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Editorial

The Future of Digital Services Taxes

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In March 2018, the Commission presented its ‘Digital Taxation Package’,[1] which included not only a long-term solution in the form of a ‘significant digital presence’ (‘SDP’),[2] but also a short-term proposal for a ‘digital services tax’ (‘DST’). Under that proposal, the DST would be structured as a 3% tax on the revenues from specific digital services – online advertising, digital intermediary activities and the sale of user data – of large multinationals (total annual worldwide revenues of EUR 750 million) with significant digital footprints in the EU (digital EU revenues of EUR 50 million).[3] It built on the ‘equalization tax’ idea discussed in the OECD Base Erosion and Profit shifting (BEPS) Action 1 report,[4] and, indeed, the ‘amounts raised’ by the DST as an interim measure ‘would aim to reflect some of what these companies should be paying in terms of corporate tax’.[5] However, neither the Commission’s proposal nor a subsequent ‘reduced’ approach focusing on targeted advertising, i.e., a Digital Advertising Tax (‘DAT’), achieved unanimity in Council in early 2019.[6] Indeed, and while the EU DST is not yet (officially) shelved,[7] the EU has since endorsed the OECD’s work on Pillars 1 and 2, but also noted, in May 2020, that a ‘digital tax’ may be a possible reaction ‘if no global agreement is reached’.[8] That ‘digital tax’, however, was initially announced to ‘build on OECD work on corporate taxation of a significant digital presence’.[9] Both, scope and frame, have since shifted: Following its Work Programme for 2021, where it announced a legislative proposal on a digital levy and a proposal for digital levy as own resource,[10] in mid-January 2021 the Commission has published an Inception Impact Assessment regarding a Proposal for a Council Directive on a “Digital Levy”.[11] In it, the Commission notes that “the work undertaken in the OECD Inclusive Framework to find a global consensus-based solution that addresses the tax challenges of the digitalisation of the economy is considered and should be factored into the final design and scope of the initiative, as it is important not to undermine the ongoing discussions at the OECD nor to fuel international trade tensions”. The proposal will take account of the “take account of developments at international level”, and the Commission will identify additional policy options, such as a corporate income tax top-up to be applied to all companies conducting certain digital activities in the EU, a tax on revenues created by certain digital activities conducted in the EU, and a tax on digital transactions conducted business-to-business in the EU. Hence, many options seem to be on the table, including again a revenue-based tax on digital activities.

At the international level, on 12 June 2020, the US had called for a pause in the discussions on OECD’s Pillar 1, reinforced its approach that this pillar should be on ‘safe harbor’ basis, objected to unilateral DSTs as falling largely on a limited group of predominately US-based companies, and threatened retaliatory measures if

1 *See* the Commission’s Communication *Time to Establish a Modern, Fair and Efficient Taxa-tion Standard for the Digital Economy*, COM (2018)146.

2 *See* the Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM (2018)147, and the Commission Recommendation of 21 Mar. 2018 relating to the corporate taxation of a significant digital presence, C (2018)1650.

3 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. For discussion *see* e.g., G. Kofler & J. Sinnig, *Equalization Taxes and the EU’s ‘Digital Services Tax’*, 47 Intertax 176 (176–200) (2019).

4 *See* paras 302 et seq. in OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1–2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (2015).

5 *See* the Political Statement – Joint Initiative on the Taxation of Com-panies Operating in the Digital Economy (9 Sept. 2017).

6 No agreement on the initial DST proposal was reached in Dec. 2019 (Doc. 14885/18 FISC 510 ECOFIN 1148 [29 Nov. 2018] and Doc. 14886/18 FISC 511 ECOFIN 1149 [29 Nov. 2018]). The proposal was subsequently limited to digital advertising services in Mar. 2019 (‘DAT’; Doc. 6873/19 FISC 135 ECOFIN 242 [1 Mar. 2019]) but then postponed in Mar. 2019 (Doc. 7368/19 PRESSE 12 [12 Mar. 2019]).

7 It has indeed been stated that the discussion on the DST might be resumed if no OECD consensus on the taxation of the digitalized economy is reached (Doc. 9773/19 FISC 281 ECOFIN 528 [7 June 2019]).

8 *See* the Commission’s Communication, *Europe’s Moment: Repair and Prepare for the Next Generation*, COM(2020)456, 4.

