The Compatibility of the EU's Digital Service Tax with EU and WTO Law:

Requiem aeternam donate nascenti tributo

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Abstract:

This study aims to assess the compatibility of the EU's proposal on a Digital Service Tax with EU and WTO law. In the author's view, besides not meeting the requirements set by its legal basis, the proposal is also an infringement of the subsidiarity and proportionality criteria. Moreover, it fails to meet its underlying goal of aligning taxation with value creation, particularly in what concerns the taxation of digital advertisement services.

Keywords: EU, discrimination, subsidiarity, proportionality, internal market, competition, WTO, tax, turnover taxes, digital economy

JEL Classification: K33, K34, F13, E62, D78, E62, F02, F23, F42, H20, H22, H23, H25, H26, H87, O19, O23, O24

1 – Introduction

In September 2017, in its communication *on a fair and efficient tax system*,[2] the European Commission expressed concerns regarding the compatibility of any short-term measures aimed at taxing the digital economy with both the European Union (hereinafter EU) and the World Trade Organization (hereinafter WTO) Law. In the words of the Commission:

> "All short-term options have pros and cons, and further work is needed on the detailed approach to find a workable solution for the Single Market and the global economy as a whole. Questions about the compatibility of such approaches with the double-taxation treaties, State aid rules, fundamental freedoms, and international commitments under the free trade agreements and WTO rules would need to be examined."[3]

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[2] European Commission, A Fair and Efficient Tax System in the European Union for the Digital Single Market, COM(2017) 547 final (21 September 2017).

[3] See Communication, supra n. 2, p. 10.

However, and in March 2018, the approach changed quite radically. Commenting on the proposals, the Commission noted that:

> "*The retained approach does not breach any double tax treaties with third countries or WTO rules. It remains fully grounded the most basic principle of corporate taxation – namely, that profits should be taxed where value is created*"[4].

In less than six months the Commission moved from a sceptical to a very confident stance. The EU short-term proposal was not only compatible with WTO law (and EU Law) but was also aligned with value creation, considered as "the most basic principle of corporate taxation".

Despite the efforts to adopt this proposal, in the December 2018 ECOFIN Member States eventually failed to reach consensus for its adoption. Nonetheless, the proposal has not derailed and "technical work will continue on the basis of the ECOFIN discussions".[5] France and Germany had already the opportunity to note that they are still supportive of the proposal with a narrower scope and "urge[d] the Council to adopt the legally binding directive on DST without delay and in any case before March 2019 a the latest", to "enter into force on 1st January 2021, if no international solution has been agreed upon"[6]. At present, it is not possible to predict when the technical work will end[7].

In this paper, the author will examine the compatibility of the EU proposal for a Digital Service Tax (hereinafter DST)[8] with EU and WTO Law. This analysis will be limited to this measure (also known as the interim measure or the short-term approach) and to its application as a directive. It will not take into account domestic unilateral measures inspired by this proposal. It will not take into account other EU proposals to deal with the challenges created by the digitalisation of the economy (and namely the long-term EU proposal on the significant digital presence PE).[9] It will also not discuss the different policy options to tackle the challenges created by the digitalisation of the economy[10] or the policy reasons for the introduction of a digital services tax[11]. It will not discuss the compatibility of the proposal if

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[4] European Commission, Q&A on a fair and efficient system for the Digital Single Market (21 March 2018).
[5] See General Secretariat of the Council, ECOFIN report to the European Council, 6.11.2018, FISC 519 ECOFIN 1158 CO EUR-PREP 57.
[6] See Franco-German joint declaration on the taxation of digital companies and minimum taxation, 04.12.2018 (available at: https://www.consilium.europa.eu/media/37276/fr-de-joint-declaration-on-the-taxation-of-digital-companies-final.pdf, last access: 15 January 2019).
[7] If consensus is not reached before March 2019, it will be likely for the new Commission to give proper impulse to the proposal, which will depend on the new political agenda.
[8] For the purposes of this analysis, the latest version will be taken into account: Council of the European Union, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, 7420/18 FISC 151 ECOFIN 277 DIGIT 48 IA 78, 29.11.2019.
[9] European Commission, Proposal for a Council Directive laying down the rules relating to the corporate taxation of a significant digital presence, COM(2018) 147 final, 21.03.2018 [https://online.ibfd.org/kbase/#topic=doc&url=%252Fhighlight%252Fcollections%252Fevdeulaw%252Fpdf%252Fevd_com_2018_147_corporate_taxation_of_a_significant.pdf&q=COM(2018)+147+final+finals&hlm=altering&WT.z_nav=Navigation&title=COM(2018)+147+Corporate+taxation+of+a+significant+digital+presence].
[10] Not only the amendment of the PE concept, to extend source-state taxation to cases where there is economic but no physical presence but also the possibility of introducing withholding taxes on certain transaction (digital or not). Sustaining the latter option see A. Baez & Y. Brauner, Tax Policy Options regarding tax challenges of the digitalized economy under Benjamin Franklin's rule for decision making, in: Haslehner, W. Tax and digital economy, Kluwer Law International, 2019, ch. 5. This option had already been discussed by the same authors on an IBFD's white paper. See Y. Brauner & A. Baez Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy, IBFD White Papers, 2 February 2015 [https://www.ibfd.org/sites/ibfd.org/files/content/WithholdingTaxesintheServiceofBEPSAction1-whitepaper.pdf].
[11] For a fierce conceptual defence of the introduction of such a measure see Wei Cui, The Digital Services Tax: A Conceptual Defence, SSRN, 26.10.2018.

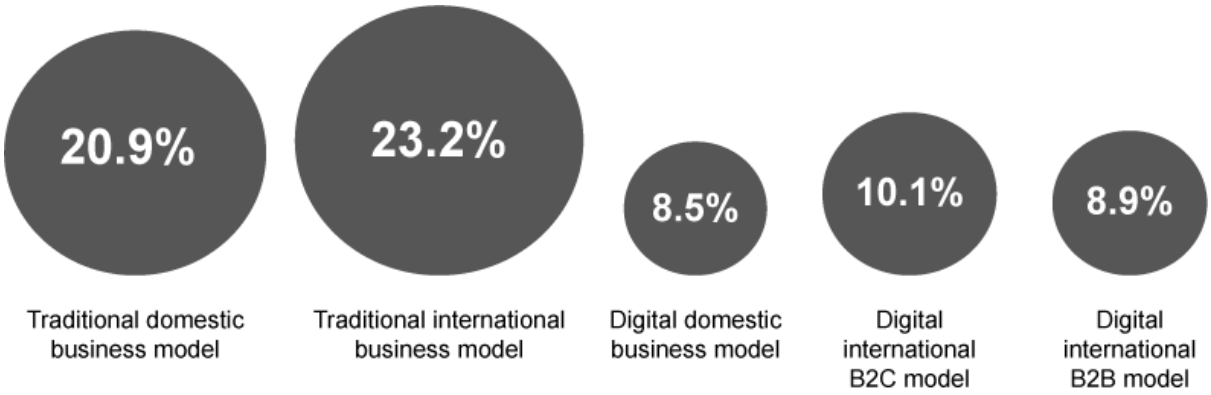
adopted throughthe enhanced cooperation mechanism. Finally, it will also not take into account the non-tax issues raised by the proposal[12].

2 – Rationale behind the Commission's intervention in this area

Over the past years, there have been many discussions concerning the amount of corporate income tax paid by multinationals (hereinafter MNEs). Many argue that these companies benefit from unfair tax advantages, namely granted through rulings that allow them to pay zero or almost zero taxes in Europe[13]. Unlike their smaller national competitors (standalone companies), multinationals operating cross-border are also able to benefit from mismatches between countries' tax systems[14]. Moreover, whereas individuals and small and medium enterprises (hereinafter SMEs) face with increasingly higher effective tax rates, MNEs were able to lower their effective corporate income tax burden.

This issue is more noticeable in case of digital businesses, as these are capable of offering their services without any physical presence in the place were the services are rendered, avoiding source taxation of their business profits[15].

This latter concern is apparently quantified by the European Commission, in the following grapic entitled "effective average tax rate in EU28"[16]:



These numbers were computed by the EC based studies provided by the Zentrum für Europäische Wirtschaftsforschung (ZEW), duly identified in the Impact Assessment of the

[12] Namely the issues in terms of access to the users' personal data (geo-location) and infringement of the right to privacy.
[13] Or, more broadly, in high-tax jurisdictions. See political statements and literature reviewed in the first two footnotes of W. Schön, *Ten Questions about Why and How to Tax the Digitalized Economy*, 72 Bull. Intl. Taxn. 4/5 (2018), Journals IBFD.
[14] European Commission, Communication from the Commission to the European Parliament and the Council – A Fair and Efficient Tax System in the European Union: 5 key areas for action, COM(2015) 302 final, 17.6.2015, section 2.
[15] As Moscovici puts it: "Corporate tax frameworks in particular have not been able to keep up. They were conceived in a pre-internet age and are confounded by today's mobile, globalised and digital companies. They rely heavily on the concept of physical presence and are underpinned by the simple principle that profits should be taxed where value is created. Digitalisation has shaken this principle to its core. In a digitalised world, it can be difficult to pin down the value that has been created, how it has been created, and where it should be taxed". See P. Moscovici, Keynote speech at the "masters of digital 2018" event, 20 February 2018 (available at http://europa.eu/rapid/press-release_SPEECH-18-981_en.htm, last access: 15.01.2019).
[16] Diagram reproduced from the twitter account of the EU Tax & Customs, published on 8 February 2018. The data used for this diagram can be found on the impact statement accompanying the proposals. See European Commission, Commission Staff Working Document – Impact Assessment accompanying the document Proposal for a Council Directive laying Down rules relating to the corporate taxation of a significant digital presence and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, SWD(2018) final/2, Brussels, 21.03.2018, p. 137. Part of these results had already been discussed on the Communication "Time to establish a modern, fair and efficient taxation standard for the digital economy, supra n. 2, p. 5.

proposals[17]. They would support the conclusion that "digital business models in the EU face a lower effective average tax burden than traditional business models"[18].

