April 30, 2021

The Honorable Katherine C. Tai
United States Trade Representative
600 17th Street NW
Washington, D.C. 20508

Docket No. USTR–2021–0008

RE: Proposed Actions in Section 301 Investigation of Digital Services Taxes - Multijurisdictional Issues

Comments of Engine Advocacy

Engine Advocacy respectfully submits the following comments to the Office of the United States Trade Representative (USTR), pursuant to the agency's request for comments published March 31, 2021.

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 agency scrutiny of international taxation regimes that have the potential to disproportionately affect U.S. digital firms—particularly startups. Austria, Italy, Spain, the United Kingdom, Turkey, and India have all implemented digital tax regimes that—despite taxing at varying rates and revenue levels—could all ultimately impact startup growth and result in the cost of the levies being passed down to users and small businesses. USTR should feel compelled to take the appropriate action needed to discourage unilateral digital services taxes in a manner that does not harm the U.S. startup ecosystem.

II. Burden on the U.S. Economy from the Implemented Digital Services Taxes

Engine is understanding of the need to update international taxation frameworks to reflect changes in the world economy and the growing reliance on Internet-enabled businesses. But any changes to international taxation frameworks should be fair and non-discriminatory and should not burden nascent startups. The digital services taxes (DSTs) from the six jurisdictions at issue will undoubtedly have an effect on the U.S. economy by trickling down—impacting American users, small businesses, and startups. And while these unilateral measures are harmful, they represent only a fraction of the DSTs that have been implemented or are under consideration. As Engine has stated in the past, startups are the lifeblood of the U.S. economy and are significant contributors to U.S. job growth.[1] Though most of the DSTs under consideration (with the exception of India) target high-revenue companies, these taxes do not and will not exist in a vacuum. And the proponents of these taxes seem to have given little consideration to the impact the taxes will have on small- to medium-sized companies. Instead, these DSTs—which are discriminatorily directed at American companies—will likely result in passed down costs that increase the price of services that these companies provide to small businesses and startups. As we have stated in the past, "[b]ecause these companies provide digital services important to nascent startups, like those that allow startups to reach new audiences and host critical computing tools in the cloud, startups will likely face rising fees for the traditionally inexpensive tools they need to grow."[2] And these services are crucial for users, including startups, to connect with consumers across the globe without needing a brick and mortar place of business—creating an outsized amount of value for these companies.[3] The DSTs at issue could ultimately result in some startups no longer being able to access covered services due to cost concerns. This could further cement the ability of only the largest players to dominate certain fields, limiting competition and crushing innovation.[4]

Indeed, preliminary studies concerning the French digital services tax (which is similar to some of those at issue here) indicated that costs of the tax would likely be passed down to consumers. As we previously indicated to USTR, "one study by Deloitte and Taj on the French DST determined that only five percent of the tax burden would impact the large firms directly subject to the tax; the rest of the burden will fall on consumers and businesses using their

---

[1] See Engine's Comments to the United States Trade Representative, available at: https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/5f99a9e26004c6772b63dd1c/1603906019130/Engine+Comments+301+Investigation+July+15%2C+2020.pdf.; U.S. Small Business Administration Office of Advocacy, 2019 Small Business Profile, available at: https://cdn.advocacy.sba.gov/wp-content/uploads/2019/04/23142719/2019-Small-Business-Profiles-US.pdf.
[2] Engine, *supra* note 1.
[3] *Id.*
[4] *Id.*

services at 55 percent and 40 percent respectively."[5] And as these taxes have been implemented, digital companies have responded by shifting the burden of the taxes. In September 2020, Google announced that it would add on an additional fee for advertisements in three countries at issue here—Austria, Turkey, and the U.K.—effectively passing on the cost associated with the DSTs.[6] And other companies, like Amazon and Netflix, have followed suit in countries with discriminatory DSTs.[7] Any shift in costs, however marginal, could be enough to force a nascent company to close its doors. Even successful startups that have gotten far enough to attract outside funding only have about $55,000 per month to work with—an amount that doesn't go very far when expenses like staffing, legal resources, and product development are factored in.[8] With such limited resources, many simply will be unable to afford the added burden caused by DSTs.

