Confédération Fiscale Européenne CFE ECJ Task Force*

Opinion Statement ECJ-TF 2/2020 on the ECJ Decision of 3 March 2020 in *Vodafone Magyarország Mobil Távközlési Zrt*. (Case C-75/18) on Progressive Turnover Taxes

This CFE Opinion Statement discusses the decision of the Grand Chamber of the ECJ in *Vodafone*. The Court held that the imposition of the Hungarian progressive turnover-based tax on the telecommunications sector did not infringe the EU fundamental freedoms or article 401 of the VAT Directive (2006/112), and that the question regarding the prohibition of State aid was inadmissible. *Vodafone* is especially important in respect of the current debate regarding turnover-based digital services taxes.

1. Background and Issues

In recent years, the Court of Justice of the European Union (ECJ) has frequently dealt with the EU law aspects of various elements of turnover-based taxes, for example, in *ANGED* (Case C-233/16)[1] and *Hervis* (Case C-385/12).[2] Moreover, a recent batch of cases – *Poland v. Commission* (Joined Cases T-836/16 and T-624/17),[3] *Hungary v. Commission* (Case T-20/17),[4] *Vodafone* (Case C-75/18)[5] and *Tesco* (Case C-323/18)[6] – concerns EU objections to progressive turnover-based taxes from several angles:[7] first, the State aid rules of articles 107 and 108 of the Treaty on the Functioning of the European Union (2007) (TFEU)[8] with regard to the question of whether progressive taxation of economically stronger undertakings also constitutes unjustified aid in favour of other undertakings; second, the fundamental freedoms, especially the freedom of establishment under articles 49 and 54 of the TFEU, with regard to potential covert discrimination of foreign-owned taxpayers; and, finally, article 401 of the VAT Directive (2006/112),[9] which prohibits domestic taxes that can "be characterised as turnover taxes". While the General Court in *Poland v. Commission* and *Hungary v. Commission* dealt with the substantive State aid issues of progressive turnover-based taxes on certain sectors of the economy (and annulled the Commission's decisions), *Vodafone* and *Tesco* shed light on the assessment of indirect discrimination under the fundamental freedoms and the compatibility of sector-specific turnover taxes with article 401 of the VAT Directive (2006/112). As Advocate General Kokott succinctly pointed out, the questions raised in *Vodafone* "at the same time have particular importance for the turnover-based digital services tax currently being proposed by the European Commission",[10] i.e. the Commission's 2018 digital services tax (DST) proposal.[11] Moreover, *Vodafone* might have immediate rele-

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1. ES: ECJ, 26 Apr. 2018, Case C-233/16, *ANGED v. Diputación General de Aragón*, EU:C:2018:280, Case Law IBFD.
2. HU: ECJ (Grand Chamber), 5 Feb. 2014, Case C-385/12, *Hervis Sport- és Divatkereskedelmi Kft. v. Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Főigazgatósága*, EU:C:2014:47, Case Law IBFD.
3. PL: General Court, 16 May 2019, Joined Cases T-836/16 and T-624/17, *Poland v. Commission*, EU:T:2019:338 (pending before the ECJ as C-562/19 P, following the Commission's appeal of 2 July 2019, OJ C 328/29 (2019)).
4. HU: General Court, 27 June 2019, Case T-20/17, *Hungary v. Commission*, EU:T:2019:448 (pending before the ECJ as C-596/19 P, following the Commission's appeal of 6 Aug. 2019, OJ C 348/10 (2019)).
5. HU: ECJ (Grand Chamber), 3 Mar. 2020, Case C-75/18, *Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, EU:C:2020:139, Case Law IBFD.
6. HU: ECJ (Grand Chamber), 3 Mar. 2020, Case C-323/18, *Tesco-Global Áruházak Zrt. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, EU:C:2020:140, Case Law IBFD; *see also* HU: Opinion of Advocate General Kokott, 4 July 2019, Case C-323/18, *Tesco-Global Áruházak Zrt. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, EU:C:2019:567, Case Law IBFD.
7. *See also* IE: ECJ (Grand Chamber), 3 Mar. 2020, Case C-482/18, *Google Ireland Limited v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, EU:C:2020:141, Case Law IBFD (concerning obligations relating to registration with the Hungarian tax authorities with regard to a tax on advertising activities based on turnover).
8. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), Primary Sources IBFD.
9. Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 (2006), Primary Sources IBFD.
10. HU: Opinion of Advocate Kokott, 13 June 2019, Case C-75/18, *Vodafone Magyarország Mobil Távközlési Zrt. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, EU:C:2019:492, para. 1, Case Law IBFD. Indeed, Advocate General Kokott mentions DSTs at several points in her Opinion and hence made a clear connection between *Vodafone* and the digital tax debate (*see* paras. 1, 4, 71, 96, 101, 119, 123, 184 of the Opinion).
11. European Commission, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM(2018) 148 final (2018), Primary Sources IBFD [hereinafter DST Proposal]. It should be noted that no agreement on that proposal was reached in Council in Dec. 2019 (*see* Doc. 14885/18 FISC 510 ECOFIN 1148 (29 Nov. 2018) and Doc. 14886/18 FISC 511 ECOFIN 1149 (29 Nov. 2018)), and that the proposal was subsequently "downsized" to digital advertising services in Mar. 2019 ("DAT"; Doc. 6873/19 FISC 135 ECOFIN 242 (1 Mar. 2019)) and finally postponed in Mar. 2019 (Doc. 7368/19 PRESSE 12 (12 Mar. 2019)). However, the Council also agreed that work on a DST or DAT might be taken up again if no OECD consensus on the taxation of the digitalized economy is reached (*see* Doc. 9773/19 FISC 281 ECOFIN 528 (7 June 2019)).

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vance to the unilateral DSTs that have been implemented by a number of EU Member States in recent years.[12]

Three of these cases before the Court concerned the same Hungarian "law on the special tax on certain sectors", as applied to retail trade (*Hervis* and *Tesco*) and telecommunications activities (*Vodafone*), which introduced a turnover-based tax, with a progressive rate structure, applicable to certain sectors of the economy.[13] In 2014, the Court had already found, in *Hervis*,[14] that this special tax, as applied in that case, infringed the freedom of establishment because the Hungarian "aggregation rule" used Hungarian group-wide revenue for the purposes of calculating the tax rate for an individual group member.[15] The 2020 decisions in *Vodafone* and *Tesco*, however, had to address the core issue directly and irrespective of "aggregation": Can a progressive rate structure of a turnover-based tax *per se* give rise to covert discrimination?[16] Both decisions concerned Hungarian subsidiaries of companies of another EU Member State, the same Hungarian tax and the same legal claims. In both cases, and in contrast to what had happened in *Hervis*, the Grand Chamber of the Court upheld the Hungarian law.

Focusing on *Vodafone*, the facts and legal issues can be presented rather quickly: The complainant, Vodafone Magyarország Mobil Távközlési Zrt., was a Hungarian company wholly owned by Vodafone BV, a company of the Netherlands, itself part of the Vodafone Group plc with its registered office in the United Kingdom (which, at the time of the proceedings, was still a Member State of the European Union). Following an inspection, the tax authorities determined that Vodafone was liable to pay an additional amount of tax within the framework of the law on the special tax on certain sectors, including the telecommunications sector in which Vodafone was active.