Moreover, the Commission expresses concerns about the international allocation of taxing powers. Non-resident digital businesses benefit from the infrastructures created by the State where the customers are located but are deprived of any possibility of taxing them:

> "For mostly.'web-based' companies, this will include the physical internet infrastructure, rule of law and judiciary in the country but also the education and digital skills of potential users. Within the Single market, all companies with cross-border activities benefit from the fundamental freedoms. Therefore, a non-contribution to the public budgets is seen as inherently unfair by many and can undermine taxpayer morale"[19].

In the author's view, the expression "potential users" is purposedly used. What seems to matter are not the revenues from a given State, but the potential this State has as a market jurisdiction, given the investments it makes on its human resources and infrastructures. Thus, and more than value creation, it somehow hints that the tax aims to compensate access to a certain market. This line of reasoning will be decisive to understand its design and the allocation of revenues among the Member States, particularly in the case of advertisement services.

3 – Main features of the Digital Services Tax

The EU Commission presents its DST as "an easy-to-implement measure targeting the revenues stemming from the supply of digital services where users contribute significantly to the process of value creation. Such a factor (user value creation) also underpins the action concerning corporate tax rules.". The reasons for adopting an interim measure are further described in the preamble as: i) the need to stop the erosion of the corporate tax base[20]; ii) the need to prevent uncoordinated unilateral measures by the Member States, that would further fragment the internal market and distort the competition[21].

In a nutshell, it consists of a 3% tax on the gross revenue (net of VAT) derived from the provision of certain digital services (qualifying activities) by certain companies (qualifying companies).

The qualifying activities include: i) online advertisement services; ii) making available of an online platform; iii) sale of personal data. The qualifing entities are those providing those digital services meeting a double and cumulative threshold: i) worldwide revenues over EUR 750 Million, and; ii) revenues in the European Union exceeding EUR 50 Million[22]. These

[17] See Impact assessment, supra n. 16, p. 137.
[18] See Impact assessment, supra n. 16, p. 136.
[19] See Impact Assessment, supra n.16, Annex 1 at page 138.
[20] § 6 of the preamble of the proposal, supra n.8.
[21] § 6 of the preamble, supra n. 8.
[22] Art. 4 of the Proposal, supra n.8.

thresholds will likely be reduced (and the European Parliament has already proposed to decrease the second threshold to EUR 40M.[23]

At this point, it is also essential to review the reasons for introducing the revenue thresholds.[24]

The first threshold (worldwide revenues) aims to limit incidence to companies of a certain size, as they are the ones able to benefit from the user contribution (or are dependent on this contribution). As the EC puts it, these companies "heavily rely on extensive user networks, larger user traffic, and the exploitation of a strong market position" and "such business models, which depend on user value creation for obtaining revenues are only viable if carried out by companies with a certain size".[25] Additionaly, it is mentioned that the threshold is to catch companies that are able to engage in aggressive tax planning scheme and was set at this level to match the threshold used in the CCCTB proposal[26].

The second threshold aims to limit coverage to companies "significant digital footprint at the Union level" while excluding start-ups and other entities "in the process of becoming more digitalised"[27].

For this study, it is also important to consider the deduction system. The new version of the preamble merely states that:

> "*This Directive should not prevent a Member State from allowing businesses to deduct the DST paid 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.*"[28]

Most EU tax systems allow residents to deduct (non-)corporate income taxes and other levies from the corporate tax base. In the impact assessment[29], the Commission confirms that "the new tax is an expense for a company that arises in the course of it[s] business. As such, it is natural to allow it to be deducted from the corporate tax base". This mechanism does not eliminate double taxation but "in the absence of the possibility to credit the new tax against corporate income tax paid on the same revenue (…), allowing the deduction of the tax from the corporate tax base would contribute to a fairer outcome overall"[30].

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[23] See press release of the European Parliament, MEPs agree on new rules to tax digital companies' revenues, 13.12.2018 (available at: http://www.europarl.europa.eu/news/en/press-room/20181205IPR20944/meps-agree-on-new-rules-to-tax-digital-companies-revenues, last access: 15.01.2019).

[24] As the Commission states, the goal is not to tax these services just because they are provided digitally but to tax three categories of services just because they are provided digitally. This would allow the State where the user is located to tax its contribution (user contribution) to the value creation chain of a specific (digital) business (as this amount is currently not encapsulated in the existing tax systems).

[25] See § 23 of the preamble to the proposal, supra n.8.

[26] See European Commission, Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 final, 25.10.2016, Art. 2, European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM(2016) 683 final, 25.10.2016, also Art. 2.

[27] See § 24 of the preamble to the proposal, supra n.8.

[28] See § 27 of the preamble to the proposal, supra n.8. The previous version stated that "In order to alleviate possible cases of double taxation where the same revenues are subject to the corporate income tax and DST, it is expected that MS will allow businesses to deduct the DST as a cost from the CIT base in their territory, irrespective of whether both taxes are paid in the same MS", § 27 of the preamble to the previous version, as presented on 21.03.2018.

[29] See Impact Assessment, supra n.16, p. 73.

[30] See Impact Assessment, supra n.16, p. 73.

Although presented as temporary, the proposal does not include any sunset clause[31]. The Franco-German declaration proposes it to expire in 2025 (lasting for mere four years)[32].

4 – Compatibility with EU Law

4.1 Introduction

An EC proposal, like any secondary legislation, is not immune from the scrutiny of the Court of Justice (hereinafter: the Court or CJEU) and has to comply with EU primary law (and in particular with the Treaty on the Functioning of the European Union, hereinafter TFEU).[33]

If the proposal is adopted and implemented by the Member States, it will be hard to claim infraction – by a Member State – of its EU law obligations. In fact, the implementation would not be more than a fulfilment of its EU law obligations[34].

According to the Court, one should presume that any acts of the Commission are EU Law compliant unless in extreme cases, where it is evident that the act does not exist or that it blatantly infringes EU law[35]. Anyhow, the directive can still be challenged by any Member State, the European Parliament, the Council or the Commission[36] in the framework of an action for annulment[37]. Moreover, anyone affected by the measure can challenge its legality in the Court of the country applying it. This Court has the possibility of assessing the admissibility of the measure[38].

In the following sections, the author will examine some selected issues of compatibility with primary EU law. The author will start by assessing compatibility with state aid rules and fundamental freedoms. Subsequently, will assess the fulfilment of the requirements connected with the directive's legal basis and conclude focusing on its subsidiarity and proportionality.

4.2 Compatibility with State Aid rules

According to the TFEU, a measure will amount to prohibited state aid if it is an aid (regardless of the form), granted by a Member State or its subdivision or through State

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[31] Art. 25(4) of the Proposal, supra n. 8. In the latest version, it includes a sunset clause, although no date is mentioned.
[32] See Franco-German Joint declaration, supra n. 6.
[33] Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), EU Law IBFD [https://online.ibfd.org/kbase/#topic=doc&url=/collections/eulaw/html/tt_e2_00_eng_1992_tt.html&q=treaty%20on%20the%20functioning%20of%20the%20European%20Union%20europeans%20treaties%20unions&WT.z_nav=crosslinks&hash=tt_e2_00_eng_1992_tt].
[34] The Court has already considered that a Member State that "has done no more than maintain in force national rules adopted on the basis of [a directive] and which comply with that provision, (…) has not failed to fulfil its obligations under community law". See GR: Judgement of the CJEU Judgment of 5 October 2004, Commission / Greece (C-475/01, ECR 2004 p. I-8923) ECLI:EU:C:2004:585, § 24.
[35] DE: Judgement of the CJEU 15 June 1994, Commission / BASF and others, C-137/92 P, ECR 1994 p. I-2555, (SVXV/I-201 FIXV/I-239) ECLI:EU:C:1994:247, §§ 48-50.
[36] And also the Court of Auditors, the European Central Bank and the Committee of the Regions for the purpose of protecting their prerogatives.
[37] Article 263 of the TFEU, supra n. 33.
[38] Art. 267 TFEU, supra n. 33.

resources, distorting or threatening to distort competition, favouring certain undertakings or the production of certain goods[39].