And while most of the DSTs at issue would subject only large digital firms to taxes themselves, the equalization levy imposed by the Indian government targets companies of much smaller size—a six percent levy on specified services for companies with a revenue threshold of around $267,000. With such a low threshold, startups doing business in or seeking to expand into India could easily be exposed to liability. And as Engine has stated in the past, "the lower revenue threshold exposes a greater number of small American companies to the levy, many of these startups will have to undertake costly tax planning to determine if they in fact owe tax, what their tax burden is, how to remit the tax."[9] Moreover, because DSTs are not income tax, the implemented taxes may result in companies not receiving credit for their payment in their home countries, and therefore may result in double taxation.[10]

The DSTs at issue also stand to significantly impact high growth startups and tech companies that are not yet profitable but nonetheless produce innovative products and services

[5] Engine, *supra* note 1; and, 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.
[6] Alex Barker, *Google to Pass on Cost of Digital Services Taxes on to Advertisers*, Financial Times (Sept. 1, 2020), https://www.ft.com/content/fda648aa-bb52-4ab2-aa18-46b5023cb893.
[7] *Id*; and, Dennis Waweru, *Netflix Increases Price in Kenya Following Digital Service Tax* (April 26, 2021), https://gadgets-africa.com/2021/04/26/netflix-increases-prices-in-kenya/.
[8] Engine, the Charles Koch Institute, and Startup Genome, The State of the Startup Ecosystem (April 2021), https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/60819983b7f8be1a2a99972d/1619106194054/The+State+of+the+Startup+Ecosystem.pdf.
[9] Engine, *supra* note 1; and, Surabhi Agarwal, *Big Tech takes Equalization Levy Row to U.S. Govt* (April 1, 2020) available at: https://economictimes.indiatimes.com/tech/internet/big-tech-takes-equalisation-levy-row-to-us-govt/articleshow/74922783.cms?from=mdr.
[10] *Id.*

and generate American jobs. Because these DSTs tax revenues rather than profits, they threaten to ensnare high revenue, low-profit businesses that will not have the funds necessary to plan for or pay the taxes. One study found that a three percent tax on the revenue of a company with a five percent profit margin amounted to a corporate tax rate of 60 percent;[11] therefore, companies with low profit margins could be forced to pass an even greater percentage of the tax on to consumers—like startups and small businesses—likely through increased prices. This would only serve to further limit their competitiveness in the marketplace.[12]

The taxes themselves—particularly for startups on the cusp of a threshold—also present a significant administrative and compliance burden for companies, many of whom may not be able to bear that cost. And for DSTs that are retroactive, affected companies are even more limited in their ability to undertake tax planning. Moreover, all affected or possibly affected businesses will have to undertake costly tax planning to determine what revenue falls within the scope of the taxes. While this may be more bearable for large, profitable firms, the cost could be significant for companies that have yet to turn a profit. As Engine noted to USTR with respect to the French DST, "even in instances where tax is owed, that liability could still be dwarfed by the cost of determining the liability itself. Furthermore, it would be irresponsible not to consider the fact that if the large companies targeted by the tax pass the tax through to its customers and consumers, they will do the same thing with the tax's compliance burden."[13] And the growing number of countries implementing unilateral DSTs means companies will face an extraordinary administrative burden across jurisdictions. Targeted companies may face similar liabilities with the same revenue taxed at different rates in multiple countries. As Engine has previously asserted, though "we are living in an increasingly digital world and international taxation frameworks should be re-examined in light of the digital economy, a patchwork approach will only benefit other nations' treasuries and push steep, unforeseen costs onto the U.S. startup ecosystem."[14]

Even further, these taxes are problematically anti-growth. It is possible that companies approaching the revenue threshold may choose to remain below the threshold so as to not trigger

