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Plans to introduce a digital tax in the Czech Republic

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On 22 January the Czech Chamber of Deputies approved a government proposal to introduce a digital tax at the first reading, and sent it to the parliamentary committees for further work. According to the project, the tax should be paid by internet companies with an annual worldwide revenue in excess of €750 million and of at least 100 million crowns (around €4 million) in the Czech Republic. 7% of the revenue generated in the Czech Republic should go into the state budget. In practice, the tax will mainly affect global-scale US companies, such as Google, Amazon, Facebook and Apple (which is why it has been called the GAFA tax). The Czech government expects the state budget to benefit by around €200 million annually.

The aim of the planned changes is to create a situation in which internet companies will pay taxes in proportion to the scale of their operations in the Czech Republic (including their use of the local internet infrastructure). Today, many of them only pay taxes in the countries where their European headquarters are located (these are usually countries that specialise in attracting IT giants through lower tax rates, such as Ireland and the Netherlands). The Czech Republic wants to apply the so-called DST (digital services tax) model based on proposals put forward by the European Commission in March 2018. This model assumes that the taxable takings from the Czech Republic will include fees for targeted advertising on websites or paid services on social networks. The services of companies such as Airbnb and Uber would also be subject to taxation. On the other hand, online shops and services related to computer games would be exempt from the tax. The Commission's proposal was not finally adopted at the level of the member states' finance ministers in spring 2019 because several of them were opposed (for example, Ireland pushed for the profit to be taxed instead of the revenue, whereas Denmark feared that the tax would violate the agreements on double taxation, and could thus expose the state to arbitration disputes). Most member states supported an attempt to find a solution at the OECD level, and so the EU joined in the global negotiations which that organisation is conducting.

Commentary

- The decision to send the digital tax project for legislation has led to discord in the hitherto blossoming cooperation between the Czech Republic and the US. Less than a year ago, Prime Minister Andrej Babiš (ANO) was received at the White House by President Donald Trump (the first such meeting since 2011). Moreover, in December 2018 the Czech Republic was the first country in Europe to formally warn national

operators of critical IT infrastructure against using hardware from the Chinese manufacturers Huawei and ZTE (due to the threat to national security), a move which Washington welcomed. Another boost to Czech-US relations was the announcement that Prague would increase defence spending (this year it amounts to €2.9 billion, the largest such sum in history, and an increase from 1.3% of GDP this year to 2% in 2024 is planned), and in particular that it would purchase (without holding a tender) 12 Bell helicopters in the process of modernising the Czech army (an intergovernmental agreement of around €580 million euros to this effect was signed on 12 December 2019). However, Washington has criticised the start of work on the digital tax. The behind-the-scenes talks on the subject over the last few months have not led to a compromise, and in December 2019 the US ambassador wrote in the *Lidové noviny* newspaper that if the law is passed, the US will adopt retaliatory measures.

- The Czech Republic will probably postpone the introduction of the tax, and could possibly reduce its size. Proposals to reduce the rate from 7% to a level between 3 and 5% have already been developed by opposition MPs, and the head of the ANO party in the Chamber of Deputies has not ruled out agreeing to this. The OECD's work on devising common solutions in this area should be completed before the end of 2020, which – like the co-ordinated approach at the EU level – would allow the Czech government to avoid further controversy in its bilateral relations with the United States. This approach has been confirmed in statements by Foreign Minister Tomáš Petříček (of the Czech Social Democratic Party, ČSSD), which indicated that the Czech digital tax would be a temporary measure to be adopted until an 'international solution' is found.
- The failed attempts to implement a digital tax in France (at a lower rate, 3%) plead further against the idea of rapidly introducing a similar project in the Czech Republic. The US responded to Paris with a threat to impose duties on products which France specialises in exporting (such as a 100% duty on wine). As a result, Paris has postponed the tax collection until a compromise has been reached in the OECD (although it will be imposed retroactively if the OECD countries do not arrive at a solution). Czech economists are worried that US duties could be imposed on the main items of the dynamically expanding Czech export to the US (around €4 billion in 2019, representing an increase of 18% year on year), including engines and tyres. As a result, the positive budgetary impact of the tax would be neutralised. Fears have also been expressed by those Czech companies which have managed to build a strong position on the US market. The digital tax could also call into question cooperation with US institutions in the field of artificial intelligence, which would weaken the Czech state's position in its efforts to open in Prague one of the four EU centres of excellence in this area. In addition, the Czech Republic (which has strong economic ties with Germany) is observing all the trade tensions between the US and the EU with apprehension, especially because of the risk that the US will impose additional customs duties on vehicles manufactured within the EU.
- While the legislative proposal for the digital tax is formally the responsibility of the Ministry of Finance, which is controlled by ANO, its main proponent is the ČSSD, another member of the ruling coalition. When both parties reached a compromise on the issue in April 2019, the Social Democrats stressed that they were responsible for pushing through the raise in the rate from 3-5% to 7%. Also, their reactions to the announcement of

American retaliation have been more hostile. While Prime Minister Babiš merely called into question his earlier declarations of getting defence spending to 2% of GDP by 2024, Deputy Prime Minister Jan Hamáček of the ČSSD suggested that the decision to buy the helicopters from the US could even be reversed. This statement was also a gesture towards that part of the leftist electorate which is hostile to the United States, for whom the ČSSD is competing with the Communists and the Pirate Party, the latter of which is becoming the main opposition force. The Social Democrats are treating the attempts to introduce the digital tax as part of their efforts to raise funds for more generous social policies. Their slogan of stopping foreign companies from taking their profits out of the country plays an important role in these attempts. To this end, apart from the digital tax, the ČSSD has also long demanded the introduction of a bank tax (a progressive tax on bank assets ranging from 0.05% to 0.3%). However, Babiš has resisted this because it would worsen the conditions for banks to give loans to companies (including his own Agrofert, which is deeply in debt).