9 *See* the Commission’s Communication, *The EU Budget Powering the Recovery Plan for Europe*, COM(2020)442, 15.

10 *See* Annex I to the Commission Work Programme 2021, COM (2020) 690.

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countries went ahead with such taxes.[12] A number of EU finance ministers reacted, on 17 June 2020,[13] by proposing a phased approach with regard to Pillar 1 (initially focused on automated digital services) noting that this 'would also pave the way for possible transitional solutions to be discussed with the United States, notably with respect to existing or upcoming national digital service taxes', and stressing that the suggestion 'that the United States could retaliate against national fiscal policy decisions would be neither in the economic interest of the United States and Europe nor consistent with the quality of relations between allies'. Indeed, in October 2020, the OECD has published its Blueprints on Pillars 1 and 2 in October 2020, with Pillar 1 leaving a number on policy options on a phased approach on the table and still noting that the US has 'proposed implementing the new taxing right on a 'safe harbour' basis, which would enable an MNE group to elect on a global basis to be subject to Pillar One'.[14] It remains to be seen how the US under the Biden-Harris-administration will approach the OECD discussions in the near future.

Let's put the light back on unilateral DSTs: While there is clearly no consensus on either merit or need of equalization taxes such as DSTs,[15] it seems, however, that the EU DST proposal was a facilitator for a number of similar unilateral measures: Many Member States (such as, e.g., Austria, Belgium, Czech Republic, France, Italy, Hungary, Poland, Slovenia, Spain), but also third States (such as, e.g., Brazil, Canada, India, Turkey and the UK) have introduced or announced to introduce unilateral digital services taxes with various scopes and thresholds. While those turnover-based, sector-specific taxes are heavily criticised as 'bad policy' from an economic perspective (regarding, e.g., double burdens, impact on investment, innovation, welfare and growth, distortion of consumer choices and business decisions, benefits the older over digital technology etc),[16] recent scholarship has found some sympathy for DSTs as a potentially appropriate taxation of location-specific rents.[17]

Apart from these policy considerations, much has been said about potential legal barriers to unilateral[18] DSTs, including conflicts with bilateral tax treaties, the EU fundamental freedoms (Articles 49, 54, 56 of the Treaty on the Functioning of the Europan Union, TFEU) and/or EU state aid rules (Articles 107 TFEU), and Article 401 VAT Directive, which prohibits domestic taxes that can 'be characterised as turnover taxes'. Neither of these objections seems entirely convincing:

– As for tax treaties, there is a strong academic consensus that typical DSTs are structured so to not be covered by tax treaties (and potentially barred by their 'permanent establishment' requirement) as taxes on 'elements of income' or '*in lieu*' taxes within the meaning of Article 2(2), (4) OECD-MC.[19] It should moreover be noted that the OECD has discussed that question in its 2018 Interim Report (and given some design recommendations),[20] and it might be indicative that DSTs would not (even) be considered a covered tax on income (or *in lieu* of an income tax) in the OECD's Pillar 2 Blueprint.[21] Also, the Commission's DST proposal had implicitly rejected the idea that a DST would be creditable against corporate income tax, and rather addressed the issue of possible cases of double taxation where the same revenues are subject to the corporate income

[12] *See* the letter from Steven T. Mnuchin of 12 June 2020, available at 2020 TNTI 125–23.

[13] *See* the letter from Bruno Le Maire, María Jesús Montero Cuadrado, Roberto Gualtieri and Rishi Sunak of 17 June 2020, available at 2020 TNTI 125–24.

[14] *See* paras 8, 168 and 169 in OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project (2020).

[15] *See* paras 405 et seq. in OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project (2018).

[16] *See* e.g., M. Bauer, *Five Questions about the Digital Services Tax to Pierre Moscovici*, ECIPE Occasional Paper, No. 04/2018.

[17] *See* the discussion by, e.g., W. Cui, *The Superiority of the Digital Services Tax over Significant Digital Presence Proposals*, 72 Nat'l Tax J. 839–856 (2019); W. Cui, *The Digital Services Tax: A Conceptual Defense*, 73 Tax L. Rev. 69 (2020); Y. R. Kim, *Digital Services Tax: A Cross-Border Variation of the Consumption Tax Debate*, 72 Alabama L. Rev. 131 (2020); D. Shaviro, *Digital Services Taxes and the Broader Shift From Determining the Source of Income to Taxing Location-Specific Rents*, NYU Law and Economics Research Paper No. 19–36.

