15 July 2020 [17:50 Singapore Time]

The Honorable Robert E. Lighthizer
U.S. Trade Representative
Office of the United States Trade Representative 600 17th Street NW
Washington, DC 20508

Asia Internet Coalition (AIC) Comments and Recommendations to USTR's Initiation of Section 301 Investigations of Digital Services Taxes (DST) [Docket Number USTR-2020-0022] (updated)

On behalf of the Asia Internet Coalition (AIC) and its members, I am writing to express our sincere gratitude to the United States Trade Representative ("USTR") for the opportunity to submit comments on the investigations into digital services taxes under Section 301 of the 1974 Trade Act. AIC is an industry association comprised of leading Internet and technology companies in the Asia Pacific region with an objective to promote the understanding and resolution of Internet and ICT policy issues. Our members are Airbnb, Amazon, Apple, Expedia Group, Facebook, Google, LinkedIn, SAP, LINE, Rakuten, Twitter and Yahoo (Verizon Media), Cloudflare and Booking.com.

We commend this initiative by USTR and understand the concerns related to DSTs that are adopted or under consideration by the jurisdictions covered in the investigation. We have been actively involved in regular industry submission and dialogues on the regulations concerning digital taxation in Asia, detailed submissions on which can be found here.

As responsible stakeholders to shape the industry dialogue around the most pressing issues related to taxation, we appreciate the ability to participate in this discussion and the opportunity to provide inputs to the investigation. As such, please find appended to this letter detailed comments and recommendations, which we would like to respectfully request USTR to consider, which could be a useful feedback for future consultations to determine an optimal approach to implementing an effective taxation framework.

Should you have any questions or need clarification on any of the recommendations, please do not hesitate to contact our Secretariat Mr. Sarthak Luthra at Secretariat@aicasia.org or at +65 8739 1490. Importantly, we would also be happy to offer our inputs and insights, directly through meetings and discussions.

Sincerely,

Jeff Paine
Managing Director,
Asia Internet Coalition

Comments and Recommendations

The digital tax measures under investigation threaten to erode the U.S. tax base and undermine established international principles of taxation. The proliferation and expansion of these measures also threaten a growing number of innovative companies that are in parallel working with the governments on post-pandemic economic recovery efforts.

A. Unilateral DSTs undermine the stability of the international tax system

Unilateral DST measures threaten to undermine the existing international tax framework, which for decades has provided stability and predictability to tax administrators and taxpayers. This framework is based on nexus rules for the taxation of business income grounded in physical presence and on profit allocation rules based on the arm's length principle (ALP). These DSTs are not income taxes and are not consumption-based taxes such as a Goods and Services Tax (GST) or a Value-Added Tax (VAT), but DSTs constitute a third level of tax that is imposed on companies based on gross receipts. The proliferation and variation of these measures introduces significant uncertainty into the tax system.

In Asia, the AIC has been closely working with the governments of India, Indonesia, The Philippines and Thailand to advocate on the best practices to create an effective taxation regime. It is therefore concerning that the governments of India and Indonesia have proposed unilateral DSTs that go against international tax norms. The Indian Equalization Levy applies to the online sales of goods and services owned or facilitated by the e-commerce operator, or any combination of these services. The measures enacted by Indonesia could capture a wide variety of online activities including e-commerce sales and cloud computing and digitally-enabled financial services.

Such measures threaten to normalize discrimination in the global tax system, encourage countries to develop ever-expanding universes of activities subject to digital taxes, escalate the potential of double or multiple taxation on the same revenue, and jeopardize the foundation of a discipline international tax policy. A strong response by the USTR is therefore warranted, given that other jurisdictions could emulate the concept and impose similar taxes on trade dependent countries.

These unilateral measures are undermining the ability to achieve multilateral consensus at the Organization for Economic Cooperation and Development (OECD) on the tax challenges of the digitization of the economy.

Any derivation from the currently-agreed international tax framework must be driven by a durable rebalancing of taxing rights that reflects consensus among countries. Future rules must be clear, predictable, and applied neutrally across industries and business models.

We acknowledge that reaching multilateral consensus is difficult. However, these unilateral measures make it even harder for countries to achieve multilateral consensus on global standards to guide policymaking with respect to tax and the digital economy.

