

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

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Executive summary

On 10 July 2019, the United States Trade Representative (USTR) announced it would commence an investigation under Section 301 of the *Trade Act of 1974* into France's pending Digital Services Tax.¹ The DST legislation in France, which is moving through the French legislative process, is the farthest advanced, but many other countries around the world also are considering the enactment of such a tax that would apply to digital businesses based on the local presence of users. The US action is utilizing the trade mechanism under Section 301 to address what is seen as unfair treatment of US-based companies under the DST.

In addition, with respect to US-China trade, the USTR published, in a Federal Register Notice (FRN) on 9 July 2019, a new set of exclusions to 110 products subject to a 25% punitive tariff as part of the 818 tariff lines covering US\$34 billion² worth of imports from China annually (US List 1).³ This is the sixth exclusion announcement from the USTR to date as the agency continues to review company requests for relief from the punitive tariffs.

Also, with respect to US-EU trade, the USTR announced on 1 July 2019 a proposed list of additional products for tariff countermeasures in response to the ongoing review of harm caused by European Union (EU) aircraft subsidies. A total

of 89 tariff subheadings with an approximate trade value of \$4 billion have been added to the \$21 billion initial list published on 12 April. The list of additional products is provided in an FRN dated 5 July 2019.⁴

All three USTR trade actions are summarized below.

Detailed discussion

Section 301 investigation of France's Digital Services Tax

On 10 July 2019, the USTR announced the initiation of a Section 301 investigation into the DST that is currently moving through the French legislative process. The tax, passed by the French Senate on 11 July 2019 and subject to France's Constitutional Counsel for consideration of its validity under French law, will consist of a 3% levy on global revenues generated by "digital interface" services provided to French users. The tax will apply to companies that have global, annual revenues in excess of €750 million, or US\$845 million, and that have €25 million, or US\$28.15 million, of digital sales that are generated in France.

The tax will be retroactive to 1 January 2019. It has been suggested, based on the text of the bill as well as comments from French officials, that the DST is intended to target the US technology sector. France's Finance Minister, Bruno Le Maire, has stated that tech giants pay little tax in large European countries, which he calls a "fiscal injustice."⁵ The tax is estimated to impact 30 companies, which includes one French company, and will raise approximately €500 million.

The Section 301 investigation will seek to determine if the DST is discriminatory and unreasonable to an extent where it will cause harm to US companies. If the USTR finds that the DST tax will have a material impact on US industry and commerce, it will then determine a responsive action to take, pursuant to the authority granted to the USTR under Section 301 of the *Trade Act of 1974*. The response may come in the form of negotiations with the French Government or in the form of retaliatory measures through tariffs on specific goods originating from France, as seen with the Section 301 punitive tariffs on China. USTR Lighthizer has expressed his belief that the tax will disproportionately impact US businesses and that it is a matter the US should act forcefully upon.⁶

The USTR announcement provides a timeline for the investigation as well as a request for public comment. Public comments can be submitted via the Federal eRulemaking Portal (<http://www.regulations.gov>) and should focus on whether the French levy is unreasonable or discriminatory, the extent to which it may burden US commerce, and what, if any, actions should be taken by the USTR in response. The deadline for filing requests to appear at the public hearing, as well as a written version of proposed oral testimony, is 12 August 2019. All written comments must be submitted by 19 August 2019 by noon EDT, the same date that the Section 301 committee will convene for the public hearing. Post-hearing submissions must be filed by 26 August 2019.

Considering the imposition of any tariffs in response to the French DST, a non-direct trade matter, would be another in a series of actions by the US Administration to use US domestic trade law to address concerns with other countries' policies and actions. Other examples include the imposition of US tariffs on Steel and Aluminum under Section 232, earlier threats to impose tariffs on Mexico over immigration under the *International Emergency Economic Powers Act* (IEEPA), and the use of Section 301 against Chinese IPR policies and business practices.

USTR exclusions for Section 301 on China

On 22 March 2018, US President Trump executed a Presidential Memorandum directing the Administration to take a full range of action responding to China's acts, policies and practices involving unfair and harmful acquisition of US technology.⁷ The USTR subsequently proposed, and President Trump ordered, punitive duties of 25% to be imposed on List 1.

The USTR's 9 July 2019 FRN reaffirms that product exclusion decisions will be made based on the criteria stated in the notices establishing the exclusion process. Specifically, the criteria require applicants to provide the following detailed information for consideration of a determination to grant an exclusion: (1) availability of the product outside of China; (2) harm to US interests due to additional tariffs; (3) significance of the product to Chinese industrial policy; and (4) whether an exclusion would undermine the objective of the Section 301 investigation.

Product exclusions apply to products that meet the description contained in the FRN Annex which are entered for consumption or withdrawn from warehouse on or after 12:01 EST on 6 July 2018 and are not limited to the particular requestor.

The FRN added a new specific 10-digit Harmonized Tariff Schedule (HTS) code, 9903.88.11, for reporting the products now covered by the latest exclusions. The latest exclusions apply to 110 products by specific descriptions. These products include:

- ▶ Various machinery parts imported under 8413.91.9095
- ▶ Fork-lift trucks, propane gas powered imported under 8427.20.8090
- ▶ Furnace casings imported under 8514.90.8000
- ▶ Medical equipment imported under 9018.90.6000
- ▶ Various electrical parts imported in CH 85

Congruent with the previous five lists of granted exclusions, the sixth list includes products such as pump parts, particularly those used for pumping water, heavy machinery parts, such as those used in forklifts, conveyers, elevators, electrical switches and medical devices. The USTR has appeared to heavily grant exclusions for products that fall under these similar categories.

