Before the

Office of the United States Trade Representative

Washington, D.C.

In re: Action Pursuant to Section 301: France's Digital Services Tax	Docket No. USTR-2019-0009

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Comments of Engine Advocacy

Engine Advocacy respectfully submits the following comments to the Office of the United States Trade Representative, pursuant to USTR's request for comments as published in the Federal Register at 84 Fed. Reg. 66,956 on December 6, 2019.

I. Introduction

Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship. To that end, Engine welcomes U.S. scrutiny of international taxation regimes that have the potential to disproportionately affect U.S. digital firms—particularly startups. The French Digital Services Tax (DST) stands to impact the U.S. economy on the whole and could lead to a downturn in startup activity and growth, due to additional costs imposed on small businesses resulting from the French DST and similar taxes currently being considered by other nations.[1]

II. Burden on U.S. Economy from French DST

In its request for comments, USTR specifically asks for comments "with respect to any issue related to the action to be taken in this investigation." While the French DST undoubtedly will have significant effects on the digital sector of the U.S. economy and possibly embolden other nations to pursue similar taxation regimes, allowing the French DST to go into effect unchallenged will also have a negative impact on startups and small businesses seeking to establish themselves and grow outside of the United States.

A. Impact of DST on Startups

Despite the prominence of America's largest digital firms, small businesses and startups are the lifeblood of the American economy and are huge drivers of U.S. job growth. While the French digital services tax regime, signed into law on July 24, 2019, targets the roughly 30

[1] Elke Asen, *Announced, Proposed, and Implemented Digital Services Taxes in Europe* (July 18, 2019), available at: https://taxfoundation.org/digital-taxes-europe-2019/

largest firms providing online intermediation services and targeted digital advertising sales, Engine is concerned that this duplicative tax on large digital companies will still impact small businesses and startups. Indeed, preliminary studies and comments have indicated that the large digital companies will not primarily bear the impact of the tax - rather, the cost of the tax will be passed both to the consumer and to businesses operating in the digital marketplace.[2] One study by Deloitte and Taj determined that only 5% of the tax burden would impact the large firms directly subject to the tax; the rest of the burden will fall on consumers and businesses using their services at 55% and 40% respectively.[3]

Furthermore, because the French DST is a 3% tax on revenue rather than profit, companies with high revenues but low or negative profit margins will be forced to pass an even greater percentage of the cost of the DST onto their consumers or users - possibly leading a low margin company to no longer be market competitive.[4] In some instances, the tax could be an existential blow, forcing low margin companies to shutter their doors entirely. At the very least, they would have no choice but to pass the cost of the tax onto their customers, making them less competitive and possibly forcing them out of business.[5]

Digital services companies with tight margins are not a rare occurrence in the tech world. New businesses aggressively pour revenues back into their companies in order to reach more customers and expand their services. Many of the companies Engine works with launch with thin margins and almost insurmountable challenges, beginning with accessing enough capital to get off the ground, providing and expanding services to consumers, and finding new revenues and funding to grow their business in the process. Many of these startups are founded with limited staff, who often take no salary, few resources, and have little to no revenue to speak of.

Because of those limited resources, startups rely on services that are inexpensively provided by the U.S. firms targeted by France's DST. The digital services tax will likely require these companies to pass the tax onto consumers of their services. In other words, the DST will

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[2] Deloitte, Taj, *The French Digital Services Tax: An Economic Impact Assessment* (2019), available at: https://taj-strategie.fr/content/uploads/2020/03/dst-impact-assessment-march-2019.pdf

[3] Elizabeth Schulze, *France's Digital Tax Could Hurt Consumers More than Tech Companies* (July 12, 2019), available at: https://www.cnbc.com/2019/07/12/france-digital-tax-could-hurt-consumers-more-than-tech-companies.html

[4] Matthias Bauer, European Center for International Political Economy, *Five Questions about the Digital Services Tax to Pierre Moscovi* (June 2018), available at: https://ecipe.org/publications/five-questions-about-the-digital-services-tax/

[5] Id.

increase the costs of services crucial to startups' success (e.g. advertising on popular internet platforms), which will further raise barriers to entry, making it even harder for innovative new digital companies to break into the market.[6]