[18] For a harmonized EU DST an additional consideration might be whether the Union has the competence, under Art. 113 or Art. 115 TFEU, to pass such legislation (*see* for analysis, e.g., J. Nogueira, *The Compatibility of the EU Digital Services Tax with EU and WTO Law: Requiem Aeternam Donate Nascenti Tributo,* ITAXS 1–2019, 1; for the likely qualification of a DST as a 'direct' tax *see* the Opinion of AG Kokott, 12 Sept. 2019, C-482/18, *Google Ireland*, EU:C:2019:728). It should also be noted that the Commission has confirmed that a DST could not be based on Art. 116 TFEU (*see* the Answer given by Mr Moscovici on behalf of the European Commission to the Parliamentary questions E-001797/2019, E-001797/2019(ASW) [27 June 2019]). On the other hand, potential State aid would be no issue if the DST were harmonized 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, 108 TFEU (GC, 5 Apr. 2006, T-351/02, *Deutsche Bahn*, EU:T:2006:104, paras 101–103; *see also* R. Mason, *A Political-Process Defense of Deference to EU Directives*, Virginia Law and Economics Research Paper No. 2018–17). Moreover, if a DST were a 'real' EU tax, i.e., imposed by the Union, no tax treaty considerations would arise as it would then not be 'imposed on behalf of a Contracting State' under Art. 2 OECD-MC.

[19] For a detailed discussion and further references *see* e.g., W. Cui, *The Superiority of the Digital Services Tax Over 'Significant Digital Presence' Proposals,* 72 Nat'l Tax J. 839 (2019); D. Hohenwarter, G. Kofler, G. Mayr & J. Sinnig, *Qualification of the Digital Services Tax Under Tax Treaties*, 47 Intertax 140 (2019).

[20] *See* the discussion of the design features in paras 405 et seq. in OECD, Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project (2018).

[21] *See* para. 148 in OECD, Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project (2020).

tax and DST only indirectly by expressing 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'.[22] What was implicit in that expectation is, first, that DSTs might indeed create double burdens, and that, second, there might be revenue shifts between Member States, i.e., between those States collecting DSTs and those States seeing their corporate tax bases reduced by the deductions.

– From an EU perspective, there is also well-argued criticism that the revenue thresholds and covered services in a DST, though facially neutral, in fact and by intention, may be characterized as targeting largely foreign taxpayers or groups rendering certain services. That would raise concerns regarding indirect nationality discrimination prohibited by the EU fundamental freedoms, and, conversely, aid granted to smaller (domestic) taxpayers, which might be in violation of the State aid rules in Articles 107, 108 TFEU.[23] However, recent judgments from the EU courts in *Poland v. Commission*,[24] *Hungary v. Commission*,[25] *Vodafone*,[26] and *Tesco*[27] on progressive turnover-based, sector specific taxes seem to indicate that also unilateral DSTs would not generally infringe upon the EU fundamental freedoms or State aid rules.[28] Indeed, 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 in Vodafone that the amount of turnover constitutes not only a criterion of differentiation that is neutral but at the same time also a relevant indicator of a taxable person's ability to pay.[29] As for State aid, the same conclusion was reached by AG J. Kokott in her Opinion in *Vodafone*[30] as well as by the General Court in *Hungary v. Commission* (and AG J. Kokott's opinion in this case[31]). Also, the distribution of the burden of a turnover tax between domestic and foreign or foreign-owned taxpayers is irrelevant, unless the features of such tax 'inherently' create a discrimination[32]; such 'inherent' discrimination, however, cannot be derived from the mere fact that most of the taxpayers are non-residents 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'.[33] Finally, and this can be derived implicitly from the Court's judgment and explicitly from AG J. Kokott's Opinion[34] as well as from the General Court's decision in *Hungary v. Commission*,[35] thresholds for taxability – even if they are high – do not seem to face any objection 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.

– Also, Article 401 of the VAT Directive[36] prohibits domestic taxes that can 'be characterised as turnover taxes'. In light of the CJEU's decision in *Vodafone* on the Hungarian turnover-based tax on the telecommunications sector,[37] which builds on cases such as *Banca popolare di Cremona*,[38] DSTs as flat-rate turnover-based taxes on certain digital services (such as targeted advertising or intermediation services) would not be prohibited by Article 401 of the VAT Directive as they would not meet the four essential characteristics of a VAT, e.g., because they are not charged at each stage of that process, do not contain a mechanism comparable to that of the right to deduction of VAT, and are not based on the value added at the various stages of that process.[39]

[22] Pt. 27 of the Preamble in the 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.

