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Dollar & Sense: France is not alone in its plan to tax tech giants
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PARTICIPANTS:

Lilian Faulhaber – Professor of Law, Georgetown Law Center

David Dollar – Senior Fellow, Foreign Policy, Global Economy and Development, John L. Thornton China Center, The Brookings Institution

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DOLLAR: Hi, I'm David Dollar, host of The Brookings trade podcast "Dollars & Sense." Today we're going to talk about the digital tax that France has introduced, the general ideas for digital taxation, and the larger issue of how to tax multinational enterprises in a world of capital mobility.

My guest is Lillian Faulhaber, a law professor at the Georgetown University Law Center here in Washington. Welcome to the show, Lillian.

FAULHABER: Thank you so much for having me.

DOLLAR: Since the French have already enacted their tax and since France is hosting the G7 summit on August 24-26, let's start with France. What is this French digital tax? What problem are they trying to address?

FAULHABER: So it's called the digital services tax and it's a 3 percent tax on gross revenue from three different types of so-called digital services. So revenue that's earned from selling advertising that's targeted to user data, revenue that's earned from the sale of data, and revenue that's earned from providing a platform for the online sale of goods or services. So, if you think about the types of taxpayers who are going to be subject to this tax, it's going to be social networks and it's going to be large multinational tech companies that don't necessarily directly sell online, but that provide their services say through apps or in other forms online.

Various French politicians have referred to this as a GAFA tax – that refers to Google Apple Facebook and Amazon. And because of the limits of the size of companies that will be subject to it it's assumed that it will target primarily these large multinational tech companies, most of whom are based in the United States.

Now the problem that France thinks that they're fixing is that these large tech companies are able to earn significant amounts of income in countries without having any type of physical presence. They don't need to have manufacturing facilities. They don't need to have store fronts. They're able to provide their services without being physically present. And this is because our existing international tax system, which was created in the 1920s, requires physical presence for income to be taxed. And so that was created at a time when there was less international trade and it was harder to provide goods and services without being in a country. And France, and the other countries that we will talk about, they've identified that the current system just feels outdated because it allows these tech companies to earn this revenue without actually being in the country that otherwise could tax them.

DOLLAR: So are other countries preparing similar taxes? And are they all the same or are we looking at perhaps a confusing situation with different approaches?

FAULHABER: There are a lot of countries that are proposing their own digital services taxes and they vary in different degrees. So, the United Kingdom has proposed one that they say is going to come out in April of 2020. It was part of their budget. They have issued guidance on it. They seem to be planning to continue moving forward with it. Boris Johnson has expressed support for it, and that's similar to the

French one but there are some differences. The rate is different, it's 2 percent, and there are provisions for credits for other digital services taxes.

There are other digital services taxes proposed in Spain and Austria. New Zealand is considering one … the Czech Republic. And a lot of these differ along the margins so some of them only target advertising revenue. Some of them target different types of income than the French one. So the concern is that these could all apply in different ways to the same types of taxpayers.

Beyond that, there have been for the last several years a whole host of other digital taxes which are not exactly the same as the French one, but that are also trying to target these same large multinational tech companies. And so the UK a few years ago had something called a Diverted Profits Tax. Australia had something called the Multinational Anti-Avoidance Law. We have other types of tests in India and other countries all of which are kind of getting at this concern that the physical presence requirement is outdated and that the international tax system needs to be reformed but they're all doing different things.

DOLLAR: So as you say, this does seem targeted particularly at a number of large American companies like Google, Facebook, and Amazon. And these companies are basically speaking out in opposition of some of these taxes. They're worried that they're going to face double taxation or triple taxation or multiple taxation. So do they have legitimate concerns?

FAULHABER: They're definitely not wrong. There's the possibility of having double or triple taxation and that's because all of these taxes could end up applying on top of each other. So if you think about the Digital Services Tax, that's a revenue tax. So that could apply on top of a corporate income tax. It could apply even in situations where the companies don't have any taxable income, because they have too many losses or too many expenses, because of gross revenue tax would still apply regardless of your expenses. So it's possible you could have a company that subject to income taxation, but also on various revenue taxes if they all define revenue differently or if they all target different types of revenue.

DOLLAR: The European Commission has its own effort to develop a digital tax, but they face the problem that they've got 20 plus members and some of their members like Luxembourg and Ireland are not really in favor of this approach. So what is the differentiation among these countries?

