France moves closer to taxing the digital economy

July 11, 2013

In brief

The digital economy has revolutionized traditional ways of conducting business around the world, while international tax rules have been slow to adapt to this new business environment. Many countries have started discussing ways to address this situation.

On July 24, 2012, the French government commissioned a report on the taxation of the digital economy. This report (by Pierre Colin & Nicolas Collin) was released on January 18, 2013. It accelerated legislative discussions and government plans towards a forthcoming proposal to tax the digital economy as part of the 2014 French budget.

On May 13, 2013 another report — the "*Lescure*" report — was presented to the President and the Minister of Culture and Communication regarding cultural policy in a digital environment. This report focused specifically on new ways to finance the creation of cultural content in a digital media environment.

If enacted, the measures proposed by these reports may have significant impact on French and foreign companies generating income from digital activities in France.

In detail

For several years, France has been trying to tax foreign technology companies and internet businesses conducted in France. Faced with the inadequacy of the current French and international tax rules to tax internet activities, previous attempts have failed.

This debate was recently reactivated with the international media focus on the tax behavior of various multinationals. The media reports suggested that some companies were paying little or no taxes despite having massive digital activities and generating large revenues in France and other countries.

Such media press raised awareness in a number of countries including France, the United States, Italy and the United Kingdom. This led to discussions of perceived business distortions and the unfair competition these companies created with their corporate tax and VAT models and their establishment in low tax jurisdictions.

In France, the tax authorities have launched a series of tax audits over the past few years seeking major tax adjustments for some internet giants.

This issue was a starting point for the *"Collin and Colin"* report on the digital economy. The report considered that the discrepancy between the effective taxes paid locally compared to the estimated value created and revenues generated from the French market was the combined result of tax optimization practices from these internet giants (and multinationals in general) together with the general inadequacy of domestic and international tax rules in dealing with the digital economy.

In the short term, France will likely address the issue on its own, possibly by creating a new domestic internet tax. In parallel, and as part of a longer term goal, France is trying to promote an international or European initiative towards reforming the existing tax rules applicable to internet activity (the digital permanent establishment (PE) concept).

This initiative has been echoed in recent G20 meetings as well as European Commission and OECD discussions around tax havens and base erosion and profit shifting. In the United States, the House Committee on Ways and Means held a hearing on June 13, 2013 on US and foreign multinational corporations' use of tax havens (including low-and no-tax jurisdictions) to avoid tax by shifting profits outside the United States and eroding the US tax base.

What to expect?

The French government is contemplating various proposal streams.

The "Marini" proposals

Since 2010, the French senate's finance committee, led by Senator Marini, has been working on potential domestic solutions. As a result, a recent legislative proposal focused on several measures including:

- Creating an obligation for foreign internet companies to register an activity in France. Such an obligation would include several tax measures: the appointment of a tax representative in France, a tax on online advertising and a tax on business-to-business purchases of online services.
- Subjecting foreign internet companies established in France to a tax on on-demand video services.

On April 4, 2013, the French senate shelved this legislative proposal. The government is considering further discussions with the European Commission in order to develop a French regime compatible with EU law.

The "Collin & Colin" proposals

The Collin & Colin report released on January 18, 2013 is considered a key reference for any future French tax reform regarding the digital economy.

The proposed measures result from the following assertions by the authors:

- Customers' data collected by internet companies in foreign jurisdictions, such as France, is considered a source of value creation essential to the business of these companies and the intangibles they develop and exploit (advertising, pricing adjustments, purchase recommendations, etc.). By monitoring the internet users' activity and collecting, storing and re-using their personal data and information, the authors believe that the internet companies benefit from uncompensated work performed by the internet users.
- Large companies in the digital economy benefit from a very low global corporate tax rate due to the location of their headquarters in low tax jurisdictions.
- The intangibles developed by such companies are located in these low tax jurisdictions.
- Foreign internet companies benefit in France (and other jurisdictions) from massive public investment (infrastructure, broadband networks etc.) to which they did not contribute in building or financing.

The authors propose the following two steps for taxing digital companies:

- Creation of a new tax which would take value creation by internet companies into account. According to the authors, the tax should be designed to create incentives for digital economy companies to adopt compliant practices in favor of "user empowerment and innovation". The precise determination of the tax and its rate are not yet defined but the tax liability could depend on the behavior and the transparency regarding the use of data collected by the digital companies.
- Introduction of a new PE definition for the digital economy whereby a PE would be created each time internet user data is collected in a domestic market. Domestic data collection would imply some de facto domestic uncompensated workers and, as such, a PE.

The "Lescure" Report

In addition to the above proposals, the French Department of Culture and Communication commissioned a report on solutions to adapt French cultural policy to the internet era. The "Lescure" report released on May 13, 2013, contained 75 general proposals regarding cinema, music, television, books and video games.

Currently, traditional French radio and TV companies, movie theatres and internet network and telecommunication providers have to allocate a portion of their income to the financing of artistic creation.

Among the numerous Lescure report proposals to finance French culture and protect artistic creation is a proposal to create a specific tax applicable to both French and foreign connected device or terminal manufacturers (primarily tablet, smartphone and computer manufacturers) whose devices allow the playing, downloading and streaming of internet content (music, videos, games, newspapers, etc). As such, foreign-based companies would also directly or indirectly participate in the financing of French culture.

The report contemplated a one percent tax rate. The tax would apply on the device's sale or rental to the end consumer. The tax would be added to the applicable VAT rate and would be due from the distributor/retailer of the device or the service provider.

At this stage it seems that the French Government will not follow these tax proposals.

The French government road map

On February 28, 2013, following the "Collin and Colin" report, the French government released its proposed roadmap for taxing digital media. The government insisted on renewing the French tax system to give France new tools to recover its power to tax digital media companies. The government believes these companies pay minimal corporate tax and VAT in France.

Therefore, the French Government will work with the OECD to develop a recognized concept of a virtual PE. The OECD's BEPS Project includes virtual PE discussions.

With respect to VAT, France will implement and actively push the other European Member States to strictly apply the European regulations regarding the European VAT "mini one stop shop". With these EU regulations, effective January 1, 2015, VAT will be due based on the respective customers' residence rather than where the seller is established. This VAT would apply to all electronically delivered services sold by EU businesses.

France is also willing to promote — at a European level — the common consolidated corporate tax base (CCCTB) for providers of electronic services. Similar to the VAT initiative, France is expected to advance the CCCTB one stop shop at the EU level.

Finally, based on the work and discussions of the French National digital council (a government think tank created in 2011 with the purpose of facilitating discussions between the French government and internet professionals and proposing solutions on key issues in this industry) the French government will consider including some specific tax provisions regarding the digital economy in the draft 2014 finance bill.

The takeaway

International and US digital companies should monitor the upcoming discussions in France. The draft 2014 finance bill, expected this fall, will likely contain proposals or tax measures that will affect multinational companies and the internet industry.

In addition, at the international level, the recent G8 Summit held in Lough Erne, Northern Ireland, on June 17-18, 2013, the upcoming OECD action plan on BEPS expected in July 2013 and the next G20 summit in September will likely provide additional guidance and proposals on the taxation of digital economies.

Let's talk

For a deeper discussion, please contact:

International Tax Services

Guillaume Glon
(646) 471-8240
g.glon@us.pwc.com

Guillaume Barbier
(646) 471-5278
g.barbier@us.pwc.com