[23] *See* e.g., R. Mason & L. Parada, *Digital Battlefront in the Tax Wars*, 92 TNI 1183 (2018); R. Mason & L. Parada, *Company Size Matters*, BTR 610 (2019); R. Mason, *What the CJEU's Hungarian Cases Mean for Digital Taxes*, 98 TNI 161 (2020); R. Mason & L. Parada, *The Legality of Digital Taxes in Europe*, 40 Virginia Tax Rev. 175 (2020).

[24] General Court, 16 May 2019, 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, [2019] OJ C 328/29).

[25] General Court, 27 June 2019, 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, [2019] OJ C 348/10).

[26] ECJ (Grand Chamber), 3 Mar. 2020, C-75/18, *Vodafone Magyarország Mobil Távközlési Zrt.*, EU:C:2020:139.

[27] ECJ (Grand Chamber), 3 Mar. 2020, Case C-323/18, *Tesco-Global Áruházak Zrt.*, EU:C:2020:140; *see also* the Opinion of AG Kokott, 4 July 2019, Case C-323/18, *Tesco-Global Áruházak Zrt.*, EU:C:2019:567.

[28] For analysis *see* e.g., the CFE ECJ Task Force, *Opinion Statement ECJ-TF 2/2020 on the CJEU Decision of 3 Mar. 2020 in Case C-75/18, Vodafone Magyarország Mobil Távközlési Zrt., on Progressive Turnover Taxes*, 60 Eur. Tax'n 555 (2020).

[29] ECJ, 3 Mar. 2020, C-75/18, *Vodafone*, EU:C:2020:139), para. 49.

[30] Opinion of AG Kokott, 13 June 2019, C-75/18, *Vodafone*, EU:C:2019:492, paras 148–187.

[31] Opinion of AG Kokott, 15 Oct. 2020, C-596/19 P, *Commission v. Hungary*, EU:C:2020:835.

[32] ECJ, 3 Mar. 2020, C-75/18, *Vodafone*, EU:C:2020:139), para. 54.

[33] ECJ, 3 March 2020, C-75/18, *Vodafone*, EU:C:2020:139), para. 52.

[34] Opinion of AG Kokott, 13 June 2019, C-75/18, *Vodafone*, EU:C:2019:492, para. 185, referring to the exemption for small undertakings in EU VAT law.

[35] GC, 27 June 2019, T-20/17, *Hungary v. Commission*, EU:T:2019:448, para. 104.

[36] Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, [2006] OJ L 347/1.

[37] ECJ, 3 Mar. 2020, C-75/18, *Vodafone*, EU:C:2020:139), para. 64.

[38] ECJ, 3 Oct. 2006, Case C-475/03, *Banca popolare di Cremona ('IRAP')*, EU:C:2006:629, para. 26.

[39] For additional arguments *see* the Opinion of AG Kokott, 13 June 2019, C-75/18, *Vodafone*, EU:C:2019:492, paras 32–37, noting that the Hungarian tax was not designed to be passed on to the consumer and that 'the Hungarian special tax constitutes a turnover-

Importantly, however, the impact of DSTs on international trade on an inter-State level is a developing and highly divisive issue. From a legal perspective it is, e.g., unclear if DSTs might be viewed as a (disguised) restriction on international trade under the World Trade Organization (WTO) rules because of the revenue thresholds.[40] Moreover, the US Trade Representative (USTR) has undertaken investigations into various unilateral DSTs. These investigations are based on § 301 of the US Trade Act of 1974, which allows the the US President to unilaterally (and hence outside the WTO framework) impose tariffs or other trade restrictions on foreign countries. With regard to the French DST, the USTR has determined that 'France's Digital Services Tax is unreasonable or discriminatory and burdens or restricts US commerce'.[41] Moreover, investigations have been opened in June 2020 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.[42] In early 2021 the USTR has issued findings in the investigations of DSTs adopted by India, Italy, and Turkey, concluding that each of the DSTs discriminates against US companies, is inconsistent with prevailing principles of international taxation, and burden or restricts US commerce.[43]