According to the preamble to the legislation, the Hungarian tax at issue was a "special tax imposed on taxpayers whose ability to contribute to the costs of public expenditure exceeds the general obligation to pay tax".[17] According to its provisions, Hungarian companies are liable to a progressive tax based on net turnover and the tax rate is structured in three bands (each band applying to the proportion of the taxable amount that does not exceed it).[18] Moreover, and this lies at the root of the case, taxpayers that fell within the highest band were "predominantly taxable persons owned by natural persons or legal persons of other Member States".[19] Accordingly, most of the tax was borne by companies owned by non-residents.[20] The structure of the Hungarian tax bands (roughly translated into euros) and the affected taxpayers with total turnover in the relevant band can be summarized as follows:[21]

Table 1 – Rate structure and affected taxpayers

Amount of turnover	Tax rate	Percentage of foreign-owned taxpayers
Under HUF 500 million (EUR 1.5 million)	0%	0%
Between HUF 500 million (EUR 1.5 million) and HUF 5 billion (EUR 15 million)	4.5%	50%
Above HUF 5 billion (EUR 15 million)	6.5%	Predominantly EU-owned

Vodafone disagreed with the assessment and appealed to the *Fővárosi Közigazgatási és Munkaügyi Bíróság* (Administrative and Labour Court, Budapest). This Court decided to stay the proceedings and referred questions to the ECJ as to the compatibility of the Hungarian turnover-based tax on the telecommunications sector with the State aid rules, the EU fundamental freedoms and article 401 of the VAT Directive (2006/112).

2. The Decision of the Court of Justice

2.1. Introduction

In its decision in *Vodafone*, the Grand Chamber of the Court reached the same results as Advocate General Kokott in her Opinion, deciding that: (i) the State aid question was inadmissible, as Vodafone could not rely on the State aid rules to challenge the potential unlawfulness of an exemption in order to avoid payment of that tax or to obtain repayment of tax paid; (ii) the Hungarian tax is

12. Indeed, as AG Kokott (in para. 1 of her Opinion) made the reference to the EU DST in the context of State aid, it seems that she had the more general discussion about unilateral turnover-based DSTs in mind. This is because State aid would not be an issue if a DST were mandated by an EU directive, as any aid would then not be imputable to a Member State and hence not fall under the prohibition of arts. 107 and 108 TFEU (*see*, for example, DE: Court of First Instance, 5 Apr. 2006, Case T-351/02, *Deutsche Bahn*, EU:T:2006:104, paras. 101-103 and AT: ECJ, 23 Apr. 2009, Case C-460/07, *Sandra Puffer v. Unabhängiger Finanzsenat, Außenstelle Linz*, EU:C:2009:254, para. 70, Case Law IBFD).
13. Law No. XCIV of 2010 on the special tax on certain sectors (*egyes ágazatokat terhelő különadóról szóló 2010. évi XCIV. törvény*). The pending case of *Commission v. Hungary* (C-596/19 P, following the decision of the General Court in HU: ECJ, 27 June 2019, Case T-20/17, *Hungary v. Commission*, EU:T:2019:448) concerns the similarly structured Hungarian Act XXII of 2014 on Advertisement Tax.
14. *Hervis* (C-385/12).
15. *Hervis* (C-385/12), para. 36.
16. *See*, for example, AG Opinion in *Vodafone* (C-75/18), paras. 48, 49-53 and AG Opinion in *Tesco* (C-323/18), paras. 46-49. *See also Vodafone* (C-75/18), para. 36, noting that the referring court added that the tax at issue in *Hervis* "is, in essence, equivalent to the special tax at issue in the present case. However, the referring court considers that it is necessary, in order to resolve the dispute in the main proceedings, to determine whether the progressive scale, using bands, of the special tax may constitute, in itself, irrespective of the application of that consolidation rule, indirect discrimination vis-à-vis taxable persons that are controlled by natural persons or legal persons of other Member States, who bear the actual tax burden, and, therefore, be contrary to Articles 49 and 54 TFEU".
17. *See Vodafone* (C-75/18), para. 4, reproducing the preamble to the Hungarian law.
18. *See*, for example, *Vodafone* (C-75/18), para. 52, wherein the Court noted "that the basic band of tax charged at 0% does not exclusively affect taxable persons owned by Hungarian natural persons or legal persons, since, as in any system of progressive taxation, any undertaking operating on the market concerned has the benefit of the reduction for the proportion of its turnover that does not exceed the maximum amount of that band".
19. *Vodafone* (C-75/18), para. 47.
20. Id., para. 48.
21. Id., paras. 46-47; for more statistical information, *see* AG Opinion in *Vodafone* (C-75/18), paras. 17-18 and 94.

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not precluded by the freedom of establishment under articles 49 and 54 of the TFEU, as there was a lack of covert discrimination (even though the actual burden of the tax is mainly borne by EU-owned undertakings); and (iii) it is likewise not prohibited by article 401 of the VAT Directive (2006/112) because it is levied periodically (and not at each stage of the production and distribution process) and without the right to an input tax deduction at an earlier stage of that process.

Advocate General Kokott's Opinion went beyond the issues addressed by the Court. First, and unlike the Court, she entered into an extensive inquiry regarding the criteria for ascertaining indirect (de facto) discrimination within the area of direct taxation, i.e. "what requirements are to be applied to the correlation between the chosen distinguishing criterion – here turnover – and the seat of the undertakings" and "whether indirect discrimination is to be taken to exist in any case if the distinguishing criterion was intentionally chosen with a discriminatory objective".[22] Second, and just like the ECJ,[23] Advocate General Kokott concluded that the State aid questions were inadmissible, but nevertheless delivered an extensive *in eventu* analysis of the substantive State aid issues raised in *Vodafone* (and concluded that the lower average taxation inevitably connected with a progressive tax rate for lower-turnover undertakings does not constitute a selective advantage for such undertakings).[24] Third, and finally, she extensively linked the issues in *Vodafone* to the current discussion of EU and unilateral DSTs,[25] while the Court refrained from such statements.

2.2. State aid

As is often the case, *Vodafone* presented a challenge with regard to a tax payment by *one* taxable undertaking on the grounds that a statutory exemption from or lower rate of the tax involves State aid for *other* undertakings. While the substantive State aid issues regarding progressive turnover taxes are (and remain) at issue in *Poland v. Commission*[26] and *Hungary v. Commission*[27] (and were addressed by Advocate General Kokott in *Vodafone*[28] and *Tesco*),[29] the Grand Chamber in *Vodafone* (and *Tesco*) merely addressed (and denied) the question of admissibility.

