates to. Such policy would have the benefit to avoid escalation of litigations and trade sanctions that would weaken in any event US companies rather than strengthen them.

44. The submission suggests so to protect interests of US digital enterprises by recognizing the valid purpose of the French DST and to focus on determining a tax policy that heads the SCOTUS case-law on fairness. The US government has the tools to collect data from the US companies and establish unilaterally tools for allocating turnover and determine profit margins that it considers fair to apply on various types of digital business conducted outside the United States. Be it for a DST or a digital permanent establishment purpose.

Sincerely,

P. Verhaeghe[21]

[21] Contact : paul.verhaeghe3@telenet.be – P. Verhaeghe, avenue de Villegas 6, 1083 Brussels, Belgium