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Indirect Tax Alert

USTR formalizes duty actions regarding France's Digital Services Tax with deferred implementation to 2021

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Executive summary

On 10 July 2020, the United States (US) Trade Representative (USTR) announced that the US would take action against France's Digital Services Tax (DST) in the form of an additional 25% ad valorem duty on specified French-origin goods.[1] The tariffs are scheduled to take effect on 6 January 2021, 180 days after the determination of action. The list covers 21 tariff subheadings, with an estimated trade value for calendar year 2019 of approximately US$1.3 billion.[2] Targeted items include cosmetics and handbags. The announcement comes after the US withdrew from negotiations regarding DSTs at the Organisation of Economic Co-operation and Development (OECD) level in June.

Detailed discussion

In July 2019, France implemented a 3% DST on companies that had global revenues generated by "digital interface" services provided to French users. The tax, retroactive to 1 January 2019, applies to companies that have global, annual revenues in excess of €750 million, or $845 million at the current exchange rate, and that have €25 million, or $28.15 million, of digital sales that are generated in France (See EY Global Tax Alert, *US initiates action against France's Digital Services Tax, issues additional exclusions on China-origin goods and supplements list of products under EU subsidies dispute*, dated 12 July 2019).

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The US determined that the DST was directed primarily towards US companies. Subsequently, the USTR conducted an investigation under Section 301 of the *Trade Act of 1974* (Section 301) into the French tax to determine if it was discriminatory against US companies.[3] Following the investigation, the USTR released a report of the findings along with the issuance of a USTR notice summarizing the findings, proposed actions, and next steps. The USTR's notice stated that the DST created a burden on US commerce due to five primary findings, which included that the tax was discriminatory against US digital companies and the tax's application to a small group of digital companies violated international tax principles against targeting the digital economy.

Based on these findings, the USTR determined that the US was entitled to take appropriate, responsive action under Section 301. The USTR then proposed tariffs of up to 100% on targeted French-origin goods, such as cheeses, sparkling wine, cosmetics, handbags and porcelain.[4] In sum, the goods covered under the proposed actions had an estimated $2.4 billion of import value. The implementation of the tariffs was ultimately suspended after France announced it would suspend the collection of the DST, pending negotiations between the US and France at the OECD level.

On 10 July 2020, the USTR issued a notice that the US would move forward with imposing a 25% punitive tariff on certain French-origin goods. The final list was reduced from the original list of 63 subheadings to cover 21 tariff subheadings. Finally, the USTR announced that it would invoke a delayed implementation date to 6 January 2021.

Key products on the announced list include:

- Lip make-up preparations imported under the Harmonized Tariff Schedule of the US (HTSUS) 3304.10.00
- Eye make-up preparations imported under HTSUS 3304.20.00
- Beauty or make-up powders, whether or not compressed imported under 3304.91.00
- Handbags, with or without shoulder strap or without handle, with outer surface of leather, composition or patent leather, nesoi, over $20 each imported under HTSUS 4202.21.90
- Handbags, with or without shoulder straps or without handle, with outer surface of sheeting of plastics imported under HTSUS 4202.22.15

While the 180-day period between the announcement and the implementation of the punitive tariffs suggests negotiations between the US and France could continue, it should be noted that the USTR included language in the notice leaving open the possibility that tariffs could be implemented sooner.[5]

Further, while the USTR determined that the additional 25% duties on products covered by the trade action "should result in the collection of tariffs at comparable, though somewhat lower amounts," compared to the value of the DST collection by France from US companies. The USTR will continue to monitor the effect of the trade action and the progress of discussions with France, and may adopt appropriate modifications.

Last month the USTR also initiated a Section 301 investigation into DSTs that have been adopted, or are under consideration, in Austria, Brazil, the Czech Republic, the European Union (EU), India, Indonesia, Italy, Spain, Turkey, and the United Kingdom. Public comments regarding the investigation are due 15 July 2020. See EY Global Tax Alert, *USTR initiates investigations into digital services taxes either adopted, or under consideration, by certain jurisdictions*, dated 4 June 2020. Further actions in response to those countries' DSTs are expected later this summer.

Actions for businesses

The trade environment remains extremely volatile. Along with this notice, companies that import French goods may also be subject to increased duties in the ongoing review of the Section 301 action in response to subsidies provided by the EU and Member States on large civil aircraft. See EY Global Tax Alert, *USTR proposes carousel tariff retaliation on EU goods under Section 301*, dated 26 June 2020. Companies that import French-origin goods which may be impacted under either of these actions should begin planning. Immediate actions companies can consider are:

- Fully understand the extent of products impacted on the proposed list of 8-digit Harmonized Tariff codes
- Review options to mitigate the impact of any potential duties, such as:
  - Utilizing US Foreign-Trade Zones or bonded warehouse storage mechanisms to provide tariff deferral, and eliminate tariffs on products re-exported
  - Structuring transactions to obtain refunds of the 301 tariffs paid through the US drawback program
  - Adjusting approaches to reduce the customs value of US imports such as first sale for export or adjustments to transfer prices

- Determine whether US customs bonds are adequate to support the increase in tariffs
- Review overall compliance processes and procedures, including classification determinations, to properly support all Customs declarations due to increased compliance enforcement and review of imports from trade remedy subject countries

Additionally, US distributors who purchase from related parties should consider transfer price impacts by the imposition of any new Section 301 duties. Along with the strategic importance of mitigating duty impact while aligning the income tax and customs approaches, mechanics for reporting any transfer pricing adjustments to US Customs should also be reviewed.

This process may be particularly complex when duties are present for only a portion of the year. US Customs has very specific rules for reporting adjustments to prices made after importation, such as transfer pricing adjustments. These rules require that the importer take specific actions before importation of goods for which prices may be adjusted, including adding customs specific language to transfer pricing policies. With proper planning, refunds may be obtained on duties paid should transfer prices be reduced. As these new Section 301 duties, if implemented, will likely take effect early next year, importers should address these requirements now to prepare appropriate mitigation when the punitive duties are imposed.

Endnotes

1. See USTR "Notice of Action in the Section 301 Investigation of France's Digital Services Tax."
2. Unless otherwise designated, all currency references in the Alert are in US$.
3. 84 FR 34042.
4. 84 FR 66956.
5. In the event the USTR determines that the suspension of the additional duties should be for less than a period of 180 days, the USTR will issue a subsequent notice amending the effective date.

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