Referring to established case law, the Court first noted that in an application to be exempted from the contested tax (rather than in a case concerning the abstract legality of the rules relating to the tax) the unlawfulness of an exemption under State aid criteria is generally "not capable of affecting the lawfulness of the actual charging of that tax, so that a person liable to pay that tax cannot rely on the argument that the exemption enjoyed by other persons constitutes State aid in order to avoid payment of that tax".[30] This would only be different if the tax were a means of financing aid, so that it would be an integral part of that aid measure.[31] However, as the revenue from the special Hungarian tax is neither allocated for the financing of aid nor has a direct impact on the amount of that aid (because the tax borne by Vodafone is transferred to the general State budget), Vodafone could not rely on that argument, rendering the question inadmissible.

2.3. Fundamental freedoms

The domestic court put the question as to the compatibility of the Hungarian tax with the freedom of establishment under articles 49 and 54 TFEU succinctly: "If the effect of that legislation is that the actual tax burden, for the highest tax band, falls mainly on foreign-owned taxable persons, is that legislation indirectly discriminatory?" Hence, the Court had to ascertain whether a net turnover tax that was "steeply progressive", the application of which resulted in most of the tax being borne by companies owned by non-residents, was incompatible with the freedom of establishment.

In confirming that a company (i.e. a Hungarian subsidiary such as Vodafone) may rely on a restriction on the freedom of establishment of another company (i.e. Vodafone Europe in the Netherlands, its parent company) which is linked to it in so far as that restriction affects its own taxation,[32] the Court was alluding to the notions of overt and covert discrimination: As the tax established no distinction between companies based on their registered office (as all the undertakings operating in Hungary in the telecommunications sector are subject to that tax, and so is the progressive tax rate), it did not amount to direct or overt discrimination;[33] however, the Court also noted that the TFEU also prohibits covert discrimination, i.e. "the application of other criteria of differentiation [that] lead in fact to the same result".[34]

Covert discrimination is what both *Vodafone* and the Commission argued, claiming that progressivity of the special tax is, in itself, to the advantage of taxable persons owned by Hungarian natural persons or legal persons and to the disadvantage of taxable persons owned by natural or legal persons of other Member States. While Advocate General Kokott went to considerable lengths to determine the criteria for factual discrimination to exist and what role legislative intent might play in choosing distinguishing criteria,[35] the Court was not at all moved by the statistical data presented to it. It merely acknowledged

22. *See* the extensive analysis in AG Opinion in *Vodafone* (C-75/18), paras 57-103.
23. *Vodafone* (C-75/18), paras. 18-32 (for the same result, *see also* AG Opinion in *Vodafone* (C-75/18), paras. 135-147).
24. AG Opinion in *Vodafone* (C-75/18), paras. 148-188.
25. AG Opinion in *Vodafone* (C-75/18), para 1.
26. *Poland v. Commission* (T-836/16 and T-624/17) (pending before the ECJ as C-562/19 P, following the Commission's appeal of 2 July 2019, OJ C 328/29 (2019)).
27. *Hungary v. Commission* (T-20/17) (pending before the ECJ as C-596/19 P, following the Commission's appeal of 6 Aug. 2019, OJ C 348/10 (2019)).
28. AG Opinion in *Vodafone* (C-75/18), paras. 148-188.
29. AG Opinion in *Tesco* (C-323/18), paras. 141-173.
30. *Vodafone* (C-75/18), para. 24.
31. Id., paras. 26-27.
32. Id., paras. 40-41, referring to UK: ECJ,1 Apr. 2014, Case C-80/12, *Felixstowe Dock and Railway and Others v. the Commissioners for Her Majesty's Revenue & Customs*, EU:C:2014:200, para. 23.
33. *Vodafone* (C-75/18), paras. 42 and 44.
34. Id., para. 43, referring to *Hervis* (C-385/12), para. 30 and *ANGED* (C-236/16 and C-237/16), para. 17.
35. *See* the extensive analysis in AG Opinion in *Vodafone* (C-75/18), paras. 57-103.

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that all companies in the highest rate band are predominantly EU-owned (and none in the lowest band are)[36] and that the special tax was mostly borne by companies that were EU-owned.[37] The Court also avoided dealing with Advocate General Kokott's analysis on the relevance of the legislature's intent in setting the tax rate structure.[38] It pointed, instead, at the Member States' discretion to establish their tax systems and consequently the application of progressive taxation,[39] and established a clear link between a taxpayer's turnover and its ability to pay:[40]

> [p]rogressive taxation may be based on turnover, since, on the one hand, the amount of turnover constitutes a criterion of differentiation that is neutral and, on the other, turnover constitutes a relevant indicator of a taxable person's ability to pay.

Having established that turnover is a neutral criterion, as well as an indicator of ability to pay, the Court moreover accepted the progressive rate structure by referring to the preamble to the Hungarian law. It noted "that, by means of the application of a progressive scale based on turnover, the aim of that law is to impose a tax on taxable persons who have an ability to pay 'that exceeds the general obligation to pay tax'".[41] This, according to the Court, is not discriminatory and discrimination is also not implied by the fact alone that "the greater part of such a special tax is borne by taxable persons owned by natural persons or legal persons of other Member States".[42] This effect is merely "due to the fact that the Hungarian telecommunications market is dominated by such taxable persons, who achieve the highest turnover in the market",[43] and, in the eyes of the Court, would arise similarly under progressive and proportional rate structures.[44] Moreover, the exemption granted by the first band of the tax benefitted both foreign- and domestic-owned companies equally.[45] Hence, the "progressive rates of the special tax do not, inherently, create any discrimination".[46]

Finally, the Court distinguished its holding in *Vodafone* from its prior decision in *Hervis*,[47] in which it had concluded that the special tax amounted to indirect discrimination.[48] *Hervis*, however, concerned "the combined application of both very progressive rates of taxation of turnover and a rule for the consolidation of turnover of linked undertakings", which led to Hungarian companies being liable on the basis of "fictitious turnover".[49] There would be indirect discrimination insofar as it was possible to establish a connection between the application of the steeply progressive scale of the special tax to a consolidated tax base consisting of turnover and foreign ownership of these Hungarian companies.[50]

2.4. VAT Directive (2006/112)

Finally, the Grand Chamber of the Court had to ascertain whether the Hungarian special tax on certain sectors infringed article 401 of the VAT Directive (2006/112), which prohibits domestic taxes that can "be characterised as turnover taxes". In making that determination, the expression "turnover tax" has to be understood in the context of the VAT Directive, i.e. whether a certain tax has the effect of jeopardizing the functioning of the common system of VAT.[51]

Referring to *Banca Popolare di Cremona* (Case C-475/03),[52] the Court confirmed that national taxes are prohibited by article 401 of the VAT Directive (2006/112) if they exhibit "the essential characteristics of VAT, even if they are not identical to it in every way", but that, conversely, article 401 of the VAT Directive – similar to its predecessor in article 33 of the 6th VAT Directive – does not preclude "the maintenance or introduction of a tax which does not display one of the essential characteristics of VAT".[53] Those essential characteristics of a VAT are (i) its application to goods and services; (ii) proportionality between the amount of the tax and the price of the good and service; (iii) applicability at every stage of the production and distribution process, regardless of the number of transactions; and (iv) the possibility of deducting the previously paid amounts on the tax due for a specific transaction ("with the result that the tax applies, at any given stage, only to the value-added at that stage and the final burden of the tax rests ultimately on the consumer").[54]