FAULHABER: So the European Commission's proposal…they had proposed a two-step process and the first step was a digital services tax and the French tax was actually modeled directly on their proposal. So they're doing something very similar to what all these other countries are doing. Now, they were not able to get the unanimous consent of the 28 member-states that they needed for the digital services tax and there are two primary reasons for that. One reason is that there are some countries that support the idea of a digital tax but they want this to move forward in an international process, so they didn't want the European Union moving forward without other non-EU countries coming forward. So, they oppose the digital services tax just because it was an EU-only effort. Another group of countries, they just don't want the changes that France and other countries are demanding because they're currently benefiting from the existing system. So if there were to be significant reforms that were to benefit some of the countries that have a lot of users or a lot of consumers these other countries who benefit from the status quo and are able to raise revenue might not be able to raise the revenue that they're currently able to raise.

DOLLAR: So the multinational companies to some extent are playing these countries off against each other.

FAULHABER: Maybe the countries themselves are playing themselves off of each other. I mean, the whole story of tax competition is one where countries are fighting to appeal to taxpayers, to get taxpayers into their jurisdictions or to otherwise encourage taxpayers to provide revenue. And the taxpayers are playing into that, but the countries themselves are the ones that are really doing the competition.

DOLLAR: So what are the prospects for a really well-coordinated approach to this? The OECD is leading an effort that involves more than 100 countries—well beyond the OECD the membership. It would seem the rational thing would be to have some kind of global solution. So what are the prospects for that?

FAULHABER: So that's the hope of the OECD. So, as you said, the OECD has this project that involves the inclusive framework that currently has 132 countries. A few weeks ago it had a 131, so it's constantly growing. And that has promised that there will be some sort of consensus on a digital tax solution by the end of 2020.

So the OECD, supported by the G-20, is currently debating two different types of digital tax solutions and they've broken it into pillar one and pillar two. The pillar one proposals are all essentially trying to allocate income to countries even when a company doesn't have a physical presence. And the pillar two proposals are essentially minimum taxes. They're saying if country A does not impose sufficient taxation then Country B is going to get to essentially top up the difference and is going to get to impose tax on the difference. So those are the two big areas that the OECD is considering. In terms of the likelihood of consensus, I think the thing that we have to keep in mind is that there are 132 countries. A lot of those countries have proposed digital taxes of their own, but a lot of them have not because a lot of them are also benefiting from the current system. And so the question is how likely is it that countries are going to agree to something that may take away their taxing jurisdiction in favor of countries who have users or consumers or some other type of link. And I think that's the open question.

You could argue that the French digital services tax is actually pushing some countries to the table because the French Digital Services Tax is explicitly designed so that once there is an OECD consensus the French Digital Services Tax will be removed. So it will be eliminated and France has announced that as soon as there's international agreement there will no longer be a digital services tax. So that may be encouraging some companies to push countries to the table to have some sort of international agreement. I think the open question is whether or not there will be effective international agreement.

DOLLAR: So the second pillar you mention is interesting. That really seems to me the general problem here is that some multinational enterprises end up paying very little tax. So how in practice can we actually enforce a minimum tax? How would that actually work in practice because it sounds like a good idea?

FAULHABER: Right. So I think that the two pillars together are basically addressing the two big issues here. One, that certain countries think they should have a right to tax. And two, certain other countries think that regardless of who gets to tax, there needs to be a minimum level of taxation. So interestingly, pillar two is if not directly modeled after U.S. tax reform provisions, very strongly influenced by some U.S. law that went into effect with the 2017 Tax Cuts and Jobs Act. And these two provisions that are basically the inspiration for pillar two are called the "GILTI" – the global intangible low taxed income provision – and the "BEAT" which is the base erosion and anti-avoidance tax. And those two together are essentially creating two different types of minimum taxes. And I think the guilty is sort of the most obvious model.

So what that does in the U.S., and what I understand the pillar two minimum tax will also do, is that it applies to subsidiaries. So if you imagine a U.S. parent – and it has subsidiaries all around the globe – if some of those subsidiaries have not paid sufficient taxation, then the U.S. will get to make up the difference. Now that's a little bit of a simplification, but the model that the OECD is considering would essentially say if France has a company, and that company has subsidiaries, and those subsidiaries have not paid enough – whatever enough, is there will have to be some sort of threshold level – then the difference between that minimum rate and the rate that has been paid will be due to France.

