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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

US Small Businesses Have Most To Lose From Digital Duties

By **Jennifer Doherty**

Law360 (February 20, 2024, 11:09 PM EST) -- The possible demise of an international moratorium on tariffs for digital products, including software and media downloads, could cut into small businesses' profits and create compliance burdens for the companies that survive.

The World Trade Organization's moratorium on the imposition of customs duties on electronic transmissions is up for renewal this month during the body's 13th ministerial conference in Abu Dhabi. While the decades-old moratorium has been renewed at each of the WTO's biannual meetings since 1998, this year a small coalition of developing countries led by India, Indonesia and South Africa have signaled plans to block it.

If WTO members cannot reach a consensus on extending the moratorium for another two years, countries will be faced with a regulatory can of worms that begins with the question: What is an electronic transmission? While streaming movies or downloading a new web browser appear to fall clearly into the category, other cross-border transactions, like telehealth video calls or massively multiplayer online games, would raise questions about what can be levied absent the moratorium, and then how to calculate duties for it.

The clear losers, no matter the answers to those initial regulatory questions, would be small firms, which would see sales shrink if their digital products are levied abroad or operating costs increase should tariffs be tacked on to foreign software downloads and digital service.

"The smaller firms and the most vulnerable firms, those with the tightest margins, are the ones that are going to — not lose the most in terms of money — but lose the most in terms of they could go out of business," said Javier López González, a senior economist at the Organization for Economic Cooperation and Development who leads the think tank's work on digital trade.

Somewhat ironically, given the moratorium's opponents, López González's team found that its end would pose the greatest risks to firms in developing countries.

"We did some analysis in our paper that shows that potentially applying tariffs on digital services could lead to export losses of about 2.5% for low-income countries and import losses of about 35%, so there's big loss there," he told Law360.

The paper, "Understanding the Potential Scope, Definition and Impact of the WTO E-commerce Moratorium," published last October, made an economic case for maintaining the moratorium in order to avoid creating uncertainty and harming business, and proposed that countries keen to collect tariffs could instead boost government revenue by applying value-added tax to digital exchanges.

That OECD paper has been cited broadly in recent weeks by advocates for maintaining the moratorium within the U.S. business community, including witnesses at a congressional hearing on national goals for MC13. At the event, former Ambassador to the WTO Dennis Shea named renewing the moratorium as "the one 'must-do'" for the U.S. delegation in Abu Dhabi.

Dozens of U.S. industry groups, including the Chamber of Commerce and National Foreign Trade Council, have also written to federal officials in recent weeks urging the Biden administration to throw all its weight behind renewing the moratorium, saying failure to do so would not only put U.S. businesses and workers in jeopardy, but would also be "the first time WTO members have changed the rules to make it substantially harder to conduct trade," as association executives said in a letter dated Feb. 13.

The countries opposing renewal argue the moratorium prevents them from collecting significant tariff revenue on digital trade, a position supported in part by research from Rashmi Banga, a senior economist in the UN Conference on Trade and Development.

In one 2019 paper, Banga highlighted the lack of clarity around electronic transmissions.

"Even after two decades, the question raised about whether electronic transmissions should be treated as 'goods' or 'services' or 'IP' remains unanswered," the paper says.

That confusion would be borne out in the immediate aftermath of the moratorium expiring, according to Alan Yanovich, a partner at Akin Gump Strauss Hauer & Feld LLP.

"The main thing, at least initially, is the uncertainty that it would create," he told Law360.

Yanovich pointed to Indonesia, the first WTO country to create space in its tariff schedule for "intangible goods" currently covered by the moratorium, as a potential example for countries looking to reap new duty revenues. While Indonesia's current rate for electronic transmissions is 0%, that could rise very quickly after the moratorium expires, he said.

"If one or two countries start trying to do this, then it's likely that other countries would follow," Tim Brightbill, co-chair of the international trade practice at Wiley Rein LLP, told Law360. "Then you get different rules for different countries imposing varying levels of duties on different types of transactions, and that can't help but chill digital trade and international e-commerce."

Brightbill cited data from a 2023 joint policy brief published by the International Chamber of Commerce and the International Trade Centre that valued the transactions that could be covered by new electronic transmission tariffs anywhere from $280 million to $8 billion annually, depending on how "electronic transmission" is defined.

And with small companies likely to face the greatest existential threat from tariffs cutting into their bottom line, new tariffs could also knock out some of the most innovative digital companies — think disruptive Silicon Valley startups — before they could really get going, Brightbill said.

The ICC paper also predicts an "explosion of costly red tape" should the moratorium lapse. Companies would also face hefty compliance costs related to navigating new, disparate digital tariff policies across dozens of countries.

Meanwhile, certain countries, including the U.S., have signed on to regional trade agreements in which the co-signers agree not to levy each other's digital goods and services.

While Washington would be bound by that commitment in certain trade relationships absent the WTO moratorium, "no one knows whether the U.S. might at some stage apply tariffs bilaterally, for example, in retaliation against India," López González said, providing one more example of potential economic uncertainty should the moratorium expire.

The U.S. could also face "a bit of a double-whammy impact" should it levy some countries' electronic transmissions, according to the OECD economist.

"It will decrease consumer welfare, the ability of consumers to afford stuff in the digital economy," López González said. "It will also affect U.S. competitiveness and employment in the sense that if big growing markets like India, Indonesia, China and others start applying these tariffs, then you become less competitive vis-a-vis the others in those particular markets, and in that sense, that will harm U.S. workers."

Those potential challenges for companies both large and small would stand to affect, by some estimates, as many as 100 million U.S. workers employed by businesses involved in digital trade, who could find their positions cut as profits shrink.

As former Deputy U.S. Trade Representative Robert Holleyman pointed out, the U.S. has championed the moratorium since its inception, and allowing it to expire would mark the end of almost three decades of U.S. leadership for a more open and innovative global marketplace.

"The symbolism around the WTO and the U.S. being less able to preserve the benefits that it fought so hard for would just be really unfortunate," Holleyman, now president and CEO emeritus of Crowell & Moring International, told Law360. "That's why I believe, and want to believe, that this will get done."

--Editing by Alanna Weissman and Lakshna Mehta.