In applying these criteria in *Vodafone*, the Court focused on the third and fourth essential characteristics of VAT, namely the charging of the tax at each stage of the production and distribution process and the existence of a right to deduction of the tax paid during the preceding stages of the process, and concluded that they were not met.[55] This alone was sufficient for the Court to find that the Hungarian special tax does not display all the essential characteristics of VAT and, consequently, is not subject to the prohibition laid down in article 401 of the VAT Directive.[56]

36. *Vodafone* (C-75/18), para. 47.
37. Id., 48.
38. For a discussion of the statements made in the relevant parliamentary debate and in government documents in Hungary, *see* AG Opinion in *Vodafone* (C-75/18), paras. 93-102.
39. *Vodafone* (C-75/18), para. 49, referring to DE: ECJ, 22 June 1976, Case 127/75, *Bobie Getränkevertrieb GmbH v. Hauptzollamt Aachen-Nord*, EU:C:1976:95, para. 9, Case Law IBFD and DE: ECJ, 6 Dec. 2007, Case C-298/05, *Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt*, paras. 51 and 53, Case Law IBFD.
40. *Vodafone* (C-75/18), para. 49.
41. Id., para. 51.
42. Id., para. 52.
43. Id., para. 52.
44. Id., para. 52.
45. Id., para. 53.
46. Id., para. 54.
47. *Hervis* (C-385/12).
48. For the difference between *Hervis*, on the one hand, and *Vodafone* and *Tesco*, on the other, *see also*, for example, AG Opinion in *Vodafone* (C-75/18), paras. 48, 49-53 and AG Opinion in *Tesco* (C-323/18), paras. 46-49.
49. *Vodafone* (C-75/18), para. 55.
50. Id., para 55.
51. *Vodafone* (C-75/18), para. 59, referring to HU: ECJ, 11 Oct. 2007, Joined Cases C-283/06 and C-312/06, *KÖGÁZ and Others*, EU:C:2007:598, para. 34, Case Law IBFD.
52. IT: ECJ, 3 Oct. 2006, Case C-475/03, *Banca Popolare di Cremona Soc. Coop.a.r.l v Agenzia Entrate Ufficio Cremona*, EU:C:2006:629, para. 26, Case Law IBFD.
53. *Vodafone* (C-75/18), paras. 60-61.
54. Id., para. 62, referring to *Banca Popolare di Cremona* (C-475/03), para. 28.
55. Id., para. 64.
56. Id., para. 65.

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It might be noted in passing that Advocate General Kokott reached the same result in her Opinion, but had put additional emphasis on the fact that the Hungarian special tax does not cover all, but only specific transactions (first essential characteristic)[57] and that – due to the progressive rate structure and the annual (and not transactional) assessment – the Hungarian tax is not designed to be passed on to the consumer (fourth essential characteristic).[58] Moreover, Advocate General Kokott concluded that "the Hungarian special tax constitutes a turnover-based special (direct) income tax which is intended to skim off the particular financial capacity of telecommunications undertakings" and not a VAT-like "turnover tax seeking to tax the consumer".[59]

3. Comments

3.1. Introduction

Vodafone sheds light on a substantial number of matters, which are dealt with in the following sections of this Opinion Statement. Its immediate relevance, however, exceeds the impact that it has on ascertaining the compatibility of the Hungarian special tax with EU law. This is because many of the features of the Hungarian tax are quite similar to the features of unilateral DSTs adopted or proposed by several Member States (such as, in addition to Hungary's advertisement tax, in Austria, the Czech Republic, France, Italy and Spain) and to the Commission's 2018 DST proposal.[60] Although the Court avoided any reference to that broader impact, it was undoubtedly aware of it given the many references to such an impact in Advocate General Kokott's Opinion.[61] The final section of this Opinion Statement will address this.

3.2. Progressive turnover taxes and the VAT Directive (2006/112)

The Court's VAT analysis in *Vodafone* follows closely the established case law, for example, *Banca Popolare di Cremona* ("IRAP") (Case C- 475/03)[62] and *Viking Motors* (Case C-475/17):[63] if a domestic levy "does not display all the essential characteristics of VAT" it is, "consequently, not subject to the prohibition laid down in Article 401 of the VAT Directive",[64] which states that Member States are *not* prevented, inter alia, from maintaining or introducing "any taxes, duties or charges which cannot be characterised as turnover taxes".

While the *a contrario* prohibition of "turnover taxes" could be given a broad literal meaning, barring all national turnover taxes altogether, the Court's traditional inquiry is based on whether a certain national turnover tax "has the effect of jeopardising the functioning of the common system of value added tax (VAT) by being levied on the movement of goods and services and on commercial transactions in a way comparable to VAT".[65] And that potential of a turnover tax to interfere with VAT is only present if that tax meets the four essential characteristics of VAT:[66]

> VAT applies generally to transactions relating to goods or services; it is proportional to the price charged by the taxable person in return for the goods and services which he has supplied; it is charged at each stage of the production and distribution process, including that of retail sale, irrespective of the number of transactions which have previously taken place; the amounts paid during the preceding stages of the process are deducted from the VAT payable by a taxable person, with the result that the tax applies, at any given stage, only to the value added at that stage and the final burden of the tax rests ultimately on the consumer.

This reading also paves the way for Member States to introduce any type of taxes (including turnover taxes) insofar as they "twist" their design, ensuring that the tax does not exhibit all of the four essential characteristics of VAT. Thus, a national turnover tax would likely not be incompatible with article 401 of the VAT Directive insofar as, for instance (i) it applies a fixed amount of tax per transaction that bears no relation with the price of the transacted good or service; (ii) it applies to only one stage (or to a limited number of stages) of the production and distribution process; (iii) it only covers specific, rather than all, transactions; and (iv) it does not allow for the deduction of taxes previously paid, which can be the result of having different taxes levied at different stages of the production and distribution process, with no possible credit of one against the other. More generally, and irrespective of economic incidence, if the tax is not designed to be passed on to the consumer, it would typically also not be prohibited by article 401 of the VAT Directive.[67] Certain design features of a turnover tax, such as a progressive rate structure or an annual (and not transactional) assessment,

