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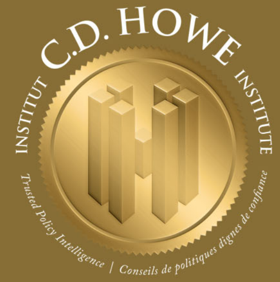

From: Jon Johnson

To: Global Affairs Canada and the Canada Revenue Agency

Date: December 1, 2020

Re: **FRANCE'S DIGITAL SERVICES TAX AND SECTION 301 – A CAUTIONARY TALE**

France has begun trying to collect its digital services tax (DST) from US companies, bringing this simmering issue between France and the US to a head.

The French DST, signed into law last year, imposes a three percent levy on revenues derived by companies providing certain digital services in France. The tax only applies to companies with income over certain thresholds and the practical effect is that almost every affected company is American.

The same day the law passed, the Office of the US Trade Representative (USTR) initiated a Section 301 investigation on the DST. Section 301 covers not only trade agreement violations but also practices that are unreasonable or discriminatory and burden or restrict US commerce. Last December, the USTR issued a report that raises multiple objections, including: the DST discriminates against US companies; the DST applies retroactively; the DST applies to gross revenues and not income; the DST applies to revenues unconnected to a presence in France contravening prevailing international tax principles; and the DST targets a small group of digital companies for special, unfavourable tax treatment.

France agreed in January to suspend collection of its DST pending the conclusion of negotiations being conducted through the Organization for Economic Cooperation and Development (OECD) to develop an internationally agreed approach to taxing digital services. But the US pulled out of those talks in June, and when the OECD recently advised that its discussions would extend into 2021, France started collecting its DST.

Meanwhile, last July, the US side outlined its intention to impose 25 percent duties on a wide range of French products. These tariffs, which are set to take effect next January 6, could offset any benefit that France hopes to achieve through its DST.

While the USTR action under Section 301 may seem arbitrary and not in accordance with internationally agreed rules, there are multiple problems with digital services taxes as described in a recent Tax Foundation survey of global digital taxation regimes. Problems include double taxation. The US provider of digital services to French customers will be subject to double taxation unless the US agrees to provide a credit for the French taxes paid.

If Canada unilaterally adopts a DST, US retaliation will likely follow regardless of the change from a Trump to a Biden administration.

As recommended in the new Communiqué from the C.D. Howe Institute's Fiscal and Tax Working Group, Canada could instead apply GST/HST to digital services. GST/HST currently applies to digital services only if the seller has a "permanent establishment" or physical presence in Canada. As described in the Tax Foundation report, many countries apply value added tax to digital services provided by non-resident suppliers.

One drawback is that Canada would probably depend on the non-resident supplier of the digital services to register in the GST/HST system and collect and remit the tax. However, the burden of the tax would be borne by the Canadian purchaser of the digital services and not the supplier. With a few exceptions, such as banks, Canadian purchasers who carry on businesses and who are registered in the GST/HST system are entitled to an input credit for all GST/HST paid, so that the economic burden of the GST/HST is passed on to end consumers.

If Canada wishes to tax imported digital services, the safest route is through the GST/HST system.

Before even considering taxing foreign suppliers of digital services, Canada should wait for the OECD to complete its work, and apply a DST only in accordance with a taxation system agreed to by other countries, particularly the United States.

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