Looking at its effects, this tax could create some progressivity in the taxation of corporates (regardless of its actual classification as an income tax which could be understood as an aid to smaller companies, that would be better off than their bigger competitors (which, in some instances - and depending on the sector - may be foreign-owned).[40] The Commission has already considered that such systems may be considered as illegal state aid.[41] There is also a pending CJEU case where the referring Court asks whether "a Member State's legislation imposing a tax liability on turnover calculated by a progressive tax rate" is compatible with the prohibition of State Aid.[42]

However, this tax can never be considered as prohibited State aid since it is not an aid granted by a State. The conclusion stems from a stable line of cases initiated with Deutsche Bahn[43] according to which the rationale of the State aid prohibition is to prevent:

> "decisions of Member States by which, in pursuit of their own economic and social objectives, they give, by unilateral and autonomous decisions, resources to undertakings or other persons or procure for them advantages intended to encourage the attainment of the economic or social objectives sought"[44].

A directive is not imputable to a specific State since, in implementing it "Member States are only implementing Community provisions by their obligations stemming from the Treaty"[45]. Thus, the measure would fall outside the scope of the referred EU law prohibition[46].

4.3 Compatibility with fundamental freedoms

Besides State aid, compatibility of the proposal with primary law must also be assessed in the light of fundamental freedoms. According to the Commission, the proposal is fully compliant with fundamental freedoms:

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[39] Art. 107 TFEU, supra n. 33.
[40] See J. Kokkot, *Herausforderungen einer Digitalsteuer*, Internationales Steuerrecht (2019) forthcoming, sec. III.1a.
[41] See European 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 (notified under document C(2016) 6929), C/2016/6929, OJ L 49, 25.2.2017, p. 36–49. At § 50 it states "The progressive tax structure introduced by the Act appears deliberately designed by Hungary to favour certain undertakings over others. Under the progressive tax structure introduced under the Act, the undertakings publishing advertisements are subject to different tax rates progressively increasing from 0 % towards 50 %, depending on the brackets into which their turnover falls. Consequently, a different average tax rate applies to undertakings subject to the advertisement tax depending on the level of their turnover".
[42] HU: Vodafone Magyarország (Case C-75/18), pending.
[43] DE: Judgment of the Court of First Instance (First Chamber, extended composition) of the Court of Justice of the European Union of 5 April 2006, Deutsche Bahn AG v Commission of the European Communities, T-351/02, ECLI:EU:T:2006:104. The Court ascertained whether a German tax exemption introduced in the implementation of a directive (in a situation where the directive did not grant any other possibility of action) should be considered as aid granted by the State. According to the Commission, the exemption could not be considered as State aid since the directive gave the German State no other option than to implement the exemption on its domestic law. Thus, "the exemption is not imputable to the State" (§ 92). The Council also considered that there was not State aid since i) the Commission does not have the power to investigate if a certain provision of EU law in force is inapplicable; ii) the sub judice measure did not amount to an advantage to the companies, creating an additional burden to the State, and; iii) even if a certain measure could in abstract constitute aid, the Council has the power of exempting certain categories of aid "from complying with the procedure for reviewing their compatibility with the common market" (§ 98).
[44] Deutsche Bahn, supra n. 43, § 99.
[45] Deutsche Bahn, supra n. 43, § 102.
[46] Art. 107 TFEU, supra n. 33, prohibits State aid by States and not by the Commission or EU institutions.

> "The preferred interim option is compatible with the fundamental freedoms of the TFEU. Currently Member States are allowed to design their own direct tax systems, however, they have to respect the obligations imported by the treaties. Considering its main features, the interim solution would not infringe the internal market freedoms of establishment (article 49 TFEU) and to provide services (art 56 TFEU) as interpreted by the CJEU. The scope of the tax will include both non-resident and domestic transactions and companies. Cross-border activities/companies will be not taxed heavier than similar domestic ones. In the light of the CJEU, only one rate will apply".[47]

Examining this excerpt (and all accompayning documents), it is not possible to ascertain the reasons that support the Commission's conclusions. Recently, some have argued that the establishment of high revenue thresholds for the delimitation of the taxable entities would amount to de facto discrimination against third-country companies and, as such, would be incompatible with EU law.[48] These concerns have been taken into account in the preliminary work of the Commission. The impact Assessment recognised that the:

> "Thresholds have to be set as to not systematically exclude domestic companies from the scope of the tax". [49]

Another worrysome element is the deduction system, as suggested in the preamble.

The author will start by examining the scope of the freedoms; he will then move (even if merely on an academic endeavour) to the exam of an eventual restriction and whether this could be justified on a proportional manner.

4.3.1 Scope of fundamental freedoms and the EU Commission proposal

Non-EU situations can matter for EU purposes since the TFEU liberalises capital movements from and to third-countries. However, this is the sole exception, as all other freedoms restrict their geographic scope of protection to the EU.

In a situation that falls within the scope of two or more fundamental freedoms (being one the free movement of capital), "the Court will in principle examine the measure in dispute in relation to only one of those two freedoms if it appears, in the circumstances of the case, that one of them is entirely secondary in relation to the other and may be considered together with it"[50]. So, the Treaty protection will only extend to situations with third countries if free movement of capital is not an entirely secondary freedom.

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[47] European Commission, Commission Staff Working Document – Impact Assessment accompanying the document Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence and Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, SWD(2018) final/2, Brussels, 21.03.2018, annex 1 at page 148.

[48] Mason and Parada consider that "The very large revenue triggers in the various digital proposals guarantee – as they were meant to – that digital taxes will fall disproportionately on U.S.-headquartered companies". See R. Mason, L. Parada., *Digital Battlefront in the Tax Wars*, 92 Tax Notes International, Number 12, December 17 2018, p. 1185.

[49] See Impact Assessment, supra n.47, p. 148.

[50] DE: ECJ, 3 Oct. 2006, Case C-452/04, Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht, ECJ Case Law IBFD, § 34. The same line of reasoning is followed in later cases such as DE: ECJ, 12 June 2003, Case C-234/01, Arnoud Gerritse v. Finanzamt Neukölln-Nord, ECJ Case Law IBFD, § 23.

The DST falls squarely under the free movement of services[51] , and thus, even if one considers that it also affects free movement of capital, the Court would likely only examine it under the freedom to provide services. As the latter does not have an external dimension, discrimination against third country service providers would be lawful.

The analysis could simply end here. Anyhow, and merely for the sake of ensuring the completeness of the analysis also envisaging the –although not so likely – possibility that the Court of Justice could change its orientation, and starts to allow a parallel application of the free movement of services and capital, the author will continue to examine the compatibility of the measure in what concerns the subsequent moments of the Court's reasoning.

4.3.2 Restriction

4.3.2.1 The deduction system

The deduction system is not part of the proposal and is merely mentioned in its preamble. Due to the way our corporate tax systems are structured, income tax deductions are only granted to resident companies (in order to determine the real profit of a company). Non-residents would need to offset the DST in their countries of residence so this deduction would be granted by residence states only. For EU law purposes, this limitation may be problematic.

As a rule, "the obligation to take account of a taxpayer's personal situation is, in principle, a matter for the competence of the State of residence, and not that of the State where the income originates"[52]. However, and in this case the "business expenses in question are directly linked to the activity that generated the taxable income in [the State where the DST is levied], so that residents and non-residents are placed in a comparable situation in that respect"[53]. Thus, if the States exercises its taxing powers equally on residents and non-residents, the two groups become comparable.

The Member State cannot claim it is merely implementing the directive since the deduction is merely mentioned in the preamble and, for the CJEU, preambles are not binding[54]. Thus, the decision of a Member-State to grant the deduction merely to its residents would likely be considered a discriminatory restriction to the freedom to provide services[55].

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[51] Art. 56 of the TFUE, supra n. 33. In Brisal, the Court analysed the compatibility of Portuguese rules concerning the taxation of interest paid to banks. Although the parties (Brisal and KBC Ireland) claimed an infringement of both free movement of capital and of services (§ 12 of the decision), the CJEU analysed the case merely in the context of the freedom to provide services. It also stated that services provided by a specific sector (in that case, the banking industry; here, the digital sector) should not be distinguished from any other services (§ 26-28). See PT: ECJ, 13 July 2016, Case C-18/15, *Brisal – Auto Estradas do Litoral S.A., KBC Finance Ireland v. Fazenda Pública*, ECJ Case Law IBFD.

[52] DE: ECJ, 12 June 2003, *Gerritse*, supra n. 50, § 35 and cited case law.

[53] DE: ECJ, 12 June 2003, Case C-234/01, *Arnoud Gerritse,* supra n.50, § 27. See also DE: ECJ, 6 July 2006, Case C-346/04, *Robert Hans Conijn v. Finanzamt Hamburg-Nord*, ECJ Case Law IBFD, § 20 and DE: ECJ, 15 Feb. 2007, Case C-345/04, *Centro Equestre da lezíria Grande Lda v. Bundesamt für Finanzen*, ECJ Case Law IBFD, § 23.