57. AG Opinion in *Vodafone* (C-75/18), para. 32, noting that the Hungarian special tax "is not therefore a (general) turnover tax in accordance with the first criterion, but would be at best a special excise duty, which the Member States would not be permitted at present, however, only under the conditions laid down in Article 1(2) and (3) of Directive 2008/118/EC".
58. AG Opinion in *Vodafone* (C-75/18), paras. 33-36.
59. AG Opinion in *Vodafone* (C-75/18), para. 37 (*see also* para. 35, wherein AG Kokott describes the tax as being similar "to a special (direct) corporate tax for certain undertakings, in this case telecommunications undertakings").
60. DST Proposal, *supra* n. 11.
61. AG Kokott mentioned DSTs at several points in her Opinion and hence made a clear connection between *Vodafone* and the digital tax debate (*see* AG Opinion in *Vodafone* (C-75/18), paras. 1, 4, 71, 96, 101, 119, 123 and 184).
62. *Banca Popolare di Cremona* (C-475/03).
63. EE: ECJ, 12 June 2018, Case C-475/17, *Viking Motors and Others, TKM Beauty Eesti OÜ, TKM King AS, Kaubamaja AS, elver AS v. Tallinna linn, Maksu- ja Tolliamet*, EU:C:2018:636, Case Law IBFD.
64. *Vodafone* (C-75/18), para. 65.
65. *Vodafone* (C-75/18), para. 59, referring to *KÖGÁZ* (C-283/06 and C-312/06), para. 34.
66. *Vodafone* (C-75/18), para. 62, referring to *Banca Popolare di Cremona* (C-475/03), para. 28.
67. *See*, for that discussion, for example, *Viking Motors and Others* (C-475/17), paras. 45-47, wherein the Court pointed out "that the legislation governing the sales tax at issue in the main proceedings did not require taxpayers to add the amount of that tax to the sale price or to indicate separately on the invoice delivered to the purchaser the amount of the tax to be paid. Thus, the passing-on of that tax to the final consumer was a possibility and not an obligation for the retailers who could at any time choose to bear that tax themselves, without increasing the prices of the goods and services provided. […] Therefore, it cannot be certain that the burden of the sales tax at issue in the main proceedings was ultimately borne by the final consumer in a way similar to a tax on consumption such as VAT. […] The Court has already held that a tax levied on production in such a way that it is not certain that it will be borne, like a tax on consumption such as VAT, by the final consumer is likely to fall outside the scope of Article 401 of the VAT Directive […]".

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imply, according to Advocate General Kokott, that such tax is not (legally) *meant to* be passed on to the consumer,[68] whatever its economic incidence may be. Additionally, in respect of a progressive tax, one may wonder if it is even "proportional to the price charged", i.e. if it could fulfil the second essential characteristic of a VAT.

3.3. Prohibition of State aid

Both Advocate General Kokott and the Court found the State aid-related questions in *Vodafone* to be inadmissible. This is not surprising and follows a consistent line of reasoning of the Court in this field concluding that taxpayers cannot challenge a tax based on the argument that a statutory exemption from or lower rate of the tax involves State aid for *other* taxpayers, unless the tax itself is allocated to the financing of aid and has a direct impact on the amount of that aid (neither of which was the case with the Hungarian special tax in *Vodafone*).[69] It should be noted that the party to be targeted by State aid rules in these cases is the party benefitting from the exemption or the lower rate because that party is receiving a selective advantage that must be repaid if the domestic rule constitutes incompatible aid. This also means that, in such situations, the effective protection of competition within the internal market cannot be achieved by an application to be exempted from the contested tax, even if that tax would amount to State aid under article 107 of the TFEU and the respective state had infringed its obligations under article 108 of the TFEU. Accordingly, the only remedy from a State aid perspective would be "to seek an abstract review of the legislation before a national court", which is "then able to make a request for a preliminary ruling as appropriate".[70]

The Grand Chamber in *Vodafone* did not enter into a substantive State aid analysis of the progressive turnover-based Hungarian tax, as it simply rejected the admissibility of the respective questions.[71] However, State aid issues regarding progressive turnover taxes were already at issue in the 2019 General Court's decisions in *Poland v. Commission*[72] and *Hungary v. Commission*,[73] and the Commission's analysis was rejected in both cases. The Court will therefore have an opportunity to provide clear guidance in the pending appeals in those two cases[74] on the Hungarian advertisement tax and in *Commission v. Poland* regarding the Polish tax on the retail sector. It should be noted that Advocate General Kokott also reached the same result as the General Court in her *in eventu* analysis of the substantive State aid issues raised in *Vodafone* and concluded that the lower average taxation inevitably connected with a progressive tax rate for lower-turnover undertakings does not constitute a selective advantage for such undertakings.[75]

3.4. Indirect discrimination

At the core of *Vodafone* was the argument that the progressive rate structure amounted to covert discrimination, as it, in fact, targeted largely foreign-owned taxpayers. Indeed, similar EU law concerns have been raised against unilateral DSTs with regard to their thresholds for taxability, and it is clear that the Commission was aware of these issues when it tabled its flat-rate DST proposal in 2018,[76] which is limited to certain digital services and employs a two-prong threshold for taxability, i.e. EUR 750 million of global revenue and EUR 50 million of taxable EU revenue, both at a consolidated level. Broadly, those objections also underly the US trade investigations into the digital services taxes in France[77] and other EU Member States (Austria, the Czech Republic, Italy and Spain),[78] in respect of which it is argued, for example, that the French DST "is intended to, and by its structure and operation does, discriminate against U.S. digital companies, including due to the selection of services covered and the revenue thresholds".[79]

It is evident from the Court's case law that covert or indirect forms of discrimination could arise from criteria that do not constitute nationality discrimination from a purely formal perspective, but have the same effect, such as residency-based discrimination or differences in taxation based on unlimited or limited taxation of the taxpayer's parent company.[80] Until *Vodafone* and *Tesco*, the Court had never assessed whether a progressive rate structure

68. AG Opinion in *Vodafone* (C-75/18), paras. 33-36.
69. *See* the discussion in AG Opinion in *Vodafone* (C-75/18), paras. 136-147 and in *Vodafone* (C-75/18), paras. 18-32 and 37.
70. AG Opinion in *Vodafone*, para. 146.
71. *Vodafone* (C-75/18), paras. 18-32 (for the same result, *see also* AG Opinion in *Vodafone* (C-75/18), paras. 135-147).
72. *Poland v. Commission* (T-836/16 and T-624/17) (pending before the ECJ as C-562/19 P, following the Commission's appeal of 2 July 2019, OJ C 328/29 (2019)).
73. *Hungary v. Commission* (T-20/17) (pending before the ECJ as C-596/19 P, following the Commission's appeal of 6 August 2019, OJ C 348/10 (2019)).
74. *Commission v. Hungary* is pending as Case C-596/19 P, *Commission v. Hungary* (*see* the Commission's appeal of 6 Aug. 2019, OJ C 348/10 (2019)), and *Commission v. Poland* is pending as Case C-562/19 P (*see* the Commission's appeal of 2 July 2019, OJ C 328/29 (2019)).
75. AG Opinion in *Vodafone* (C-75/18), paras. 148-188.
76. *See* the Commission Staff Working Document Impact Assessment, COM(2018) 147 final (21 Mar. 2018), pp. 67-69.
77. *See* the Investigation by the US Trade Representative (USTR) under § 301 of US: Trade Act of 1974, wherein the USTR determined that "France's Digital Services Tax is unreasonable or discriminatory and burdens or restricts U.S. commerce" (*see* 84 Fed. Reg. No. 235, 66956 [6 Dec. 2019], based on an extensive report of 2 Dec. 2019), noting, inter alia, that in respect of advertising 8 of 9 covered companies are American and, for digital interfaces, 12 of 21 covered companies are American (and none based in France).
78. The USTR has recently opened investigations with respect to DSTs adopted or under consideration by Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey, and the United Kingdom (*see* 85 Fed. Reg. No. 109, 34709 (5 June 2020)).
79. *See* 84 Fed. Reg. No. 235, 66956 (6 Dec. 2019).
80. *See*, for example, DE: ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, para. 26, EU:C:1995:31, Case Law IBFD; BE: ECJ, 22 Mar. 2007, Case C-383/05, *Talotta*, EU:C:2007:181, para. 17, Case Law IBFD; FR: ECJ, 8 July 1999, Case C-254/97, *Société Baxter, B. Braun Médical SA, Société Fresenius France and Laboratoires Bristol-Myers-Squibb SA v. Premier Ministre, Ministère du Travail et des Affaires sociales, Ministère de l'Economie et des Finances and Ministère de l'Agriculture, de la Pêche et de l'Alimentation*, EU:C:1999:368, para. 13, Case Law IBFD; DE: ECJ, 12 Dec. 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, EU:C:2002:749, paras. 27-30, Case Law IBFD; NL: ECJ, 18 Mar. 2010, Case C-440/08, *F. Gielen v. Staatssecretaris van Financiën*, EU:C:2010:148, para. 37; *Hervis* (C-385/12), para. 30; and *ANGED* (C-233/16), para. 30.