---

[11] 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/.
[12] *Id.*
[13] See Engine's comments to the USTR regarding their 301 Investigation of the proposed French Digital Services Tax, available at: http://engine.is/s/Engine-Comments-USTR-France-DST.pdf.
[14] Engine, *supra* note 1.

the need to comply with the tax. Or a startup may simply choose to not expand at all so as to avoid that possibility. And in forcing startups to make this choice, the effect of the taxes could in turn serve to limit innovation. Because these taxes favor domestic companies at the expense of American digital firms, the taxes not only limit competition and user choice, but could restrict firm growth, limiting the ability of otherwise promising startups to innovate on a global scale. And because the levies force companies to undertake complicated tax planning, the measures "further distort incentives and divert capital away from research and other growth opportunities. . . Taxes are powerful disincentives and negative motivators."[15]

As Engine noted to the European Commission during the consultation process on a European Union-wide digital levy, aside from minimal efforts to exclude small businesses from having to remit DSTs, little consideration has been paid to the potential long-term ramifications for global small businesses and startups.[16] For example, as the pandemic continues to impact the global economy, will the revenue thresholds inch lower and ensnare more companies? And what about those companies that are too small to be directly affected now but could be affected in the future—will the DSTs limit this growth? Will DSTs have an impact on potential startup exits like mergers and acquisitions? As Engine has noted in the past, "[s]tartups are inherently risky ventures that often generate little profit in their early stages, when founders choose to invest all or most of their revenues back into the company. Mergers and acquisitions represent a promising exit strategy to help offset some of the risks inherent to funding a startup."[17] The merger of two startups could potentially push them over the threshold and therefore may no longer be an attractive exit option.

Finally, the burden of the DSTs is compounded by the continual pursuit of unilateral taxes, particularly as a multilateral approach is currently under consideration. By pursuing unilateral levies, the governments of Italy, Spain, Austria, Turkey, the U.K., and India are undermining a collaborative process that has been under way for some time at the Organization for Economic Co-operation and Development (OECD)/G20 level. Some of these countries have indicated support for that collaborative process or belong to a multinational body (e.g., the EU)

---

[15] Engine, *supra* note 13.
[16] Engine, *Supporting documentation from Engine Advocacy on a fair and competitive digital economy-digital levy* (April 12, 2021), https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/60885b67e21f7a4c9d0c61[…]c5/1619549031462/Engine+-+EU+Digital+Tax+Consultation.pdf.
[17] Engine, *supra* note 1.

that has indicated support for the process.[18] And while some have indicated that they are pursuing unilateral measures in order to recoup lost revenue stemming from the COVID-19 pandemic, many unilateral DSTs have been under consideration even prior to the coronavirus outbreak.[19] Ultimately, the jurisdictions considering DSTs or that have already implemented taxes—including those with respect to this request for comments—are doing so in order to discriminate against successful American digital companies, in contravention of international taxation norms. In doing so, the jurisdictions are enabling trickle down consequences for U.S. startups that stand to impact global innovation and startup growth.

Engine commends USTR for pursuing action as appropriate against the jurisdictions implementing discriminatory digital services taxes, and encourages the agency to continue to support a multilateral solution at the OECD. We similarly encourage the agency to push back against other jurisdictions considering or implementing similar taxes. While we do not have feedback with respect to what duties should be issued, we do feel that USTR should use their power to dissuade unilateral approaches in a manner that does not inhibit U.S. startup formation or growth.

III. Conclusion

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

Engine Advocacy
700 Pennsylvania Ave. SE
Washington, D.C. 20003
policy@engine.is

[18] Engine, *supra* note 16.
[19] *Id*; Information Technology Industry Council, *ITI Response to European Commission's Inception Impact Assessment for a Digital Levy* (Feb. 11, 2021), https://www.itic.org/documents/europe/2021.02.11ITIresponsetoEUIIAforadigitallevy.pdf.