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Why 'Digital Taxes' Are the New Trade War Flashpoint

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Big internet companies have long been the target of complaints that they don't pay enough in taxes. Fed up, France became the first country to introduce a "digital tax" -- a 3% levy on the digital revenue of companies that make their sales primarily in cyberspace, such as Facebook Inc. and Alphabet Inc.'s Google. Other nations are also targeting companies -- many of which are American -- that have multinational earnings that often escape the taxman's grip. The U.S. has threatened retaliatory tariffs, potentially opening another front in the global trade war.

1. How does a digital tax work?

The idea is to focus taxation where users of online services are located, rather than where companies base their regional headquarters or book their earnings. Targeting revenue rather than profit gets around techniques many companies use to shift their earnings to lower-tax jurisdictions. France moved ahead with its law in July 2019 after wider efforts by the European Union to develop a harmonized approach failed to make progress. Its 3% levy applies to companies with at least 750 million euros ($845 million) in global revenue and digital sales of 25 million euros in France. Of about 30 businesses affected, most are American, but the list also includes Chinese, German, British and even French firms.

2. How is the U.S. fighting back?

The U.S. government says France's tax is discriminatory, fighting back in December 2019 with proposed tariffs on roughly $2.4 billion in signature French products, including wine, cheese, handbags and makeup. France said the EU would retaliate against any U.S. sanctions. In January, the two countries agreed on a truce on the sidelines of the World Economic Forum, whereby neither side would impose tariffs right away. France agreed to delay collection of the digital tax due until the end of 2020 to allow for further talks and renewed efforts to reach a multilateral solution. It hasn't agreed to scrap the tax altogether.

3. Could this be amicably resolved?

France denies that the levy is discriminatory, though it has said it would drop its tax if the U.S. and others agree to a global effort for a uniform approach under the stewardship of the Paris-based Organization for Economic Cooperation and Development. Long before adopting its digital tax, France had pushed for a EU-wide digital levy that was scrapped when four countries -- Sweden,

Finland, Denmark and Ireland -- refused to accept it. The U.S. is exploring whether to open investigations into the digital taxes proposed by other countries, citing Section 301 of the U.S. Trade Act of 1974, which allows it to retaliate for trade practices it deems unfair. It's the same tool President Donald Trump used to justify tariffs on Chinese goods due to alleged theft of intellectual property.

4. What's the case for a digital tax?

Because corporations are often domiciled in other countries -- including low-tax jurisdictions such as Ireland or Bermuda -- and shift money seamlessly across borders, companies that sell online can easily avoid paying taxes in countries where they nevertheless make significant sales. More fundamentally, France argues that the structure of the global economy has shifted to one based on data, rendering 20th-century tax systems archaic. According to 2018 figures from the European Commission, global tech companies pay a 9.5% average tax rate compared with 23.2% for traditional firms.

5. Who else is imposing a digital tax?

Italy enacted a tax similar to France's; it took effect on Jan. 1. Turkey's government has proposed a digital tax of 7.5%. The U.K. government plans to move ahead in April with a 2% levy on the revenues of search engines, social media platforms and online marketplaces that "derive value from U.K. users." Austria, Spain, and Belgium are also considering digital levies. Plans being floated would generally emulate the French model by taxing sales of electronic data, online advertising and the services of intermediaries such as Uber Technologies Inc. and Airbnb Inc. that connect users to products.

6. Why tax revenue instead of profit?

The short answer is that it's simpler to tax revenue. Taxing profits requires establishing where earnings actually accrue, which is hard enough for any global company but even more so in the digital sector; you might book a taxi in London, for instance, but your payment could be settled in Amsterdam. Politicians also argue that taxing revenue may be the best way to squeeze money out of companies such as Amazon.com Inc. that report large sales but paltry earnings. Still, it's not straightforward to work out which revenue is linked to a specific country. To do that, French tax collectors propose to tax internet companies proportionally to their "digital presence" in the country relative to the rest of the world.

7. Is tax a new front in the trade war?

Transatlantic tax wars aren't new. Apple Inc. was slapped with a 13 billion-euro bill for back taxes by the European Commission three years ago, which Chief Executive Officer Tim Cook called "political crap." The U.S. Treasury tried and failed to sway the EU's Apple investigation, which alleged that the company got an illegal subsidy in Ireland due to rules there governing the transfer of

sales booked elsewhere in Europe. The Commission has also probed Google's Irish tax arrangements and ordered Amazon to pay 250 million euros in back taxes to Luxembourg. Other U.S. companies, including non-technology firms such as Starbucks Corp. and Nike Inc., have also been targeted in tax probes. The EU insists that the common thread isn't that they're American but that they've used complex legal structures and intellectual-property licensing to limit their tax payments.

8. How are tech companies responding?

Tax is only part of a bigger EU backlash against big tech. Internet firms have been put on notice over issues ranging from privacy to market dominance -- and they're fighting back with lobbying and court cases. Google won a legal fight against a $1.2 billion French tax bill in April. Apple and Amazon are contesting their respective European tax decisions in EU courts, and a legal victory could halt that part of the bloc's crusade. Some companies may be changing their tax structures or moving income outside of the EU to stay ahead of the curve, as some European lawmakers alleged about Apple.