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of a turnover-based tax could *per se* amount to covert discrimination of *foreign-owned* taxpayers.[81]

In *Vodafone*, however, the Court's reasoning was focused on the progressivity of the tax as such,[82] which, in the Court's view, did not amount to discrimination since it was (on its face) neutral and applied equally to domestic- and foreign-owned companies. This conclusion was not affected by the fact that the higher band covered only foreign-owned companies and that most of the tax was borne by foreign-owned companies. In focusing on progressivity as a distinguishing criterion and the consequential distribution of the tax burden as a "fortuitous" indicator, the Court also did not deal with the section of Advocate General Kokott's Opinion in which she discussed the legal relevance of "discriminatory intent" of the legislature in setting the tax rate structure.[83]

It is not, however, easy to reconcile the two Grand Chamber decisions in *Hervis* and *Vodafone*.[84] The distinctive element in *Hervis* seems to be the fact that the special tax took into account the full turnover of the worldwide group ("linked undertakings") before allocating turnover to the Hungarian company and taxing it at steeply progressive rates.[85] Accordingly, elements of the economic activity of the group became relevant in computing the tax liability of a Hungarian resident. The Court in *Hervis*, however, accepted the existence of covert discrimination in respect of such a system if "the taxable persons covered by the highest band of the special tax are 'linked', in the majority of cases, to companies which have their registered office in another Member State",[86] while it did not even ask that question in *Vodafone*.

While the Grand Chamber of the Court accepted, without hesitation, that a criterion of annual net turnover of that specific undertaking did not amount to indirect discrimination since the criterion itself was not inherently discriminatory (and hence did not even entertain the question of whether the Hungarian rate structure was intentionally structured so as to disproportionately affect foreign-owned taxpayers), Advocate General Kokott had taken a more nuanced approach with regard to situations in which a distinguishing criterion – that is intrinsically not disadvantageous – was, in subjective terms, intentionally chosen to effect a high degree of disadvantage, in quantitative terms, for undertakings with generally foreign shareholders.[87] While Advocate General Kokott accepted that, in principle, the legislature's intent to discriminate could potentially be relevant, the Grand Chamber of the Court – though clearly alerted to that issue – refrained from addressing it directly. One might therefore argue that the Court endorsed a narrow approach by considering the distribution of the tax burden as "fortuitous"[88] and noting that the domestic criterion did not "inherently" create any discrimination.[89] Both approaches have merits. The Court's narrow approach and judicial restraint certainly avoid interference with market forces. The fact that a tax is borne in the vast majority of cases or exclusively, by non-residents or foreign-owned residents should not necessarily be seen, in itself, as indirect discrimination. In the context of the internal market and of highly integrated economies, it is to be expected that states and companies will specialize in the goods and services in which they have a comparative advantage. Therefore, it might be seen as a necessary consequence of a smoothly operating internal market that, at a certain point, national economic operators of one state might even decide to stop offering a certain good or service that is beginning to be offered by economic operators of another Member State. From that, it follows that the mere fact that goods and services are (vastly or exclusively) provided by non-residents cannot mean that a state should be prevented, by EU law, from levying a tax on those products or services, or even on the economic operator offering them. Advocate General Kokott's approach, however, would avoid a situation in which Member States establish seemingly neutral criteria but nevertheless set those criteria, in "bad faith", by intentionally targeting foreign enterprises. This certainly requires the drawing of lines, and establishing reliable criteria is undoubtedly a hard task. It remains to be seen how the Court will further develop its case in light of seemingly contradictory decisions, for example, in *Jacquier*[90] and *Hervis*, on the one hand, and *Vodafone*, on the other.

3.5. Turnover taxes, ability to pay and resilience in the face of profit shifting

On a general level, one main objection against turnover-based taxes is that they – by design – do not take into account any of the expenses, costs or losses incurred by the taxpayer. So even if they are levied at a relatively low rate, their impact in relation to the taxpayer's profits depends on the respective profit margin, which may differ from sector to sector and taxpayer to taxpayer. Moreover, turnover has traditionally been viewed as a poor indicator of ability to pay and hence progressivity as adverse to the level of turnover. Indeed, turnover taxes allow for effective collection even in cases where the taxpayer has genuine losses or has a reduced involvement in the global chain, as it operates as a limited-risk manufacturer. In both cases, a comparison with a profit-making company or with a full-fledged manufacturer shows that companies with very different abilities to pay (from a net income perspective) might have comparable turnover. This was also the outspoken position of the Commission with respect to State aid, which views progressivity as a potential justification

81. *See*, for example, AG Opinion in *Vodafone* (C-75/18), paras. 48, 49-53; AG Opinion in *Tesco* (C-323/18), paras. 46-49.
82. *Vodafone* (C-75/18), para. 54.
83. For a discussion of the statements made in the relevant parliamentary debate and in government documents in Hungary, *see* AG Opinion in *Vodafone* (C-75/18), paras. 93-102.
84. For an argument based on ability to pay, *see* sec. 3.4. of this Opinion Statement.
85. *See also*, for that distinguishing feature, *Vodafone* (C-75/18), para. 55.
86. *Hervis* (C-385/12), para. 45.
87. AG Opinion in *Vodafone* (C-75/18), para. 84 et seq.
88. *Vodafone* (C-75/18), para. 52.
89. Id., para. 54.
90. FR: ECJ, 30 Nov. 1995, Case C-113/94, *Elisabeth Jacquier, née Casarin v. Directeur Général des Impôts*, EU:C:1995:413.