B. Unilateral DSTs are unreasonable, discriminatory and burdensome

1. European DSTs

With respect to the European measures under investigation, the high revenue thresholds and choice of covered services have the effect of carving-out most if not all domestic companies:

- **High revenue thresholds:** The various DSTs in countries including Austria, the Czech Republic, Italy, Spain, Turkey and the United Kingdom apply only to companies that meet two revenue thresholds – at least £500-€750 million in global gross revenue from taxable digital services, as well as a separate revenue threshold from taxable digital services supplied domestically or within the EU. A host of successful U.S. technology companies meet these thresholds, while very few (if any) domestic companies meet both thresholds.
- **Choice of covered services:** Among the DSTs enacted or proposed in Europe, the DST covers a subset of digital commercial activities where U.S. companies are more successful, and excludes revenue models that some of Europe's largest digital service providers rely on.

2. Brazil's digital services tax

Like the DSTs proposed or enacted in Europe, Brazil's proposed DST features a high threshold for global gross revenue (US$525 million) and domestic revenue threshold (US$17.5 million), and selectively targets digital services.

3. India's Equalisation Levy

On March 23, 2020 the Indian Parliament passed an amended national budget (Union Budget 2020), which includes an expansion of scope of India's existing "equalization levy" to include a new two percent tax on the sale of goods and services by non-Indian companies over the internet into India ("the tax"). The tax was incorporated into the Union Budget 2020 at a late stage and without any public consultation or Parliamentary debate and was set to apply from April 1, 2020 onwards.

The tax applies broadly to foreign "e-commerce operators," which includes any non-resident who owns, operates or manages a digital or electronic facility or platform for the online sale of goods and/or services, and/or who facilitates such a sale through their online platform or services.

The scope of the application is broad, applying too goods or services procured by a person resident in India and to any person who buys goods or services using an IP address located in India. India's Equalisation Levy is far broader in scope than the DSTs proposed or enacted in EU Member States. The measure is blatantly discriminatory against non-resident companies, and was enacted by Parliament without public consultation or debate.

The tax presents several key concerns:

- **It directly discriminates against U.S. firms and exports while explicitly exempting Indian firms.** The new tax targets "e-commerce operators," defined as *non-residents* who own, operate or manage a digital or electronic facility or platform for online sale of goods, online provision of services, or both. This broad definition would include large numbers of U.S. online marketplaces, services providers, retailers, and manufacturers. As drafted, the new tax will not be assessed against Indian companies and places the burden of reporting and compliance exclusively on non-Indian companies.
- **Its scope is significantly broader than that of national European digital services taxes.** Unlike DSTs, India's new tax applies to *all* services as well as *all* goods supplied over the internet. In addition, its exemption threshold is set at roughly US$267,000, substantially lower than thresholds included in national European DSTs, some of which are hundreds of millions of dollars.
- **It detracts from efforts at the OECD and sets a problematic precedent.** The Indian tax represents the broadest framing of a unilateral tax on e-commerce firms that we have seen to date, and runs directly counter to the Indian Government's commitment to reaching a

multilateral solution in ongoing negotiations at the OECD on the taxation challenges of digitalization to the global economy.

4. Indonesia's Corporate Income Tax and Electronic Transaction Tax

The e-commerce industry in Indonesia is still very much in its nascent stage. E-commerce expenditure in Indonesia is still relatively low at 3% of total retail, as compared to 16% for China and 12% for US. Given e-commerce is still in an early stage of development, stringent tax regulations may halt the growth of the sector and diminish the economic as well as social benefits. It could also add to inequality as the burden of compliance will fall hardest on smaller entrepreneurs who are using e-commerce as ways to expand business, reach new customers, and manage risks. Furthermore, tax burden such as the one proposed in Indonesia may push sellers to go back to informal channels, inhibiting their growth and hence potentially reduce future tax base.

Indonesia enacted a new corporate income tax that significantly expands the definition of Permanent Establishment based on a determination of the Ministry of Finance (MOF) as to a company's gross revenue and amount of sales and users in Indonesia. Indonesia has also enacted an Electronic Transaction Tax on transactions involving Indonesian buyers and users as a backstop where the expanded PE concept does not apply.

Indonesia's measures present several concerns:

- **The scope of digital tax in PERPU-1 is overly expansive and discriminatory against foreign firms:** The scope of PERPU-1 is discriminatory as it unfairly targets non-resident online marketplaces, retailers that sell to Indonesian customers over the Internet, manufacturers that operate online sales portals, and any non-resident online service providers when compared to local Indonesian businesses. If the ETT provision is implemented as a revenue-based tax measure, it appears to impose a tariff for doing business in Indonesia rather than creating a recognized tax category under the existing international tax framework and global norms. Local Indonesian businesses pay tax on profits earned and many low-margin or loss making businesses may not be paying any Indonesian income tax. Applying ETT does not level the playing field between local and non-resident businesses and poses a non-tariff barrier to foreign firms' entry into the Indonesian market.