And so the idea here is that, one, it will force multinationals to pay a minimum rate of tax regardless of where they're located. And two, more strategically, it will take away the incentive for jurisdictions to have low tax rates. Because if it turns out that a company is going to have to pay 5 percent or 10 percent or whatever the number is, regardless of what your own jurisdictional tax rate is, then what's the benefit of offering a two percent rate. That's the whole idea. So the idea is that it's supposed to sort of bring up rates so that tax competition is no longer a race to the bottom, it's instead a race to whatever this minimum percentage is – whether that's five or 10 or whatever.

DOLLAR: So I'm definitely not a tax expert and some of this is definitely a little bit confusing to me. So, at heart, the parent company in a sense has to belong to some country. Am I right that that's a key provision?

FAULHABER: Yes.

DOLLAR: So we imagine there's such a thing as a French company, an American company, and so if they're not paying a sufficient amount of tax – which is what would presumably be negotiated in this international agreement – then basically the home country would be able to raise the tax.

FAULHABER: Exactly. And so the residents of a company is its own legal issue and generally there are two ways of determining the residents. If you think about the U.S. rules, we essentially say if you're incorporated in the United States you are a U.S. company. So any company which is incorporated in the United States, if it has subsidiaries, those subsidiaries are going to be subject to this rule. And in some other countries, they use the second method which essentially says if your sort of primary place of business is in this country then you're seen as a resident of this country and all of your subsidiaries would be subject to that. So you're right – you need to have a parent company residence and then that residence jurisdiction is the one that gets to make up the difference.

DOLLAR: And could you still have tax competition in the sense of what the tax rate is for the home country?

FAULHABER: Definitely. And I think that's actually an issue that's worth focusing on because what I just said was that it's not a race to the bottom, it's the race to the minimum rate. So whatever rate is agreed on is suddenly going to become the anchor for tax rates around the world because if the OED says everybody has to pay at least 5 percent, well then if you have a 12 percent or you have a 21 percent tax rate, that's much higher than the 5 percent minimum rate. And so there could still be residence country competition.

There could also be source country competition. So, you know, these subsidiaries are earning income in some other jurisdiction. And if that jurisdiction tax is higher than the minimum rate then there might be some pressure to push down to the minimum rate. So, this is saying a race to zero is a problem, but we don't know what rate they're going to set yet.

DOLLAR: So in this OECD led discussion are people talking about specific numbers? Because five strikes me as very, very low.

FAULHABER: So the OECD does not like to set specific numbers. So I've previously written about tax competition issues in the OECD, and there's a space in the OECD – the Forum on Harmful Tax Practices – that addresses tax competition, and the OECD has always been very explicit that they never say what counts as a low rate. The only rate that they're concerned about is a rate that is lower than the country is otherwise normally applying rates. So if you have a 35 percent rate and you provide some special 20 percent rate, even though 20 percent might not objectively seem low it's lower than your 35 percent rate. So the OECD has always been very wary of ever saying that something is a low rate in and of itself. So one of the big questions with pillar two, with this minimum tax pillar, is whether or not the countries sitting around the table at the OECD will be willing or able to agree to a rate. And if they're not willing or able to agree to a rate, then a minimum tax is not that effective. If instead they are willing to agree to a rate, then that adds a whole new dynamic to the tax competition space.

DOLLAR: So, if I understand correctly, some of this was already built into the U.S. corporate tax reform in 2017.

FAULHABER: Yes.

DOLLAR: Do we have any sense of how that's working? Because you still hear about companies booking profits in Ireland or booking profits in Luxembourg which suggests that they're still trying to get around even the reduced U.S. rate – about 21 percent – that's pretty high, actually. So is this new provision working?

FAULHABER: So that's an open question. We need a few more years of tax filings to actually see what's changed and there are a lot of moving parts because we had several other tax reform changes. So we had a shift to a quasi-territorial system which means that we don't tax worldwide income in the same way that we used to. We had a change in the rules that apply to repatriating your income. So those all kind of affect this.

One thing to keep in mind with the U.S. rule is that the rate that applies to the U.S. rule is lower than the 21 percent rate. So, there is a minimum tax, but it's lower than 21 percent. Now it's sort of fluctuating. There are different ways that you can make that lower or higher and it's actually changing in the next few years. This has eliminated tax competition entirely, but it has made it less attractive to have a subsidiary and a zero-rate jurisdiction. It may not have changed the appeal of having a subsidiary in say a 12 percent rate jurisdiction, which would still be…where the effect of the GILTY provision wouldn't maybe be as effective as it would in those zero percent jurisdictions.