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for taxes on profits or net income in light of a redistributive purpose,[91] but not for taxes on turnover.[92]

Advocate General Kokott's Opinion, however, as well as the Grand Chamber's decision in *Vodafone*, hold that the notion of ability to pay (and hence the permitted different treatment of taxpayers with differing ability to pay)[93] is not limited to income taxes, and that a turnover base does not rule out a progressive rate. Quite to the contrary, and in light of the stated *ratio essendi* of the Hungarian tax, "the amount of turnover constitutes a criterion of differentiation that is neutral and, on the other, turnover constitutes a relevant indicator of a taxable person's ability to pay".[94] This clearly rejects the view that, from an EU law perspective, only progressive taxation of net income is consistent with the principle of taxation according to ability to pay. The underlying assumption seems to be that large profits require large turnover (even if the latter does not necessarily imply the former), and there is no fundamental objection against the "general presumption evidently made by the Hungarian legislature that, as a rule, larger (higher-turnover) undertakings also have more financial capacity than smaller undertakings", "[e]ven though turnover is not a compelling indicator for financial capacity".[95] However, while ability to pay is relevant to determining the comparability of taxpayers or to ascertaining a possible justification (not only for income, but also for turnover taxation), the Court's reference to ability to pay should not be understood as being a general principle of EU direct taxation. And, insofar as there is no direct EU tax, there is no need for that either. And, of course, the Court's finding is limited to EU law; it might therefore be the case that domestic (constitutional) courts will consider that turnover-based taxes, due to their design, infringe their respective national ability-to-pay principle.

Ability to pay might also be a relevant factor in distinguishing *Hervis* from *Vodafone*: Under the "aggregation rule" at issue in *Hervis*, the group's entire Hungarian turnover was taken into consideration for the purposes of the application of the progressive tax rate, so that Hervis, as a member of such a group, was subject to a much higher average rate of tax than would have been the case had only its own transactions been used as the basis for the calculation of tax. As such, the progressivity in *Hervis* was determined in relation to the turnover of all "linked entities" and hence did not relate to the taxpayer's standalone "ability to pay". In this sense, the special tax levied in *Hervis* infringed ability to pay. In contrast, and taking into account only the effective turnover of the taxpayer, *Vodafone* was in line with the Court's notion of ability to pay.

Advocate General Kokott also linked turnover-based taxes with the OECD's BEPS Project. Both in the BEPS debate and the discussion that led to the Hungarian sectoral tax, "it was or is not a question of heavier taxation of *foreign* undertakings, but of heavier taxation of *multinational* undertakings".[96] Moreover, "focusing on turnover gives less scope for organisational models of multinational undertakings, which has been one of the main points of the BEPS debate over the last decade and was also a key element of the Hungarian parliamentary debate".[97] Advocate General Kokott went all the way in terms of that line of argument and even concluded that "turnover is in some ways even more appropriate than profit for representing an undertaking's financial capacity", as it is less amenable to profit shifting and can be an effective means of countering aggressive tax planning.[98] In this respect, Advocate General Kokott also seems to implicitly accept the underlying idea of the Commission's proposal for a turnover-based DST for certain high-turnover undertakings in the digital sector, noting that "this taxation technique is expressly explained by the fact that 'the opportunity of engaging in aggressive tax planning lies with larger companies'".[99] Finally, "it is also understandable to have regard to turnover rather than profit, as the former is easily ascertainable (simple and effective administration)",[100] and that "there can be no objection from the point of view of administrative procedure if the number of retail establishments covered, and thus to be checked, is reduced by means of a threshold".[101] All in all, Advocate General Kokott's Opinion can reasonably be understood as a pre-emptive defence of the main structure of DSTs, as exemplified in the Commission's 2018 DST proposal.[102]

91. *See* para. 24 of the (old) Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384/3 (1998) and para. 139 of the (current) Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ C 262/1 (2016).
92. *See*, for example, paras. 68-69 of Commission Decision (EU) 2017/329 of 4 November 2016 on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, C(2016) 6929), OJ L 49/36 (2017): "It is a natural consequence of (single-rate) turnover taxes that the bigger the turnover of a company is, the more tax it pays. As opposed to taxes based on profit …, a turnover-based tax is however not intended to take into account – and indeed does not take into account – any of the costs incurred in the generation of that turnover. Therefore, in the absence of specific evidence to the contrary, the level of turnover generated cannot automatically be considered as reflecting the ability to pay of the undertaking. Hungary has not demonstrated the existence of the alleged relationship between turnover and ability to pay nor that such relationship would be correctly mirrored in the pattern of progressivity (from 0% to 50% of turnover) of the advertisement tax. […] The Commission considers that progressive rates for taxes on turnover could only be justified exceptionally, that is if the specific objective pursued by a tax indeed requires progressive rates. Progressive turnover taxes could, for example, be justified if the externalities created by an activity that the tax is supposed to tackle also increase progressively – i.e. more than proportionately – with its turnover. However, Hungary did not provide any justification of the progressivity of the tax by the externalities possibly created by advertisement".
93. *See* AG Opinion in *Vodafone* (C-75/18), paras. 109-110, with further references.
94. *Vodafone* (C-75/18), para. 49.
95. *See* AG Opinion in *Vodafone* (C-75/18), para. 100. It should be noted that the English translation of that paragraph of the Opinion (the original language being German) is not correct. It states that the Hungarian presumption that larger (higher-turnover) undertakings also have more financial capacity than smaller undertakings "is in any case not accurate", but should read "not inaccurate" or "not inappropriate". The original German version reads "*jedenfalls nicht sachfremd*" and the French version uses "*semble en tout état de cause raisonnable*".
96. AG Opinion in *Vodafone* (C-75/18), para. 95.
97. Id., para. 101.
98. Id., para. 123.
99. Id., para. 101, referring to recital 23 of the DST Proposal, *supra* n. 11.
100. Id., para. 186.
101. Id., para. 185.
102. DST Proposal, *supra* n. 11.

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From the Member States' perspective, turnover taxes may be seen as a preferred way of increasing tax revenues. Some of the deficiencies in their design (namely in comparison with income taxation) could be viewed as an advantage by the Member States in respect of an increase in tax revenues, prevention of tax planning and administrability. Turnover taxes are indeed immune to most base erosion and profit shifting techniques. In the long-run, however, they may lead to unnecessary adjustments in corporate groups. Moreover, turnover is indeed a "bad proxy" for income in many instances (even if taxed at relatively low rates), for example, in low-margin situations or in loss situations. Moreover, those taxes might lead to economic distortions and their tax and economic effects might amount to an obstacle to the strengthening of the internal market, especially if they lead to economic double taxation (where ability to pay is targeted by a turnover-based tax and a profit-based tax at the same time) and revenue shifts between Member States (where, for example, the turnover-based tax of one state is a deductible business expense in another state).[103] Also, the traditional divide between turnover and income taxation may have to be revisited. Some elements of the design of turnover taxes may make them similar to income taxes; conversely, some simplified income tax systems (namely for small and medium-sized taxpayers) are based on turnover.

3.6. Impact of *Vodafone* on DSTs

The special Hungarian tax at issue in *Vodafone* has some features that are similar to those apparent in respect of DSTs, i.e. generally flat-rate turnover-based taxes on certain digital services (such as targeted advertising or intermediation services). DSTs were introduced or are being discussed in some Member States (such as, in addition to Hungary's advertisement tax, in Austria, the Czech Republic, France, Italy and Spain) and a DST Directive was proposed by the EU Commission in March 2018.[104] This has been noted by Advocate General Kokott multiple times,[105] but was not mentioned at all by the Court.