- **Indonesia's effort to deem foreign traders and services providers with a significant economic presence as permanent establishments sets a dangerous precedent.** It undermines the traditional definition of a Permanent Establishment and creates a significant barrier to cross-border trade.

- **Significant ambiguities exist regarding key aspects of the rules, including the scope, applicable rates of tax, and how taxpayers can comply.** We understand that the Indonesia Ministry of Finance has significant discretion to draft broad implementing regulations. While the MOF assesses provisions to include in any implementing regulations, we respectfully encourage the MOF to consider the concerns set forth below. For example, as currently drafted, the Significant Economic Presence (SEP) and Electronic Transaction Tax (ETT) provisions in PERPU-1 could be interpreted as unilateral tax measures that do not align with existing international norms and practices, and are misaligned with the Indonesia Government's goal to forge stronger economic ties with other nations as well as develop Indonesia as a thriving digital economy.

- **Provisions of PERPU-1 conflict with Indonesia's international tax and trade commitments:** The Government of Indonesia has made international commitments to other countries through its international agreements and membership in multilateral organizations like the World Trade Organization (**WTO**) and the World Customs Organization (**WCO**). Indonesia's tax treaties prescribe clear rules regarding how to allocate taxing rights. The SEP provision creates an entirely new income tax right in cases where a foreign company meets certain prescribed rules based on the company's consolidated group turnover, sales into Indonesia, and number of active digital media users. The ETT provisions of PERPU-1 expand Indonesia's taxing rights even further by creating a unilateral taxing right, the nature of which remains unclear, but which is solely applicable to non-Indonesian businesses who would otherwise benefit from a bilateral income tax treaty. Indonesia's attempt to circumvent global tax norms and tax treaties it concludes that allocate taxing right among countries is likely to result in retaliatory measures by its trading partners.

Due to the global health crisis, the WTO and WCO are encouraging their members (Indonesia included) to avoid disruptions to cross-border trade in goods by carefully considering adding any new permanent measures that would inhibit cross-border trade activities. The international trade bodies issued a joint statement providing that any new trade measures should be targeted, proportionate, transparent, and non-discriminatory. PERPU-1 does not meet this standard as the law discriminates against non-Indonesian companies and acts as a trade barrier for the export of goods and services to Indonesia.

- **PERPU-1 contradicts Indonesia's commitment to the efforts of the Organization for Economic Co-operation and Development (OECD) to address the tax challenges arising from the digitalization of the economy:** As a member of the Inclusive Framework on BEPS, Indonesia has been actively engaged in the ongoing OECD-led process to achieve a multilateral, consensus-based solution to address concerns with the current international tax framework. The imposition of unilateral measures, which target non-Indonesian businesses before the OECD process is even concluded, does not consider the negative impact these measures will have on achieving multilateral agreement. Unilateral measures contradict the OECD approach which is consultative in nature. Such measures lead to a lack of trust among the negotiating countries and may encourage other nations to adopt retaliatory measures by increasing tariffs or levying taxes on exports from Indonesia. The creation of a negative negotiating environment risks adversely impacting the effort to achieve a consensus-based solution to these global tax challenges. One of the conditions for countries signing onto the OECD consensus solutions was that they drop any unilateral measures like DST that have been passed in the interim. Considering the significant costs of developing systems that would be required to collect information and income tax due under Indonesia's SEP/ ETT, this again suggests that Indonesia should wait to review OECD's agreed solution before making any significant tax laws changes on the direct tax side, and should instead focus on updating its VAT rules as applied to digital services in the interim.

- **PERPU-1 undermines the growth of Indonesian Small and Medium sized-businesses (SMBs):** Most of Indonesia's startups and SMBs leverage the opportunities offered by the internet and use non-Indonesian digital suppliers including software providers, app stores, software-as-a-service (**SaaS**) providers, and cloud service providers, as well as infrastructure, and social networking sectors to access the best of the world technology at lower costs. Access to such services is key to the development of the startup and SMB sector and contributes to the growth of these businesses in Indonesia. Imposing an additional tax on goods and services provided to these Indonesian businesses will only serve to increase their costs and stymie growth. SMEs who operate in low-margin businesses (such as the retail sector) may be forced to pass these additional costs along to their Indonesian customers. Indonesian businesses and consumers will be left with limited access and choice in online services, thereby lagging behind their contemporaries in other countries. The Indonesian government should seek to encourage the growth of Indonesian business opportunities by enacting tax policies that facilitate the growth of SMBs and encourage the expansion of this important economic sector.