DOLLAR: So I mentioned we have the G7 leaders' summit coming up August 24 to 26 and Biarritz, France, and I don't think this is a central part of the agenda. The French have set inequality is the theme, which is kind of interesting since what we're talking about definitely has a bearing on inequality, but my experience with these summits is often the formal agenda is not very important, it's what happens on the sideline. President Trump has certainly said some hostile things about the French digital tax and I'm sure he'll have a side meeting with President Macron. So is there a prospect for getting in some sense agreement between the U.S. and France or coordination among this G7 group?

FAULHABER: So one thing to keep in note is that in July the G7 finance ministers and central bankers had a meeting where they already gave their support to the OECD process that's going on – the OECD G20 process – so I think it's possible that the outcome of the G7 leaders' summit that's taking place will be that the G7 explicitly supports the OECD process and says that they're looking forward to seeing what the OECD comes up with at the end of 2020, and also that they support the two pillar approach which is what the finance minister said.

Now whether or not there are other in the margins meetings that affect this, that I think is more of a political question, and I think it's not clear whether or not the U.S. will be able to convince France to get rid of the digital services tax or whether or not there will be discussions about things like tariffs on French wine. But I do think the fact that the G7 has previously come out and supported the OECD process means that that's likely where there's going to be the move for consensus, that the G7 may come out in support of it, but it's unlikely they're going to do their own thing at the leaders' summit.

The U.S. has been a part of the OECD process. They are part of the inclusive framework. They have been part of all of the discussions. So whether or not there will be some sort of agreement, that depends on all of 132 countries. There is not a sense that the U.S. is the country that's blocking this right now but more that so many countries have their own interests that it's an open question as to whether or not they'll be able to come together and reach not just consensus but actually effective consensus for some sort of digital tax measure.

DOLLAR: The United States Trade Representative has raised the issue of whether this French digital tax might be a violation of WTO rules. Since this is the trade podcast – I probably should have said right at the beginning — this is an interesting new type of international trade. So French citizens turn to Amazon, and perhaps they buy a book and have it downloaded directly to their computer or they order something and have it delivered, so this is an interesting new aspect of international trade. Do you have a view on whether or not there's going to be problems with the WTO?

FAULHABER: So I'm not a trade lawyer, I'm a tax lawyer. But my understanding is that the U.S. is considering this as both a WTO violation and they're doing a Section 301 investigation. And I think the concern in both places is that this is specifically targeting U.S. multinationals. And if you look at the terms of the law it doesn't explicitly say Google, or Apple, or anything, but it does say multinationals with over 750 million euros of worldwide revenue, who engage in these types of digital services, who have a certain amount of revenue earned in France. And that has the effect of limiting it to not entirely U.S. companies, but primarily U.S. companies just because those are the more successful multinational tech companies. And so I think the trade question is going to be: If something ends up having the effect of applying to mainly U.S. companies, is that a trade question? I think the tax question is if we end up having back and forth retaliatory measures, is that actually going to make it impossible for countries to reach any type of international agreement. So, if the French measure and the proposed U.K. measure got some countries to the table at the OECD, and at least made them more serious about trying to reach consensus, is there the danger that pushback at the political level will actually make them less likely to reach any agreement because they'll be in the spotlight in a way that they weren't a few months ago.

DOLLAR: Last question, Lilian, follows from that. So are you optimistic that we'll get some kind of global agreement…two or three years down the road we'll look at the situation and feel that digital taxation is moving in a rational direction? And that more important issue about minimum taxation of multinational enterprises, that seems very important. So are you basically optimistic?

FAULHABER: Let's say I'm hopeful. I don't know if I would say I'm optimistic. I think the big question is what form any type of reform will take or any type of international agreement will take. I think it's basically impossible for us to stay with the status quo. I think countries are just too frustrated with the international tax system that we have now. So I'm very, I don't if I say optimistic, but I think it's very likely that there will be significant changes in the next few years. My concern is that those changes may end up being just a hodgepodge of unilateral measures and that I think is concerning. I think my hope and my aspiration is that that change will take the form of something that's just more international and more coordinated which will prevent there from being overlapping taxes that all apply inconsistently.

DOLLAR: I'm David Dollar and I've been talking to Lillian Faulhaber about the important issue of digital taxation, France's digital tax, other ideas, what's happening with the multinational corporation taxation, et cetera. Thank you for helping us understand some really complicated but obviously very important stuff. So, thanks.

FAULHABER: Thank you so much.

DOLLAR: Thank you all for listening. We'll be releasing new episodes of Dollar & Sense every other week, so if you haven't already, make sure to subscribe on Apple Podcasts or wherever else you get your podcasts, and stay tuned.

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