[54] See, for instance, DE: ECJ, 24 November 2005, C-136/04, *Deutsches Milch-Kontor GmbH*, § 32 "preamble to a Community act has no binding legal force and cannot be relied on either as a ground for derogating from the actual provisions of the act in question or for interpreting those provisions in a manner clearly contrary to their wording"

[55] PT: ECJ, 13 July 2016, Case C-18/15, *Brisal* – Auto Estradas do Litoral S.A., KBC Finance Ireland v. Fazenda Pública, ECJ Case Law IBFD, § 28. On the non binding nature for Member States of the deductibility recommendation included in the Preamble of the proposed Directive, see also A. Turina, *Which Source Taxation for the Digital Economy?*, 46 Intertax 6/7 (2018), p. 509.

4.3.2.2 Worse treatment of non-EU service providers

As most of the digital services providers are located outside of the Union[56], one could additionally argue that the proposal (particularly considering its high thresholds) leads to a systematic disfavouring of cross-border (non-EU) business as a result of a covert, or de facto, discrimination.

First, and to establish comparability, it is important to take into account the purpose and content of the relevant provisions[57]. As indicated earlier, the DST aims to tax value creation in the State where the contributing user is located. For the Commission, covered and non-covered digital service providers are not comparable since only "companies of a certain scale" could benefit from user value creation as "such business models, which depend on user value creation for obtaining revenues are only viable if carried out by companies with a certain size"[58].

Even if one accepts the reasoning of the Commission, a careful review of the proposal and all accompayning documents does not provide any proper evidence of the stated difference. Thus it is difficult to sustain the non-comparability of the two groups of subjects (covered and non-covered digital service providers).

In case they are considered comparable, it is still necessary to ascertain if there is covert discrimination. In this respect, there are no clear doctrinal or jurisprudential standards on how it should be done. The author finds the argumentation of AG Kokott[59] in the recent ANGED case particularly persuasive and helpful for these purposes[60].

According to the AG, the fact that most of the entities affected by the tax are foreign is not, per se, enough to characterise a measure as covert discrimination[61]; the provision should also "affect foreign undertakings in particularly intrinsic or in the vast majority of the cases"[62]. In the authors' view, this two-pronged test can be applied in this case and supports reaching a conclusion[63].

In what concerns the first prong, there is nothing intrinsicly "American" or "non-European" in providing digital services, or in meeting revenue thresholds. It is true that many "digital giants" are in the US but there is no link between that and being "American" or "non-European".

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[56] Although there is no available data on this aspect. Impact Assessment, supra. n.47, p. 67.
[57] DE: ECJ, 20 September 2018, Case C-685/16, *EV*, ECLI:EU:C:2018:743, §§ 88 and 89 and case law cited. As stated: "88. (…) it is clear from the Court's case-law that the comparability of a cross-border situation with an internal one must be examined having regard to the aim pursued by the national provisions at issue as well as their purpose and content (…) 89 Moreover, only the relevant distinguishing criteria established by the legislation in question must be taken into account in determining whether the difference in treatment resulting from that legislation reflects an objectively different situation (…)".
[58] See proposal, supra n.8, § 23.
[59] ES: Opinion of Advocate General Kokott, 9 Nov. 2017, Case C-233/16, Asociación Nacional de Grandes Empresas de Distribución (ANGED) v. Generalitat de Catalunya, ECJ Case Law IBFD, § 34 et seq..
[60] ANGED namely discussed the compatibility of a regional Catalonian tax on large retail establishments with the treaty. Instead of income or turnover, this tax was calculated on the basis of sales, public display and/or parking area, besides the number and density of the population on the municipality where the establishment was located. ANGED, a union of retail establishments considered that the tax was de facto discriminatory as it targeted companies seated in other Member States. The Court dismissed this claim since none of the intervening parties provided sufficient arguments (burden of proof). As the tax was levied on entities that were 61,5% of other Member States, with a revenue of 52%, it could not be considered as de facto discriminatory.
[61] ES: Opinion of Advocate General Kokott, 9 Nov. 2017, supra n.59, § 35.
[62] ES: Opinion of Advocate General Kokott, 9 Nov. 2017, supra n.59, § 38 in fine.
[63] Despite its non-application by the Court, that focused on the burden of proof. See ES: ECJ, 26 Apr. 2018, Case C-233/16, Asociación Nacional de Grandes Empresas de Distribución (ANGED) v. Generalitat de Catalunya, ECJ Case Law IBFD, § 33 and 34.

The second prong of the proposed exam focuses on the effects of the measure (without consideration of the nature of the criteria used for the distinction) and ascertains whether the measure is designed to hit non-european or non-US companies. The issue is mainly (if not merely) quantitative, and the hardship is to set the percentage required to conclude that there is discrimination. So far, the Court has never provided a number. In the Court's case law, there are merely non-numeric references such as "mere risk of a disadvantage", the "majority of the cases", "preponderance of non-residents being affected"[64] or "lead in fact to the same result"[65]. Anyhow, this quantitative exam needs nevertheless to be casuistic and should take into account all underlying facts and circumstances.

In the author's view, and even against this proposed normative framework the DST would not be considered as covert discrimination. In fact, in certain cases, not even a full match would lead to deem a measure as discriminatory. This would be the case of taxes levied on external products or non-resident producers simply because the same products or producers cannot be found in the territory. As an illustration, the fact that there is no oil extraction or refinery in a given state does not prevent it from (using its tax sovereignity) to levy a specific tax on oil derived products. Even if these products are in direct competition with products non-subject to that tax such as electricity[66]. For all other cases, there should be a close match, and a real high percentage is required. Discrimination would only occur when the measure covers the "vast majority of cases" criteria, which seems to be the reading of AG Kokott of the Court's approach in Hervis[67].

In this case, most of the digital service providers are (and, consequently, of the potential taxable entities) outside of the EU. Any levy on digital service providers, even without any threshold, would necessarily reflect the structure of the market. The threshold further accentuates this imbalance. However, this would be the result of the facts and circumstances on how the businesses are organised in this particular sector.

Provided that Moscovici's statements[68] are true, (only) 2/3 of the affected entities would be non-european. A rough analysis of the market data leads in the same direction[69]. This would clearly not amount to the "vast majority of the cases", as mentioned earlier.

Anyhow, the absence of a de facto discrimination does not provide *carte blanche* for wholly disproportionate treatment of subjects or situations. Other legal principles and requirements apply and could be invoked to prevent it (as discussed infra).

For the purposes of this study, we will assume that there is a restriction and will further examine whether it could be considered justified under EU Law.

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[64] See ES: Opinion of Advocate General Kokott, 9 Nov. 2017, supra n. 59, § 36 and cited case-law.
[65] ES: ECJ, 26 Apr. 2018, ANGED, supra, n. 63, § 30 and HU: ECJ, 5 Feb. 2014, Case C-385/12, *Hervis Sport- és Divatkereskedelmi Kft. v. Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Főigazgatósága*, ECJ Case Law IBFD, § 30.
[66] Comparing, for instance, cars running on diesel and cars running on electricity.
[67] See ES: Opinion of Advocate General Kokott, 9 Nov. 2017, supra n. 59, § 38 in fine.
[68] P. Moscovici, Speech at the FEEPS conference, 9 April 2019: "We are here talking about 108 companies that would be concerned. They are not all Americans, far from that. But 50% of the companies would be American. It is quite logical, because this is the structure of the digital market. But one third would be European companies and the others would be from rest of the world". (available on https://www.facebook.com/FEPSEurope/videos/10156270418874776/ from 01h22 approx., English translation. Last access: 15.01.2019).
[69] Alternatively, it is also possible to take into account the Forbes "Top 100 digital companies", removing "aerospace and defence", "semiconductors" and "technology hardware and equipment" as these three categories clearly do not relate with digital services. This shows that 25 companies (49%) are from the US, 18 companies (35%) are from other third countries whereas 8 (16%) are from the EU. See Forbes, "Top 100 digital companies", 2018 ranking. Available at https://www.forbes.com/top-digital-companies/list/#tab:rank; last access: 15.01.2019)

4.3.4 Justifications and proportionality

4.3.4.1 Regarding the deduction system

In connection with the deduction system, the author believes that the Court would closely follow its decision in Brisal[70].

First, the Court would unlikely consider any advantages eventually obtained by non-residents since the "unfavourable tax treatment contrary to a fundamental freedom cannot be regarded as compatible with EU law because of the potential existence of other advantages"[71].

The Court would also likely dismiss any claims regarding the balanced allocation of taxing rights given the lack of a link between the denial of the deduction and the exercise of the taxing powers by the State[72].

The Court would probably accept the risk of double deduction of the expenses considered connected with the fight against tax evasion. However, the measure would likely fail the proportionality test insofar as: i) there is an exchange of information mechanism between the DST levying State and the residence State allowing the provision of the required information; ii) the DST levying State fails to show that it is not possible to use that mechanism to ascertain the existence of a double deduction (i.e. to check if the residence State also provided a deduction).