Engine is concerned that while France's DST is framed as if it impacts only the largest digital companies, the lasting impacts of the tax framework could have a detrimental impact on startups. In forcing large affected companies to pass on costs to the consumer of services, the French DST risks eliminating competition both through enabling the companies that can afford the added tax burden and by raising costs on startups for vital and previously inexpensive services. The current low cost of online advertising services provided by the largely American companies subject to the French DST has enabled many startups and small businesses to use these services to grow their companies effectively and inexpensively.[7] These services generate a lot of value for companies with thin margins or small bank accounts. Levying a DST on these larger firms will not affect them alone. It threatens the value of their advertising services and therefore the ability of startups to grow and succeed. The added cost of the tax, which will be passed onto the consumers of these services, could eliminate startups' ability to use these services at all, which will decrease competition in the digital economy and further raise barriers to entry.[8] At a time where Congress and the Administration is investigating the market dominance of a few large digital platforms, enabling a digital services tax that only those few, large platforms can bear or navigate, eliminates new and smaller platforms' ability to compete in the market. If new and smaller platforms cannot shoulder the costs of the DST passed onto them, those few, large firms will truly be the only companies able to compete.

To make matters worse, the tax is retroactive. It applies to all transactions on January 1, 2019 and later. This is a huge administrative and compliance burden, as many companies were likely not tracking the revenues to calculate this tax prior to it being released publicly. Businesses will have to determine which revenue falls within the scope of the tax, which is further complicated by the tax's retroactivity.[9] This administrative and compliance burden will

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[6] Deloitte, Taj, *The French Digital Services Tax: An Economic Impact Assessment* (2019), available at: https://taj-strategie.fr/content/uploads/2020/03/dst-impact-assessment-march-2019.pdf

[7] Matthias Bauer, European Center for International Political Economy, *Five Questions about the Digital Services Tax to Pierre Moscovi* (June 2018), available at: https://ecipe.org/publications/five-questions-about-the-digital-services-tax/

[8] Id.

[9] Daniel Bunn, The Tax Foundation, *France's Digital Services Tax: Facts and Analysis* (March 11, 2019), available at: https://taxfoundation.org/france-digital-services-tax/

not apply only to those companies targeted by the tax—but to any company even remotely approaching that threshold. Those latter businesses will still have to determine whether they are actually subject to the tax—even if they determine that they're not. That process is further complicated by France mentioning that various users will be assigned different allocation metrics determined by the business model accessed by consumers.[10]

The DST's retroactivity exacerbates the law's already heavy compliance and administrative burden—and, because the tax applies to revenue, that burden will not just fall on large, profitable companies but newer, smaller ones as well. In fact, even in instances where tax is owed, that liability could still be dwarfed by the cost of determining the liability itself.[11] Furthermore, it would be irresponsible not to consider the fact that if the large companies targeted by the tax pass the tax through to its customers and consumers, they will do the same thing with the tax's compliance burden. This will further increase the cost of using these services, which will further raise barriers to entry and make it even more difficult for startups to expand their customer base and grow.

Moreover, the law is framed to specifically exclude French small businesses and startups, regardless of their in-country popularity.[12] Not only is this a discriminatory framework, but it creates the potential for French small businesses startups to grow and become globally competitive firms, while placing even more barriers for U.S. companies to grow in a similar fashion. While many American startups do not currently fall within the revenue scope outlined by France's DST, the tax does not operate in isolation. It will still have a large and detrimental effect on American startups. It is anti-growth and will increase costs on some of our country's fastest growing and most innovative companies.

Furthermore, no one has yet considered the effect the tax will have in the longer term. How will it affect American businesses whose revenues are too small now but may be captured by the tax in the future? It is not irresponsible to assume that, like the U.S.'s corporate Alternative Minimum Tax did, and the estate tax does now, it will force businesses into complicated, burdensome, and expensive tax planning in order to avoid the tax. That could

[10] Id.
[11] Id.
[12] See comments to USTR from the Computer and Communications Industry Association available at: https://www.ccianet.org/wp-content/uploads/2019/08/USTR-2019-0009-CCIA-Written-Comments-on-French-Digital-Tax.pdf

further distort incentives and divert capital away from research and other growth opportunities to tax planning. Taxes are powerful disincentives and negative motivators.