Key recommendations for Indonesia:

- **Hold further implementation of digital income tax and encourage Indonesia to continue to work through OECD on redefining the criteria of Permanent Establishment:** We would like to reiterate that the Government of Indonesia should continue to work through the OECD process to ensure its interests are represented, find a globally agreed solution on the taxation of the digital economy and therefore avoid unilateral measures falling outside the scope of the avoidance of double taxation treaties, such as digital tax, income tax based on SEP and ETT. Indonesia's unilateral measure which specifically targets non-resident online vendors is likely to be inconsistent with global norms, including OECD standards. Unilateral measures will run the risk of retaliation from other countries that may target Indonesian digital companies that have an international presence, damage Indonesia's international trade position, and impact Indonesia's standing in the ease of doing business index. Most countries in APAC are awaiting guidance/ consensus from the OECD, rather than imposing unilateral measures, such as digital services tax or ETT. We encourage Indonesia to do the same, especially given that consensus on Pillars One and Two is expected at the OECD level by this year. We therefore suggest that Indonesia delay on issuing implementing regulations on SEP and ETT ahead of a consensus solution at the OECD.

- **Clarify the nature of Electronic Transaction Tax in Indonesia:** Currently, the nature of ETT in Indonesia is unclear – whether it will be treated as an income tax or an indirect tax. In Article 6(6) of PERPU No. 1/ 2020, foreign suppliers who meet the SEP provisions may be treated as a permanent establishment (PE) and subject to income tax. On the other hand, if the PE cannot be established due to the tax treaty provisions, it mandates that ETT will be applied and replaces this income tax. Therefore, ETT should similarly be treated as a form of income tax. Moreover, if ETT is enacted as a revenue-based income tax, it will violate the existing principles that direct tax should apply to profit. Therefore, the enactment will put low-margin businesses at a disadvantage, which are already subject to VAT. Hence, we recommend that the government provide clarification that the ETT is an income tax and is a tax on net profit as opposed to a tax on gross revenue. The ETT discriminates against low margin / loss making companies as it's a tax based on sales revenue / turnover. As this is a form of transaction tax, the revenue derived from digital services would have been subject to Indonesian VAT under the current regulation. Similar taxes shall not be imposed twice on a single transaction.

- **Recommend simplified registration model for extraterritorial VAT:** We understand that the government will be issuing the implementing regulation for the VAT registration. As such, we would like to recommend the simplified registration model that has been widely adopted by the EU and other APAC countries with extraterritorial VAT. The simplified VAT registration allows non-residents to electronically register, report and pay VAT quickly and easily. Also, there is no physical filing of documents or requirement for local agents/ representatives. Moreover, in Australia, Singapore and New Zealand, the registration of the non-resident for VAT is not a criterion in determining whether an entity has a permanent establishment in the country for income tax purposes. In other words, registering for VAT in the country does not give rise to a permanent establishment status for the non-resident. Further, any VAT rules should be easy for foreign companies to comply with in a scalable and consistent manner without having the burden of individualized local requirements. For example, Indonesia could refer to the legislation implemented by Singapore which provides simplicity of compliance such as:

- Electronic registration and compliance;
- Simple ‘pay only’ model with no input credits;
- Make away with invoicing requirements; and
- Registering for VAT in the country should not give rise to a permanent establishment status for the non-resident.

C. DSTs may be inconsistent with countries’ WTO and treaty obligations

The high revenue thresholds and choice of covered services may be inconsistent with national treatment obligations under the General Agreement on Trade in Services (GATS) given WTO Members’ commitments in data processing services, database services and advertising services.

The high global revenue threshold and subset of revenue models covered by the tax will cause the tax to be applied primarily to U.S. and some other foreign firms while excluding like services supplied by domestic firms.

Neither criteria – the revenue threshold or choice of covered services – appear to support the underlying policy objective to tax digital activities where domestic “users” or customers are deemed to play a major role in value creation. All businesses derive some value from their users or customers. These revenue thresholds and choice of services characteristics may constitute unjustifiable discrimination and to serve as a disguised restriction on trade.

D. Conclusion

We urge countries to rescind their unilateral DSTs and to work towards a multilateral consensus on new non-discriminatory tax rules at the OECD in order to avoid undermining the global tax and trade systems. Countries should recognize that the solution to the tax challenges of the digitization of the economy is to develop non-discriminatory tax regimes that are administered in line with existing OECD guidelines.

The purpose of Section 301 investigations is to drive constructive consultations between the United States and the parties under investigation. We encourage USTR to pursue a settlement of their Section 301 investigations that would result in the countries involved rescinding existing and halting the pursuit of new DST measures.

If an agreement cannot be reached with the countries under investigation to rescind the measures, we encourage the Administration to explore and carefully evaluate a range of available remedies, while assessing the potential costs associated with different options.

We support the U.S. Government taking steps to protect U.S. businesses from these discriminatory tax regimes.