Contrary to Brisal[73], the Court would likely not admit any claims regarding the need to ensure an effective collection of tax, as the collection method is the same, for residents and non-residents.

In conclusion, and if a discrimination was found, Member States would be in a difficult position to provide a proportionate justification for it. In particular in cases where the entities are liable to DST but don't derive income for corporate income purposes. One could argue that an unlimited carry forward of the deduction would be able to neutralize the difference in treatment. However, the Court may consider that this is not enough, since there would still be a cash-flow disadvantage between residents and non-residents: i) residents with profits in their residence State would be able to deduct DST against their profits in the year it occurs; ii) non-residents with profits (in the residence State) would not be able to deduct the cost neither in the residence State (assuming that it denies deduction), nor in the state levying the DST (in case they do not derive any profits).

4.3.4.2 Regarding the de facto discrimination

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[70] See supra n. 55.
[71] See Brisal, supra n. 55, § 32.
[72] See Brisal, supra n. 55, § 32. According to Dimitropolou the Court could consider that "the Member State levying the DST does not already have an established taxing right which it is not in a position to exercise because of the lack of physical presence of the digital service provider". See C. Dimitropoulou, *The Digital Services Tax and Fundamental Freedoms: Appraisal under the Doctrine of Measures Having Equivalent Effect to Quantitative Restrictions*, 47 Intertax 2 (2019), p. 214.
[73] See Brisal, supra n. 55, § 39 et seq..

It is not easy to reconduct any of the aims portrayed by the EU Commission to the traditionally acceptable justifications. Taxing value creation where the user is located does not fit within the "cohesion" justification. The also Commission mentions tackling "aggressive tax planning"[74]. Insofar as this does not amount to avoidance[75], it would not be a valid justification. Moreover, in the framework of the fight against avoidance, the measure would still be disproportionate since it is not limited to countering wholly artificial arrangements[76] (thus failing the proportionality test)[77].

One could also claim that the measure is needed to ensure the balanced allocation of taxing powers. Usually, this refers to domestic rules that "in the absence of any unifying or harmonising measures adopted by the European Union, the Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation" [78]. This allows the Member States to "prevent behaviour capable of jeopardising the right of a Member State to exercise its powers of taxation about activities carried on in its territory".[79] DST is a multilaterally agreed measure allowing the market State to tax, even before the source or residence State can do it. However, would "such taxation [be] necessary to ensure a balanced allocation between the Member States of the power to impose taxes when that aim may be attained by non-discriminatory measures"[80]. A DST with a lower or no-threshold would be clearly less-restrictive to achieve the same aim (allocation of taxing powers to the market state) while being less-discriminatory to non-EU businesses.

In the author's view, any claim based on the infringement of fundental freedoms would likely be dismissed, given the current approach to the freedoms' scope. The real issues arise in what concerns compliance with the requirements set by the legal basis and the proportionality and subsidiarity requirements of the TFEU[81]. This analysis will be done in the next section.

4.4 Fulfilment of the requirements connected with its legal basis

4.4.1 Introduction

The legal basis for this secondary law proposal is Art. 113 of the TFEU. This special legislative procedure only allows the harmonisation of indirect taxes and relies on the qualification of the DST as a proper turnover tax, which can be challenged. Morever, it needs to pursue one of two aims: i) functioning of the internal market; ii) avoiding the distortion of competition.

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[74] See proposal, supra n. 8, § 23.
[75] As conceptually, the two expressions do not match. See P. Pistone, *The Meaning of Tax Avoidance and Aggressive Tax Planning in European Union Tax Law: Some Thoughts in Connection with the Reaction to Such Practices by the European Union,* in *Tax Avoidance Revisited in the EU BEPS Context*, pp. 73–100 (A.P. Dourado, ed., EATLP International Tax Series, IBFD 2017), Online Books IBFD.
[76] UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury* Schweppes plc, *Cadbury* Schweppes Overseas Ltd v. Commissioners of Inland Revenue, ECJ Case Law IBFD, §§ 51 and 55.
[77] See, in general terms, J. Nogueira, *Direito Fiscal Europeu: O Paradigma da Proporcionalidade: A proporcionalidade como critério central da compatibilidade de normas tributárias internas com as liberdades fundamentais*, Kluwer / Coimbra Editora, 2010.
[78] FR: ECJ, 22 Nov. 0208, Case C-575/17, *Sofina SA, Rebelco SA, Sidro SA v. Ministre de l'Action et des Comptes Publics*, ECJ Case Law IBFD, § 56 and cited case law.
[79] FR: ECJ, *Sofina SA,* supra n. 78, § 57 and cited case law.
[80]FR: Opinion of Advocate General Wathelet, 7 Aug. 2018, Case C-575/17, Sofina SA, Rebelco SA, Sidro SA v. Ministre de l'Action et des Comptes Publics, ECJ Case Law IBFD, § 41.
[81] See Art. 5 TFEU, supra n. 33.

In this section, the author will assess if these requirements given are met. Before doing that (and to enable that analysis), will explore the main legal and economic consequences of the proposal.

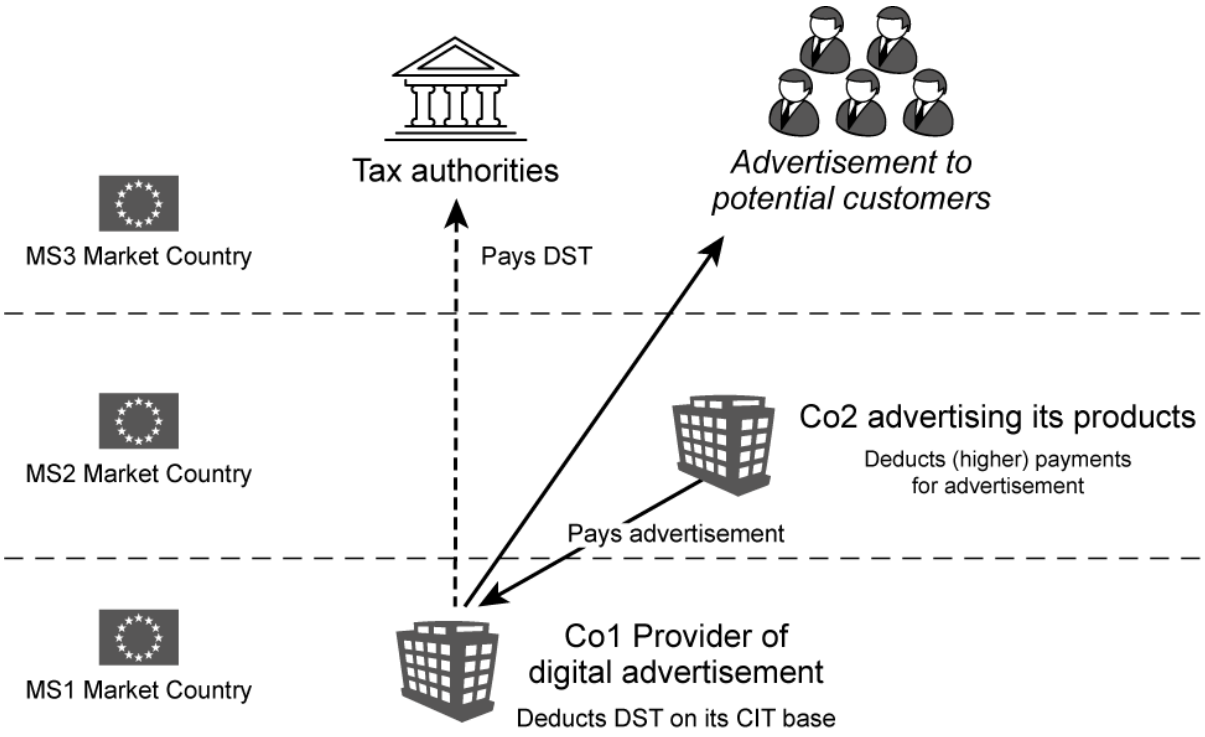
4.4.2 DST in cases of profits: the emergence of the Market State

With this proposal, the market State emerges as a new player in the international allocation of taxing rights[82]. This will be further illustrated by reference to digital advertisement services, also taking into account the Franco-German proposal of narrowing down the scope of the proposal to these services[83].

The example will take into account an EU MNE (it would be the same for a third country MNE with a subsidiary or a PE in Europe). This company is resident in Member State 1 (MS1) and provides digital services. The company wanting to advertise its products is resident in MS2. The customers to whom the digital advertisement are shown are located in MS3. Let's also assume that none of the customers buys the product. Let's also assume that there are tax treaties between all these countries, follow the latest version of the OECD MC (and, when applicable, following the credit method). The graph below helps to depict this situation.

[82] See statement from the Ministries of Finance of Sweden, Denmark and Finland entitled "Global Cooperation is key to address tax challenges from digitalization", 1.06.2018, available at https://www.government.se/statements/2018/06/global-cooperation-is-key-to-address-tax-challenges-from-digitalization (last access: 15.01.2019). According to the statement, the EU proposals "partly shift taxing rights to the country of the consumer or the digital user, based on the premise that these contribute to value creation in the digital economy. This deviates from internationally established principles. Traditionally, exporting firms do not pay taxes in their export destination simply because they have consumers there. The proposal for a digital services tax means that basically all value creation is deemed to take place at the location of the consumer. Furthermore, a digital services tax deviates from fundamental principles of income taxation by applying the tax on gross income, i.e. without regard to whether the taxpayer is making a profit or not. Such substantial changes to the current international principles need to be discussed and agreed internationally."

