Intelligence MEMOS

From: Jon Johnson

To: Global Affairs Canada and the CRA

Date: January 12, 2021

Re: **USTR Suspends Section 301 Tariffs Against French Goods**

Further to my December 1 Memo, the United States Trade Representative (USTR) has now suspended the Section 301 tariffs scheduled to be applied on January 6 to French goods as retaliation for that nation's digital services tax (DST).

The stated reason was that the USTR is conducting investigations of such taxes in other jurisdictions and wants to develop a co-ordinated approach.

Also on January 6, the USTR released reports announcing the results of three further DST investigations, namely against India, Italy and Turkey. The India and Turkey reports expressly state the DSTs in question are actionable under Section 301 and the Italy report comes to the same conclusion, although no tariffs are being imposed.

There are themes running through each of the reports similar to those in the report respecting France's DST.

Each one maintains that the DST discriminates against US digital services companies. Perhaps most obvious is the Indian DST, which applies only to foreign companies, the vast majority of which are US. It also targets services supplied digitally (such as a streamed movie) but not similar non-digital services (such as the DVD of the very same film).

Each report maintains that the DST is inconsistent with international tax principles. Each contends that because the DST taxes companies with no permanent establishment in, and hence no territorial connection with, the host country, the DST is not consistent with international practice as reflected in tax treaties. Also, each DST is based on a company's gross revenue and not its income, which each report maintains is an inappropriate basis for taxation.

Each unreasonably burden US commerce, says USTR, which takes particular exception to the wide range of services covered by India's DST. The Turkey report complains that the Turkish rate of 7.5 percent is far higher than any other DST. All reports complain about double taxation, with each US service provider being subject to a DST on gross revenue being imposed by the host country and then to corporate tax in the US. It should be noted that the US has walked away from OECD-led discussions to resolve various issues arising from DSTs, including double taxation.

Is there more to the USTR decision not to proceed with its French tariffs than its stated explanation of wanting to develop a co-ordinated approach to DST investigations? It is possible that the current USTR, with only a few days remaining in the Trump administration, wishes to leave this issue to the incoming Biden USTR.

However, it would be a mistake for Global Affairs and the Canada Revenue Agency to conclude the US has backed off retaliating against countries that unilaterally impose DSTs on US suppliers or that a Biden USTR will approach the matter any differently.

Canada may, however, take some comfort in the fact that embedded in footnotes in the India, Turkey and French reports is a statement that, besides income, consumption is an appropriate basis for taxation through value-added taxes.

That means Canada's new plan to extend the GST/HST to digital services provided to consumers by foreign companies may not draw US fire.

Jon Johnson is a former advisor to the Canadian government during NAFTA negotiations and is a Senior Fellow at the C.D. Howe Institute.