As of 5 July 2019, with respect to List 1 subject items, the US has denied 6,625 or 61.20% of the 10,826 total exclusion requests received. Exclusions granted total 2,421 or 22.36% while 1,780 requests remain under review. To date, the USTR has denied 1,320 or 45.21% out of 2,920 requests for List 2; no exclusions have been granted. As described in EY Global Tax Alert, [USTR announces formal submission process for List 3; Mexico formally ratifies USMCA and India formally retaliates against US](#), dated 26 June 2019, the USTR has announced an exclusion procedure for List 3.

USTR proposes additional products for tariff countermeasures in response to harm caused by EU aircraft subsidies

On 8 April 2019, the USTR proposed tariff countermeasures in response to harm caused by EU aircraft subsidies. Under the authority of Section 301 of the *Trade Act of 1974*, the USTR proposed the imposition of additional ad valorem duties of up to 100% on a list of 326 HTSUS codes. The USTR received over 600 comments and held a hearing on 15 and 16 May 2019 in which over 40 individuals testified.

Based on the testimony and comments received, the USTR has stated that some of the effected parties requested that the USTR consider additional products that were not included in the initial list for possible inclusion on the final list of products to be subject to additional duties. The USTR has therefore published an Annex of additional products covered under 89 tariff subheadings valued at approximately \$4 billion in terms of the estimated import trade value for calendar year 2018. The final list of products may ultimately be subject to additional ad valorem duties of up to 100%.

If the USTR determines it will take action in the investigation, a final list of products to be subject to additional duties will be provided based upon products from both the initial and supplemental lists. The USTR notes that any final list will take into account the report of the World Trade Organization (WTO) Arbitrator on the appropriate level of countermeasures to be authorized by the WTO. Finally, the USTR has also indicated that in the event that the Arbitrator issues its decision prior to completion of the public comment process on the supplemental list, the USTR will consider actions to immediately impose increased duties on the products included in the initial list. Further possible actions with respect to products on the supplemental list will then be considered when appropriate.

Comments and requests to participate in the 5 August 2019 hearing must be received by 24 July 2019. Comments should address: (1) the specific products on the additional list to be subject to increased duties; (2) the level of the increase, if any, in the rate of duty; and (3) whether increased duties on particular products on the additional list might have an adverse effect upon US stakeholders, including small businesses and consumers.

Actions for businesses

Any US company that meets the criteria for application of the French DST should consider either participation in the public hearing or submission of written comments on the material impact the tax will have on its business. All businesses should closely monitor both the action taken on the French DST and other potential actions by the US Administration that may involve DST legislation in other countries or that may otherwise impact non-traditional global trade flows such as services.

For companies importing products from China, trade negotiations between the US and China continue to remain uncertain. With the tariffs expected to remain in place and with the potential for additional tariffs, any company

involved in US-China trade is encouraged to continue to identify the potential impact of additional duties and explore mitigation strategies. Close monitoring of the negotiations and any political developments is warranted, as companies will want to assess any liability under a changing tariff regime. Terms of any deal reached are likely to contain specific conditions that may impact certainty, and possibly duration, of outcome and will need to be closely analyzed once made available.

Immediate actions for such companies to consider include:

- ▶ Reviewing contracts with suppliers and with customers to understand who has liability for increased duties and if there are opportunities for negotiation.
- ▶ Mapping their complete, end-to-end supply chain to fully understand the extent of products impacted, potential costs, alternative sourcing options, and to assess any opportunities to mitigate impact such as tariff engineering to address potential increases in 301 tariffs.
- ▶ Identifying strategies to defer, eliminate, or recover the excess duties paid under Section 301 such as bonded warehouses, Foreign Trade Zones, substitution drawback, Chapter 98, and equivalent programs under China customs regulations.

- ▶ Exploring strategies to minimize the customs value of imported products subject to the additional duties under either 301 tariffs, re-evaluating current transfer pricing approaches, and for US imports, considering US customs strategies, such as First Sale for Export.

For companies importing products from the EU, trade negotiations between the US and EU continue to remain uncertain as does the timing of the WTO arbitrator finding. Similar to prior recommended actions for products listed on the preliminary list,⁸ the impact of any imports of identified products on the additional list should be immediately considered. Impacted businesses should consider submission of comments by the published deadline of 24 July 2019 and the potential request to participate in the public hearing scheduled on 5 August 2019. Continued close monitoring of the comments and public hearing, along with the final product list once determined, is warranted for US importers of EU-origin products.

Endnotes

1. https://ustr.gov/sites/default/files/enforcement/301Investigations/Initiation_of_Section_301_Investigation.pdf.
2. Unless otherwise designated, all currency references in the Alert are in US\$.
3. <https://www.federalregister.gov/documents/2019/07/09/2019-14562/notice-of-product-exclusions-chinas-acts-policies-and-practices-related-to-technology-transfer>.
4. https://ustr.gov/sites/default/files/enforcement/301Investigations/Notice_for_Additional_Products.pdf.
5. <https://www.reuters.com/article/us-usa-france-breakingviews/breakingviews-trump-lands-pre-emptive-blow-in-digital-tax-fight-idUSKCN1U61IL>.
6. <https://www.bloomberg.com/news/articles/2019-07-10/u-s-said-to-investigate-french-plan-for-tax-on-tech-giants>.
7. <https://www.whitehouse.gov/presidential-actions/presidential-memorandum-actions-united-states-related-section-301-investigation/>.
8. <https://globaltaxnews.ey.com/news/2019-5502-ustr-proposes-retaliatory-tariffs-on-326-products-as-countermeasure-to-eu-subsidies>.

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EYG no. 003330-19Gbl

1508-1600216 NY
ED None

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