Tax Policy Alert

US compromises with the UK, France, Italy, Spain and Austria on digital services taxes and trade actions

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In brief

Austria, France, Italy, Spain, the United Kingdom and the United States on 21 October issued a joint statement on a compromise reached regarding digital services taxes (DSTs) and related unilateral measures. It follows the OECD Inclusive Framework (IF) statement of 8 October which contained details on unwinding existing DSTs and an agreement not to introduce further unilateral measures in the lead-up to the implementation of Pillar One. Under the joint statement, Austria, France, Italy, Spain, and the United Kingdom undertake to withdraw their DST rules for all companies once Pillar One takes effect. The same countries also agreed that DST liabilities accrued in their territories in the period beginning on 1 January 2022 and ending on the earlier of the date the multilateral convention (MLC) implementing Pillar One comes into force, or 31 December 2023 (the Interim Period) would be credited against the tax liability arising from the introduction of Amount A under Pillar One.

In return, the United States agrees to terminate proposed trade actions, including for periods before 8 October, and not to impose any new trade actions, until the end of the Interim Period with respect to the existing DSTs imposed by the countries participating in the joint statement.

In detail

Background

Following the enactment of DSTs by a number of European countries, the United States launched ‘Section 301 investigations’ against a number of countries. In December 2019, the United States Trade Representative (USTR) found that the DST adopted by France was subject to action under Section 301 based on findings that the DST discriminated against US digital companies, was inconsistent with principles of international taxation, and burdened US companies. In January 2021, the USTR had similar findings for the DSTs adopted by Austria, Italy, Spain, Turkey, and the United Kingdom. The USTR warned that trade tariffs would be implemented against countries with such unilateral measures if they were not repealed. Many countries had indicated that they would only repeal DST-type measures following the introduction of Pillar One, and most countries with DSTs have been charging and collecting DST liabilities since then, notwithstanding the threat of trade tariffs. In June 2021, the USTR announced the imposition of additional tariffs on certain goods from these countries, which were immediately suspended for 180 days. The USTR statement indicated that the suspension was in the interest of completing multilateral negotiations at the OECD and the G20 on an international system of taxation.

The IF agreement signed 8 October (see our insight here) noted that the Pillar One MLC will remove existing DSTs and “relevant similar measures” for all companies, including those that are not in scope of Pillar One. It also commits parties not to introduce additional, new DST-like measures. Specifically, the Statement requires the parties not to introduce any newly enacted DSTs (or similar) from 8 October 2021, until the earlier of 31 December, 2023 or the coming into force of the MLC . In this context, Canada committed to finalizing legislation to enact a DST by 1 January 2022 but would only impose it if the MLC had not come into force by 31 December 2023. In that event, Canada would start imposing the DST on 1 January 2024 retroactively, in respect of in-scope revenues earned since 1 January 2022 (see our Tax Insights - Canada).

The Joint Statement (21 October 2021)

The joint statement is characterized as a “political compromise” addressing the transitional period during the implementation of Pillar One. Under the compromise, the five countries that enacted DSTs before 8 October 2021, are not required to withdraw their DSTs until Pillar One takes effect the compromise also states that the United States will terminate any proposed trade actions and commit not to impose any further trade actions with respect to the existing DSTs until the end of the Interim Period. Subsequent to the release of the joint statement, the USTR issued a press release confirming that in return for the commitment to withdraw DSTs, “the United States will terminate the currently-suspended additional duties on goods of Austria, France, Italy, Spain, and the United Kingdom that had been adopted in the DST Section 301 investigations”.

In the joint statement, the six countries also agreed to a DST credit mechanism for businesses subject to Amount A. This mechanism provides that "*to the extent that taxes that accrue to Austria, France, Italy, Spain, and the United Kingdom with respect to existing Unilateral Measures during a defined period after political agreement is reached, and before Pillar 1 takes effect, exceed an amount equivalent to the tax due under Pillar 1 in the first full year of Pillar 1 implementation (prorated to achieve proportionality with the length of the Interim Period), such excess will be creditable against the portion of the corporate income tax liability associated with Amount A as computed under Pillar 1 in these countries, respectively*.” In other words, the excess between the total DST liability in the Interim Period and a deemed Amount A liability for the same period can be used as a credit against the corporate tax liability arising from Amount A. The DST excess credit can also be carried forward until fully utilized (see Table 1).

The DST credit can also be employed by groups coming into scope of Pillar One no later than four years after the first year of implementation.

The takeaway

For groups in scope of Pillar One, i.e., groups with global turnover above EUR 20bn and profit margin above 10%.

DSTs in Austria, France, Italy, Spain and the United Kingdom: The DST liability in excess of the tax liability created by Amount A of Pillar One (in the first year of implementation) will be credited against the corporate tax liability arising from Amount A. The relevant DST liability will accrue in the Interim Period, the period between 1 January 2022 and 31 December 2023 (or the date the Pillar One multilateral convention comes into force, if earlier).

DSTs in countries that did not participate in the joint statement or IF Statement (e.g., India, Turkey and Kenya): Nothing changes and no credit against Pillar One is allowed (unless of course we see further agreements in the months ahead).

For groups not in scope of Pillar One, nothing will change until further notice. The DSTs are calculated as normal and cannot be credited or offset against the corporate tax liability. Furthermore, the abandonment by the USTR of Section 301 actions for any periods prior to 1 January 2024 leaves these businesses with no possible relief. This will disappoint many businesses that are subject to local DSTs.

As provided in the IF Statement, once Pillar One is implemented, DSTs and similar measures will be repealed for all groups, including those not in scope of Pillar One and for all countries that joined the IF Statement, including India and Turkey.

Kenya has not signed up to the 8 October IF agreement and hence, is neither bound to implement Pillar One nor bound to repeal its DST.

The USTR stated that it is proceeding with the formal steps required for terminating the Section 301 trade actions against the countries participating in the joint statement. Given that the defined term of the Interim Period in the joint statement has a period ending 31 December 2023 (unless the MLC comes into force first), this statement could be interpreted to implicitly sanction DSTs from 1 January 2024 if the MLC has not 'come into force.'

The agreement underlying the joint statement may not be particularly substantive, but it may be fashioned to alleviate recently expressed concerns by members of the US Congress to the US Treasury regarding the repeal of DSTs seemingly targeted at large US multinational companies. Multinational entities should model the effect of DSTs and consider their existence when implementing business changes.

Table 1. Calculation of the DST credit

Calculate the corporate tax liability arising from Amount A in the five countries in the first full year of Pillar One implementation.
Calculate INTERIM PILLAR One AMOUNT = Corporate tax liability arising from Amount A * (days in interim period / 365)
Calculate DST credit = DST paid in interim period - INTERIM PILLAR One AMOUNT
Offset DST credit against Amount A corporate tax liability
If DST credit has not been fully utilized in the previous year, it can be carried forward to subsequent years (until fully utilized)

Let’s talk

For a deeper discussion of how the digital services tax and trade action compromise might affect your business, please contact:

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