While the French DST is purportedly designed to hold startups and small businesses harmless, a tax on revenue, rather than profit, could likely have a greater reach than intended. Though the revenue threshold for impact in this case appears high—€ 750 million Euros for global taxable digital services and € 25 million Euro for taxable digital services in France—the tax threatens to capture those companies with high revenues but without significant profits, or even those operating in the red.[13] Moreover, a tax on revenue rather than profit has an increasingly disparate effect on companies with low margins or net operating losses. When the European Commission was considering a European Union-wide DST, one study found that a 3% tax on the revenue of a company with a 5% profit margin, amounted to a corporate tax rate of 50%.[14] There is a reason why not a single OECD country has a corporate tax rate that high, and why corporate tax rates in the developed world are trending downwards.[15] A 50% marginal tax rate is deemed too burdensome by the entire developed world. That 3% tax on revenue combined with a further possible patchwork of digital services taxes around the globe, could be enough to force U.S. startups and small businesses to shutter their doors. It is almost certainly impossible for them to compete with the current digital titans under those circumstances.

B. Discouraged Mergers and Acquisitions

As previously indicated, startups are risky ventures. On top of that, they often generate little, if any profit, in the early stages when founders choose to invest all or almost all of the revenues back into the company. Oftentimes, larger companies will swoop in and buy up promising startups. These acquisitions provide startup founders and their investors with exit opportunities that can help offset some of the risk in choosing to launch and fund a startup.

Unfortunately, the French DST creates a tremendous amount of uncertainty with regards to these acquisitions. If a startup under the threshold is exempt from the DST but is then bought

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[13] Bloomberg Tax, *Insight: France's Digital Services Tax Goes Ahead* (July 29, 2019) available at: https://news.bloombergtax.com/daily-tax-report-international/insight-frances-digital-services-tax-goes-ahead-1

[14] Matthias Bauer, European Center for International Political Economy, *Five Questions about the Digital Services Tax to Pierre Moscovi* (June 2018), available at: https://ecipe.org/publications/five-questions-about-the-digital-services-tax/

[15] Organization for Economic Co-operation and Development, *Corporate Tax Statistics Database*, available at: https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-database.htm

by a company that is subject to the DST, will that acquired firm then be subject to the DST? Does the company being acquired have the administrative procedures in place to calculate its liability under the tax? Presumably, suddenly being subject to a tax on revenue will have a significant effect on profitability and growth. How will that affect the acquisition or potential for acquisition? That uncertainty, regardless of how the tax itself will affect the economics of acquisition, is enough to make such acquisitions less frequent and less desirable. Moreover, with the DST in place, large firms not yet subject to the DST will likely have strong incentives not to acquire or merge with startups that might push their revenues over the threshold, as they would then be subject to a new tax on revenue—the DST. Taxes create strong incentives and disincentives—that's why governments often use them to drive policy. As Trade Representative, you must consider how this new tax will affect one of the most important elements of our start-up ecosystem—mergers and acquisitions. The effects could be far-reaching and severe. If other countries follow France's suit and start implementing their own DSTs, American startups could see higher or insurmountable barriers to selling their companies. That could mean a net-loss in innovation for the United States. Revolutionary and innovative startups might never find the opportunity to achieve the growth or economies of scale required to share their services and ideas globally.

C. Digital Taxation Uncertainty

Engine recognizes the growth of the digital age and the major shift that has occurred in the economy from brick-and-mortar stores to digital platforms and the need to possibly re-assess international taxation framework in light of this shift. The Organization for Economic Co-operation and Development is currently engaged in such an activity. Individual companies pursuing their own digital services taxation schemes will only serve to undermine an internationally collaborative process and provide an even greater administrative burden to companies that face possible exposure in determining whether they are indeed subject to the patchwork of laws. The French DST forces affected companies to undertake the costly burden to create a new framework to track and assess their tax liability based off of new data. These companies may also face this hurdle in other countries as well.

The uncertainty created by the French DST and possibility of other nations implementing similar laws and the compliance costs associated with those laws may simply amount to too much for some companies to bear. Moreover, the French digital services tax and the potential patchwork of laws or overlapping laws might serve as an outright deterrent for smaller digital companies to grow or even launch, because of an inability to undertake complex international tax compliance.[16]

III. Conclusion

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

Respectfully Submitted,

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[16] Id.