While the implementation of tariffs on French products was initially suspended after France agreed to postpone the collection of its DST,[44] the USTR, in July 2020, determined to take action in the form of additional duties of 25% on certain products of France by early 2021.[45] However, those tariffs have again been suspended on 7 January 2021:

> in light of the ongoing investigation of similar DSTs adopted or under consideration in ten other jurisdictions. Those investigations have significantly progressed, but have not yet reached a determination on possible trade actions. A suspension of the tariff action in the France DST investigation will promote a coordinated response in all of the ongoing DST investigations.[46]

On January 14, and following the conclusions on further unililateral DSTs, the USTR has announced that he is 'not taking any specific actions in connection with the findings at his time but will continue to evaluate all available options'.[47] In the extreme case, the US may indeed seek the imposition of tariffs, which would further escalate tensions in the economic relations that may result in WTO dispute settlements proceedings. Also, retaliatory US trade measures could in turn result in the affected States and/or the EU with regard to its Member States pursuing counter-retaliation with tariffs targeting US exports. Those damaging tax and trade disputes are also the main concerns regarding unilateral DSTs and potentially disproportionate retaliation: Unilateralism could prove to be costly in case of retaliation,[48] and also the OECD's economic impact assessment demonstrates the negative effects on global gross domestic products (GDP), especially in a scenario involving widespread adoption of DSTs and retaliation and counter-retaliation.[49]

What, then, is the future of gross-basis digital services taxes? It seems that they are here to stay for a while, and that countries will get increasingly bolder with their unilateral policies, also to force a global change. Such a 'bold move' is also the proposed new distributive rule in Article 12B of the UN Model, which foresees a source State tax on gross payments for automated digital services, including in B2C situations.[50] DSTs might, however, not be here forever: Indeed, when the OECD released the Blueprint Reports on Pillar 1 and Pillar 2 in October 2020, it was indicated that 'unilateral measures', which might include digital services taxes, 'would need to be removed', as 'one element of an agreement on Pillar One should be a commitment to withdraw relevant unilateral measures that would undermine the stability of the agreed framework and to refrain from introducing new ones'.[51] However, even if an OECD consensus is reached in 2021, it will take a number of years for that consensus to be implemented globally. Also, if the position of the US would remain unchanged and Pillar 1

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'.

[40] For an analysis of the issues *see* e.g., A. D. Mitchell, T. Voon & J. Hepburn, *Taxing Tech: Risks of an Australian Digital Services Tax Under International Economic Law*, 20 Melb. J. Int. Law. 88 et seq (2019).

[41] *See* 84 Fed. Reg. No. 235, 66956, based on an extensive report of 2 Dec. 2019. This report noted, inter alia, that for advertising eight of nine companies covered by the French DST are US companies, and that for digital interfaces twelve of twenty-one covered companies are from the US (and none France-based).

[42] *See* 85 Fed. Reg. No. 109, 34709.

[43] The findings on each of the DSTs are supported by reports, which are available at https://ustr.gov/. *See also* 86 Fed. Reg. No. 7, 2477 (Italy); 86 Fed. Reg. No. 7, 2478 (India); 86 Fed. Reg. No. 7, 2478 (Turkey); 86 Fed. Reg. No. 12, 6406 (Austria); 86 Fed. Reg. No. 12, 6406 (UK); 86 Fed. Reg. No. 12, 6407 (Spain).

[44] France later announced that the digital services tax for 2020 is to be paid in Dec. 2020 as the OECD discussions for a global agreement have been postponed to mid-2021.

[45] *See* 85 Fed. Reg. No. 137, 43292.

[46] *See* the USTR's press release of 7 Jan. 2021, available at https://ustr.gov/.

[47] *See* the USTR's press release of 14 Jan. 2021, available at https://ustr.gov/.

[48] *See* e.g., Lee-Makiyama, *The Cost of Fiscal Unilateralism: Potential Retaliation Against the EU Digital Services Tax (DST)*, ECIPE Occasional Paper, No. 05/2018 (2018).

[49] OECD, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (2020), paras 30 et seq.

[50] *See* for the latest status E/C.18/2020/CRP.41 (11 Oct. 2020).

[51] *See* paras 6 and 852 of OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project (2020).

were indeed to be implemented only as a 'safe habour' that would enable an MNE group to elect on a global basis to be subject to Pillar 1, it is hard to see how countries would agree to removing their DSTs for MNE groups opting out of Pillar 1. Exciting times!

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