Vodafone nevertheless provides some useful direction on the examination of the admissibility of national turnover-based taxes on digital services, as follows:

(1) Using turnover as a tax base does not appear to be problematic from a fundamental freedoms perspective as such, regardless of whether the rate is proportional (such as the 3% rate in the Commission's 2018 DST proposal) or progressive (and even if steeply progressive); this follows, inter alia, from the Court's finding that the amount of turnover constitutes not only a criterion of differentiation that is neutral but at the same time is also a relevant indicator of a taxable person's ability to pay.[106] As for State aid, the same conclusion was reached by Advocate General Kokott in her Opinion,[107] as well as by the General Court in *Hungary v. Commission*.[108]

(2) The distribution of the burden of a turnover tax between domestic and foreign or foreign-owned taxpayers is irrelevant, unless the features of such a tax "inherently" create discrimination;[109] such "inherent" discrimination, however, cannot be derived from the mere fact that most of the taxpayers are non-resident or owned by non-residents or that most of the tax raised is paid by them, as such distribution of the tax burden would generally be "fortuitous".[110] It remains to be seen, however, how the Court would approach (extreme) cases in light of the freedoms or State aid rules where, for example, (i) a threshold is deliberately set so that exclusively foreign-owned or foreign taxpayers (but not a single domestic taxpayer) are covered by a DST or (ii) a certain amount of the revenue raised by the tax is earmarked to support the digital transformation of domestic taxpayers.

(3) It can be derived implicitly from the Court's decision and explicitly from Advocate General Kokott's Opinion[111] and the General Court's decision in *Hungary v. Commission*[112] that thresholds for taxability – even if they are high – do not appear to be objectionable because they are understandable based on administrative reasons and the wish to tax an undertaking's activity only when that activity reaches a certain level. Again, it is unclear how the Court would deal with thresholds that are deliberately set so as to discriminate.

(4) *Vodafone* did not reject the Court's finding in *Hervis* that the Hungarian "aggregation rule", which used the group's entire taxable Hungarian turnover to determine the progressive rate for each individual taxpayer in the respective group, violates EU law.[113] It is, however, unclear if and how that (prohibited) "aggregation rule" can be distinguished from the "consolidation features" of the Commission's 2018 DST proposal, which employs a two-prong threshold for taxability, i.e. EUR 750 million of global revenue

103. If one assumes, for example, that a typical turnover-based DST is not covered by bilateral tax treaties, the same activities might indeed be taxed both under a DST and a corporate income tax. Indeed, the Commission's 2018 DST Proposal does not foresee a credit, but rather notes the expectation "that Member States will allow businesses to deduct the DST paid as a cost from the corporate income tax base in their territory, irrespective of whether both taxes are paid in the same Member State or in different ones" (art. 27 of the Preamble to the DST Proposal, *supra* n. 11). This also means that the DST collected in one Member State might be a deductible business expense in another Member State, leading to revenue shifts outside the network of bilateral tax treaties.
104. DST Proposal, *supra* n. 11.
105. AG Kokott mentioned digital services taxes at several points in her Opinion and hence made a clear connection between *Vodafone* and the digital tax debate (*see* AG Opinion in *Vodafone* (C-75/18), paras. 1, 4, 71, 96, 101, 119, 123 and 184).
106. *Vodafone* (C-75/18), para. 49.
107. AG Opinion in *Vodafone* (C-75/18), paras. 148-187.
108. *Hungary v. Commission* (T-20/17) (pending before the ECJ as C-596/19 P, following the Commission's appeal of 6 August 2019, OJ C 348/10 (2019)).
109. *Vodafone* (C-75/18), para. 54.
110. *Vodafone* (C-75/18), para. 52.
111. AG Opinion in *Vodafone* (C-75/18), para. 185, referring to the exemption for small undertakings under EU VAT law.
112. *Hungary v. Commission* (T-20/17) (pending before the ECJ as C-596/19 P, following the Commission's appeal of 6 August 2019, OJ C 348/10 (2019)), para. 104.
113. *See Vodafone* (C-75/18), para. 55.

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and EUR 50 million of taxable EU revenue, both at a consolidated level.[114]

This being said, and despite broad criticism of DSTs from both a legal and economic standpoint, one gets the clear impression that the Grand Chamber of the Court, as well as Advocate General Kokott, in *Vodafone* wanted to signal their validation of the core features of DSTs; specifically, the many references by Advocate General Kokott to the OECD BEPS Project and countering aggressive tax planning might have set the tone for future discussion. This is particularly relevant for Member States that have already introduced (or plan to introduce) such turnover-based taxes on certain digital services, although certain specific design features might still face scrutiny from the Court. Finally, it should be noted that, in respect of a DST based on an EU directive some issues might automatically disappear or receive less scrutiny. For one, State aid would not be an issue if a DST were mandated by an EU directive, as any aid would then not be imputable to a Member State and consequently not fall under the prohibition of articles 107 and 108 of the TFEU.[115] Also, the EU legislature enjoys more leeway in light of the fundamental freedoms as the Court's general approach is to accept more easily the proportionality of a restriction that is applicable in the whole of the European Union.[116]

114. *See* art. 4(1) and (6) of the DST Proposal, *supra* n. 11.
115. *See*, for example, *Deutsche Bahn* (Case T-351/02), paras. 101-103 and *Sandra Puffer* (C-460/07), para. 70.
116. For a brief analysis and further references, *see* CFE ECJ Task Force, *Opinion Statement ECJ-TF 2/2018 on the ECJ Decision of 7 September 2017 in* Eqiom *(Case C-6/16), Concerning the Compatibility of the French Anti-Abuse Rule Regarding Outbound Dividends with the EU Parent-Subsidiary Directive (2011/96) and the Fundamental Freedoms*, 58 Eur. Taxn. 10, p. 471 (2018), Journal Articles & Papers IBFD.

4. The Statement

CFE Tax Advisers Europe notes that the Court's decision in *Vodafone* provides clarifications regarding ascertaining the compatibility of domestic turnover taxes with the fundamental freedoms and with article 401 of the VAT Directive (2006/112). This is particularly relevant in the current context, in which some Member States have adopted or plan to adopt turnover-based DSTs.

Although provided with the opportunity, the Court avoided explicitly addressing Advocate General Kokott's arguments relating to the correlation between the chosen distinguishing criterion (i.e. turnover) and the seat of undertakings and the question of whether indirect discrimination is to be taken to exist in any case if there was an intentional discriminatory objective in choosing the distinguishing criterion. Rather, the Court straightforwardly found that the distribution of the burden of a turnover tax between domestic and foreign or foreign-owned taxpayers is not an indicator of covert discrimination, unless the features of such tax "inherently" create discrimination; the mere fact that most taxpayers are non-resident or owned by non-residents or that most of the tax raised is paid by them is just a "fortuitous" effect.

CFE Tax Advisers Europe notes that this decision should not be seen as giving Member States carte blanche in respect of all technical features of domestic DSTs, for example, the choice of thresholds, the earmarking of revenue or consolidation rules. One should also not forget other non-EU law concerns, given the structural inefficiencies that this type of tax presents (for example, economic effects, trade law, domestic constitutional law, double taxation, etc.).

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