[83] See supra n. 6.



Once the DST is adopted, the MNE located in MS1 will start by paying the DST to the tax authorities on MS3. This amount will likely be deducted from the tax base in MS1. The company located in MS2 will pay to the MNE in MS1 the costs of the advertisement services provided to potential customers located in MS3 (prices which will likely be higher as the MNE will probably incorporate the amount of the DST in the cost of its services.

Comparing the pre- and post-DST scenarios, the following conclusions can be extracted:

a) Market State (MS3): pre-DST it could not tax anything; with the DST, it takes the first bite and taxes 3% of the gross revenue of the advertisement services. According to the calculations of the Commission, this 3% tax on a turnover (gross) basis is approximately equivalent to a 20% levy on a net basis[84].

b) Residence State: pre-DST was the only state that could tax the revenue resulting from the services; post-DST, it will still be able to tax, but the taxable base will be reduced by the amount of DST paid to MS3.

c) Source State: post-DST (and assuming that all or part of the DST cost is internalised in the price of the digital services) it will have to accept a higher deduction of the expenses in the operating company, reducing its taxable basis and revenue.

With the the DST, both source and residence state face a reduction of their tax revenues. In contrast, the market State gains tax sovereignty over the income and is the first one to tax around 20% of the net revenues derived from the transaction.

[84] See Impact Assessment, supra n. 47, at p. 71. The Commission has only computed the net impact of a 2% gross tax rate. However, and using the same assumptions, a 3% gross rate would equate to a 20% net tax rate.

The DST also has an impact on the results of the two companies. The operating company located in MS2 will likely pay more for the advertisement services. The MS1 MNE MS1 will also pay higher taxes (amount that depends on whether the deduction is granted): i) if the deduction is not granted, it will simply face an additional 20% tax on the revenues (a percentage higher higher than the profit margin of some business models); ii) if the deduction is granted, it will still pay more taxes since the deduction is not able to eliminate the effects of the economic double taxation (only the full exemption or credit would allow it).

The deviation from the traditional corporate tax rules is even more visible in the case of losses at the level of the MS1 MNE. One should take into account that losses are particularly frequent in these companies, which usually take several years before being able to monetise their services or before recovering from the initial investment[85]. In our example, and in case of losses, the market state will still require the MNE to pay 3% of the gross revenue of the transaction (approx. 20% of the net revenue). The residence state will not be able to react immediately, by crediting or compensating the losses. It can only accept a(n unlimited) carryforward of losses which will delay the emergence of taxable profits at the level of the MS1 MNE. This will be further discussed in the next section.

4.4.4 Internal market

Based on the prior assessment of the impact of the DST (in case of profits and losses), the author is now in a position of assessing if the DST is (or not) a step towards the goal of the "establishment and the functioning of the internal market", as required by Art. 113 TFUE.

The Commission argues that:

> "A multiplicity of different approaches to the taxation of the digital economy risks further fragmenting the EU Single Market, creating additional barriers and legal uncertainty for companies and distorting competition in the Single Market. It may also result in the creation of new loopholes that could facilitate tax avoidance. All of this would be damaging for EU competitiveness and tax fairness. In addition, uncoordinated national measures reduce the chances of converging towards a common comprehensive EU approach. For this reason, it is also necessary to find an interim solution at EU level. This should prevent the fragmentation of the Single Market and improve fairness, while allowing Member States to safeguard their revenues and creating a catalyst for a movement towards a more comprehensive solution. The interim measure should only apply until a comprehensive solution has been agreed at the international level.".[86]

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[85] For instance, Twitter was loss making for over a decade and generate its first profits in 2018. See https://www.theguardian.com/technology/2018/feb/08/twitter-makes-first-quarterly-profit-history (last access: 15.01.2019).

[86] See European Commission, supra n. Communication from the Commission to the European Parliament and the Council - Time to establish a modern, fair and efficient taxation standard for the digital economy, COM(2018) 146 final, 21.03.2018, Brussels, p. 8 and 9.

In short, the the interim measure is needed because it prevents further unilateral action that would fragment the internal market and create inefficiencies (such as new compliance costs).[87]

One should start by noting that, at the current state, direct taxation is not harmonised and Member States remain competent to define their domestic direct tax systems provided that there is no infringement of EU primary law[88]. As a consequence, disparities may occur leading both to double or multiple taxation and double or multiple non-taxation. This conclusion alone is not sufficient to justify an action from the Commission based on Art. 113 TFEU. Otherwise, this provision alone could be used to harmonise every single feature of EU direct tax systems.

Second, the Commission[89] reacted against a potential risk, and one should consider whether if a mere expectaction is enough to justify an EU action[90]. When examining carefully the wording of Art. 113 TFEU, one concludes that it should be used for the "harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation". However, at present, there are merely no domestic taxes that need to be harmonised since States do not intervene in this area by turnover taxes[91]. The DST is ultimately levied on corporate profits, and these profits are usually taxed under corporate income taxes[92].

Third, the proposal is expected to prevent unilateral action. However, it would not at all preempt uncoordinated action in what concerns the "normal" or "traditional" way of intervening in this field: direct taxation. Taxes such as the UK diverted profit tax would remain unaffected. Thus, and in the author's view, the proposal of the Commission is not even adequate to deal with the projected risk.

Fourth, the perceived "unfairness" that triggers the Commission to act is on the differences in "effective average tax rates" of domestic corporate income taxes and not on turnover or indirect taxes. In the author's view, the Commission exceeds the powers granted by Art. 113 TFEU as it is harmonising indirect taxation to correct (allegedly unfair) outcomes at the level of direct taxation.

After these preliminary remarks addressed to the statements of the European Commission, the author will now expand on the detrimental impact of the proposal (that outweigh any of its positive effects).

First, and as mentioned above, if the operating company has profits, this proposal leads to unrelieved double taxation[93] (since the proposed deduction will only be able to mitigate

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[87] According to Moscovici "either we move forward in an orderly fashion, or we move forward in a disorderly fashion. Member States are becoming increasingly frustrated at their inability to tax the high volumes of digital activity within their borders. Some have taken, or plan to take soon, unilateral measures in an attempt to solve the problem. A combination of fragmented, uncoordinated national 'patches' and solutions would negatively affect the single market, raise compliance costs and ultimately undermine competitiveness: that is the disorderly outcome we would very much like to avoid". See P. Moscovici, Keynote speech, supra n. 15.

[88] DE: ECJ, 14 Feb. 1995, Case C-279/93, Finanzamt Köln-Altstadt v. Roland Schumacker, ECJ Case Law IBFD, ECLI:EU:C:1995:31, §21.

[89] At least at the time of releasing the proposal.

[90] The situation is now quite different since several member states have announced that they will go for unilateral equalisation levies.

[91] In the Impact Assessment, supra n.47, at p. 139, this is recognised. The EC starts by stating that "most recent national tax measures to address the digital economy are in the area of indirect taxes". However, when examining those measures, is only able to list two: i) the Hungarian advertisement tax of 2014, and; ii) the Slovakian tax on feed from the intermediation through websites and online platforms. On page 125 et seqs. the Commission further analyses other planned or implemented states by member states, with a more remote connection with the current proposal.

[92] Earlier, the Commission described the equalization tax as a "tax on all untaxed or insufficiently taxed income generated from all internet-based business activities, including business to business and business to consumer, creditable against the corporate income tax or as a separate tax". Thus, a sort of a supplementary income tax. See European Commission, supra n. 2, p. 10.

[93] See J. Kokott, supra n. 40, sec. IV.

minimal amount of the double burden imposed by the DST). And double taxation is per se contrary to the proper functioning of the internal market[94].

Second, if the operating company has losses (or if the profit margin is inferior to the amount of the tax, calculated on a gross basis), the DST constitutes a significant hindrance on its ability to pay[95]. Companies will be forced to pay taxes (ultimately) on their real profits even if they have none. This is particularly harmful for innovation, which is not only one of the core goals of the internal market but also a goal of this proposal[96]. Innovating companies (that often have higher costs due to R&D investments) will face a higher cost which in some cases may deter them from investing (or to pass the cost to the end-consumer, difficulting access to innovative services).[97]

Third, a robust internal market integrates smaller and bigger economies. As illustrated, this proposal leads to the strengthening of the more significant economies ("the market countries", with many inhabitants) at the cost of smaller economies[98]. If adopted, the more significant economies will have the first undisputed bite on any profit generated by digital services, providing them with a considerable advantage in comparison with the others.

Fourth, the proposal is not even able to ensure value creation taxation[99] (assuming it is an internal market goal), at least in a consistent and systematic manner. The DST attributes taxing rights to the market State, i.e. the place where the user is located but, and consistently, fails to incorporate value creation[100]. Passively viewing of ads does not add to the value creation chain of a company and cannot be legitimately used as a proxy to value creation.[101] In these cases, [102] the DST is utterly inadequate to pursue that goal.

Fifth, some features of the proposal end up disrupting the proper functioning of the internal market. This is the case of the proposed method for allocating the tax base among member states. In case of advertisement services, if the adverts are displayed in more than one

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[94] According to the Commission "Double taxation is one of the issues of most concern for EU citizens and business" – See European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee "Double Taxation in the Single Market", COM(2011) 712 final, 11.11.2011, p. 6.

[95] On the relevance of the ability to pay for the taxation of companies see DK: ECJ, 12 June 2018, Case C-650/16, A/S Bevola, Jens W. Trock ApS v. Skatteministeriet, ECJ Case Law IBFD, § 39.

[96] See Proposal, supra n. 8, § 3 of the preamble.

[97] According to Bloch and Demange "Taxes may affect the behavior of the platform, possibly leading the platform to exclude some users and advertisers or to start charging a subscription fee. This calls for extending the analysis". See F. Bloch & G. Demange, *Taxation and Privacy Protection on Internet Platforms*, 20 Journal of Public Economic Theory 1, section 6 (2018).

[98] Same conclusion is reached by Brauner and Pistone. When discussing the short-term solutions, these authors consider that "they may also potentially harm global digital players in an unnecessary way and give rise to negative effects on the economy of smaller countries. For all of these reasons, we do not consider them to be a suitable approach to the international tax problems connected with the digital economy". See Y. Brauner & P. Pistone, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71 Bull. Intl. Taxn. 12, Sec. 5 (2017), Journals IBFD.

[99] The proposal, supra n. 8, § 9 of the preamble the Commission refers that these services were selected as they are "the ones that are largely reliant on user value creation." In § 7 it had already stated that the DST should be "an easy-to-implement measure targeting the revenues stemming from the supply of digital services where users contribute significantly to the process of value creation. Such a factor (user value creation) also underpins the action with respect to corporate tax rules". In the Impact Assessment it is also stated that "the rationale for the interim solution is to be a good and simple interim proxy to deal with the most extreme cases where users contribute a very significant share of the value". See Impact Assessment, supra n.47. See also P. Moscovici, Answer to question Nº E-002981/18 of the European Parliament, on behalf of the Commission, 18.07.2018 (available at: http://www.europarl.europa.eu/doceo/document/E-8-2018-002981-ASW_EN.html; last access: 15.01.2019)

[100] F. van Horzen & A. van Esdonk, *Proposed 3% Digital Services Tax*, 25 Intl. Transfer Pricing J. 4, p. 269 (2018), Journals IBFD. The authors "doubt whether the mere presence of users within the European Union can provide sufficient jurisdiction for EU tax law to apply in the eyes of jurisdictions where the DST taxpayers are established, especially if the 'brains' are based in these jurisdictions and not in the European Union".

[101] The closest would be the user interaction with the advertisement (in case the interaction could be further processed for commercial purposes).

[102] This is even more serious if one considers that, after the lack of agreement at the December 2018 ECOFIN, the German and French government now propose narrowing down the proposal to advertisement services. See supra n. 6.

jurisdiction, the revenues are split among Member States according to the number of times the adverts are displayed in users' device located in that country. The location is determined by the internet protocol (IP) address of the device or, if more accurate, any other method of geolocation[103]. This method of splitting the tax base creates several internal market issues: i) it gives Member States the possibility of using different criteria (some may use the IP address, while others may go for other methods) which may lead to double or multiple unrelieved double taxation (just in what concerns this tax); ii) it allocates the tax base (revenues) based on a criteria (IP address) that is hardly reconcilable with any credible economic activity indicator (the mere display of publicity – that may not even be visualised – does not correspond to any activity that indicates ability to pay, consumption, possession of capital or any other wealth-disclosing activity that legitimates levying a tax); iii) the criterion can be easily manipulated (namely through the use of a Virtual Private Networks "VPNs" on the devices, which are able to place the IP address in another jurisdiction; BOT[104]s could be used, which would lead to a different allocation of the tax base even without any human visualisation or intervention.

Lastly, there is a similarity with the modus operandi of the VAT directive[105] and the cumulation of the two would create an extra burden [106]. Besides, as an indirect tax without a real possibility of deduction, the DST would lead to cascading effect or the cumulation of tax burden (leading also to economic distortions)[107].

4.4.5 Avoid distortion of the competition

The Commission considers that the DST prevents uncoordinated action by the Member States which would lead to "creating additional barriers and legal uncertainty for companies and distorting competition in the Single Market"[108]. In this sense, it would be a measure aimed at avoiding the distortion of the competition. However, and in the author's view, this proposal further disrupts competition within the Member State and its negative impact outweighs any advantages.

The Court has had, for several times, the opportunity of further detailing what is "distortion of competition" (an expression that is also used in the framework of the prohibition

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[103] See Art. 5(5) of the proposal, supra n. 8.
[104] Software that runs autonomously or at request, allowing the performance of several tasks without any human intervention.
[105] Although there is no unlawful overlap. See Art. 401 of the Council Directive 2006/112/EC, of 28 November 2006 on common system of value added tax, OJ L 347/1, 11 December 2016, with subsequent amendments [https://online.ibfd.org/kbase/#topic=doc&url=%252Fhighlight%252Fcollections%252Fevdeulaw%252Fpdf%252Fevd_2006_-_recast_vat_directive_2006-112-ec.pdf&q=2006%252F112%252FEC&hlm=altering&WT.z_nav=Navigation&title=Directive+2006%252F112%252FEC]. For an analysis on the potential infringement of Art. 401 of the VAT Directive (EU VAT Directive (2006): Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax (as most recently amended by Directive 2008/8/EU, text applicable with effect from 1 Jan. 2015), OJ L347/1 (2006))). In this respect, see Turina, supra n. 55, p. 510, where the author, in the light of the leading case law in the area, concludes that the VAT Directive would not deem unlawful the DST proposal. At the same time, this restrictive approach has been criticised and may be perhaps be reconsidered in the future, see for instance the position expressed by AG Kokott in her Opinion of 5 Sept. 2013 in Case C-385/12 on the special Hungarian retail tax. HU: ECJ Opinion AG Kokott, 5 Sept. 2013, Case C-385/12, Hervis Sport- és Divatkereskedelmi Kft. v. Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Főigazgatósága, ECJ Case Law IBFD.
[106] See CFE Fiscal Committee, Opinion Statement FC 1/2018 on the European Commission Proposal of 21 March 2018 for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services, 58 Eur. Taxn. 8 (2018), Journals IBFD, section 8 [https://online.ibfd.org/document/et_2018_08_cfe_1].
[107] Or "double taxation of multinational companies" since "the EU already has a revenue tax based on the location of the customer – VAT" which would add up to the Digital Services Tax. See Letter of the Committee on Finance of the United States Senate, supra n. 143.
[108] See also Impact assessment, supra n.47, p. 139, last paragraph.

of State aids). In Italy v Commission, C-173/73[109], the Court considered that the assessment should be focused on the economic effect of the measure, which could be measured through a "before and after" test. In the Philip Morris case[110], it further considered that there is a distortion if a measure strengthens the position of an undertaking compared with other undertakings competing in intra-community trade. In the author's view, this proposal may lead to further distortion of the competition within the internal market, as discussed infra.

First, the proposal distorts competition between digital services' companies, due to the (high) thresholds used. Let us assume two similar companies apart from the fact that one is slightly above one of the thresholds. Whereas the first has to bear 3% DST on all digital services' revenue (even if it has no profit), the other is entirely exempt from this tax. There is no continuity in the tax response, also known as the cliff effect (not mitigated, for instance, with the inclusion of progressive rates and thresholds)[111]. The thresholds distort the competition in favour of smaller-size competitors[112].

Second, the proposal distorts competition between digital and non-digital services[113], increasing the tax costs of the first. In the absence of any negative externality that needs to be incorporated in the services' price through a tax, there is no apparent reason for intervention through an income or a turnover tax (no need for a Pigouvian approach). The DST ends up granting a competitive advantage to non-innovative services, which runs contrary to the EU goals. There is just no reason for a tax intervention that distorts competition in favour of non-digital services[114].

Third, the proposal seems to hamper future competition. In general, digital services are the outcome of several years of investments in R&D and represent innovative ways of adding value to society. If the EU introduces an extra levy on these services, the inevitable result is that companies will incorporate this cost in their R&D plans, discouraging further investments since the economic return would be less profitable.

Fourth, the Commission argues the existence of a structural difference between the effective tax rates of digital business models and non-digital ones. This difference would lead to unfair competition for non-digital business models and would legitimise this tax. In the author's view, this is not correct as indicated by a mere reading of the studies used for the calculation of the Commission's results. This fundamental flaw deprives the proposal of its alleged legitimacy and will be further discussed in the next segment.

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[109] IT: ECJ, 2 July 1974, Case C-173/73, *Italy / Commission* (ECR 1974 p. 709) (EL1974/00351 PT1974/00357 ES1974/00325 SVII/00321 FIII/00323) ECLI:EU:C:1974:71, § 13.

[110] NL: ECJ, 17 September 1980, Case C-730/79, *Philip Morris / Commission*, (730/79, ECR 1980 p. 2671) (EL1980:III/00013 SVV/00303 FIV/00313) ECLI:EU:C:1980:209.

[111] The Commission justifies the introduction high threshold as this would allow targeting only "business models, which depend on user value creation for obtaining revenues and are only viable if carried out by companies with a certain size, are the ones responsible for the higher difference between where their profits are taxed and where value is created". In these business models, "user contribution plays a fundamental role, and which heavily rely on extensive user networks, large user traffic, and the exploitation of a strong market position". See § 23 of the preamble to the proposal, supra n. 8.

[112] Besides, the proposal may have different effects depending on the business model of the company subject to the tax. See G.W. Kofler, G. Mayr & C. Schlager, *Taxation of the Digital Economy: "Quick Fixes" or Long-Term Solution?*, 57 Eur. Taxn. 12, p. 531 (2017), Journals IBFD.

[113] Brauner and Pistone consider that even if the DST – as proposed – is applied on a non-discriminatory matter, it "would structurally produce a tax bias in the treatment of traditional and new business models, which could potentially affect the exercise of freedoms and alter competition within the internal market. See Brauner, & Pistone, supra n. 97, sec.2. See also Dimitropoulou, supra n. 72, sec. 2.2.2.

[114] In the same vein, see Kokott, supra n.40, sec. III.2

4.4 Subsidiarity and Proportionality

4.4.1 Introduction

Even if one assumes that the proposal strengthens the internal market and/or avoids distortion of the competition, it would also need to comply with the requirements of subsidiarity and proportionality[115].

Subsidiarity is required in areas outside the exclusive competence of the Union. According to it, EU action can only take place if it cannot be appropriately carried out at the Member State level[116].

Proportionality requires any EU action not to exceed what is needed to achieve the goals of the Treaties[117]. In selecting the course of action, EU institutions should choose the measures that, while allowing it to reach the (underlying EU) goals, are the least restrictive to the interests affected (namely to the Member State's interests).

The Commission considers that both requirements are met. The author has a different view, which will be explained in the two following sections.

4.4.2 Subsidiarity and gap on the effective average tax rates.

For the Commission, subsidiarity is met since "it is not possible for Member States to address the problem without hampering the single market"[118]. Although there is no further characterization of the "problem", it seems to relate with the difference of effective tax rates between digital and traditional businesses.

When examining all documents accompanying the proposal, and particularly the impact assessment, it is clear that it heavily relies on a scientific study comparing effective average tax rates of digital and traditional business models.

The underlying assumption is that the numbers amount to a statistical analysis of companies operating within one of the two mentioned business models. The difference would legitimise the Commission to act in this area since any uncoordinated and unilateral action by the Member States would not allow bridging the gap between the tax burdens suffered by these two groups of companies.

The referred study was produced by the Zentrum for Europäische Wirtschaftsforschung (ZEW) and is titled *Steuerliche Standortattraktivität digitaler Geschäftsmodelle*[119]. As the title

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[115] Article 5 TFEU, supra n. 33.
[116] Article 5(3) TFEU, supra n. 33.
[117] Article 5(4) TFEU, supra n. 33.
[118] See Impact assessment, supra n.47, p. 80.
[119] ZEW, *Steuerliche Standortattraktivität digitaler Geschäftsmodelle*, edited by PwC, April 2017. This is the last of a series of studies made by this centre in this field. See also ZEW, The impact of Tax-Planning on Forward-looking Effective Tax Rates, Taxation Papers, DG Taxation

indicates, it aims at assess the tax attractiveness of certain jurisdictions for businesses with a digital business model.

This study is based on data provided by PwC regarding provisions of 33 states regarding either input incentives (namely credits) or output incentives (such as patent boxes) for R&D activities in what concerns investments in intangible assets. It only takes into account investments on a single asset ("intangible asset receiving immediate expensing") and yielding a specific type of income. Furthermore, the study assumes the costs and revenues that would be needed to maximise the tax incentives provided by each one of the examined jurisdictions. The specific goal was to assess how competitive the German corporate tax system was vis a vis the other 32 jurisdictions.

The study took into account two "tax benchmarks" that would show the tax attractiveness of a jurisdiction: i) the cost of capital (CoC), and; ii) the effective average tax rate (EATR). According to its executive summary[120], the CoC "expresses the return that a marginal investment must generate before tax to be worthwhile for an investor". The EATR "expresses the change in the capital value of a profitable investment caused by the tax burden". Thus, "a lower EATR indicated that an investment at the relevant location is more worthwhile for investors and the location is thus more attractive for profitable investments".

These "tax benchmarks" are based on specific assumptions and on hypothetical scenarios (determined to maximise the impact of the incentives). Although it uses the expression "effective tax rate", which in common economic lingo describes the effective burden of tax suffered by a certain player taking into account its gross income, the study does not provide any analysis of effective average tax. Thus, and despite the use of the same expression, the "effective average tax rate" of this study has no connection with what is normally understood as "effective average tax rate". There is no analysis of "real world data" or statistics. The results are, admittedly, the mere result of a laboratory-type approach.

After the release of the impact statement (including the results of the study), PwC released a press statement[121] confirming the afore-mentioned conclusions:

> "The study does not calculate EATRs using tax information for actual companies or sectors; more importantly, the study cannot be used to compare the tax burdens or "digital" and "traditional companies". In fact, "although the study refers to this hypothetical investment as a ´digital business model´ it merely reflects the tax treatment of an investment in a single asset, not the operation of a digital business.". Furthermore, "[i]n Interviews (…) Prof. Spengel of ZEW made clear that the study does not support conclusions that the digital sector is undertaxed".

In short, the study does not allow the Commission to conclude that there is a gap between ETR of digital and traditional service providers. And there is at least one economic study pointing out on the opposite direction[122].

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and Customs Union, 2016 and ZEW, effective tax rates in an enlarged European Union – Final report 2016 of a project for the European Commission, TAXUD/2013/CC/120.

[120] ZEW, *Digital Tax Index 2017: Locational Tax Attractiveness for Digital Business Models – Executive Summary*, edited by PWC, April 2017.

[121] Available at https://www.pwc.com/us/en/press-releases/2018/understanding-the-zew-pwc-report.html (last access: 15.01.2019).

[122] See Bauer, Digital Companies and their Fair Share of Taxes: Myths and Misconceptions, ECIPE Occasional Paper, 03/2018.

Anyhow, and even if there was a gap, one should additionally enquire whether it would not be due to avoidance or mismatches, and not to something inherent to digital businesses. As the OECD explicitly recognises:

> "The implementation of the measures described in this Part (BEPS Package) has made a number of cross-border tax planning schemes unfeasible or no longer financially attractive, including for highly digitalized businesses (…). There are also expectations that this should help establishing a more level playing field where domestic SMEs and MNEs are taxed similarly".[123]

At the EU level, there are additional hard-law measures adopted in implementation of the ATAD Directives[124].

Thus, a proper assessment by the Commission should take into account the expected impact of the recent OECD and EU measures before extracting any conclusion. Use of previous statistics will obviously not evidence the impact of these initiatives. This conclusion is of great importance as it deprives the proposal of its legitimacy in what concerns subsidiarity: the absence of the underlying issue deprives the Commission of any legitimacy to propose action at the EU level.

4.4.3 Proportionality and less restrictive approaches

The EC considers that the proposal meets the proportionality requirement. In its words:

> "the preferred option would be consistent with the principle of proportionality, that is, it does not go beyond what is necessary to meet the objectives of the Treaties, in particular, the smooth functioning of the single market"[125]; or "to ensure proportionality of the measure, avoid hurting the digitalisation of the economy and not be discriminatory against non-resident companies, the tax would apply to businesses being above both of two thresholds and at a single rate."[126].

In the author's view, this requirement is also not met[127]. Proportionality requires that the measure does not go beyond what is needed to implement the EU goals. When identifying the reasons for the differences in the average effective tax rates of different business models,

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[123] See OECD (2018), Tax Challenges Arising from Digitalization – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 106.

[124] See Council Directive (EU) 2016/1164 of 12 July 2016 Laying Down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, OJ L 193 (2016), EU Law IBFD [https://online.ibfd.org/collections/wtl/html/T0FTLEU-642671_1.html?WT.z_nav=crosslinks#wtl_eu_d1164] and Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards Hybrid Mismatches with Third Countries, OJ L 144 (2017) [https://online.ibfd.org/kbase/#topic=doc&url=%252Fhighlight%252Fcollections%252Feulaw%252Fpdf%252Feulaw_dir_2017_952.pdf&q=Council+Directive+(EU)+2017%252F952+councils+directives&hlm=altering&WT.z_nav=Navigation&title=COUNCIL+DIRECTIVE+(EU)+2017%252F952+of+29+May+2017+amending+Directive+(EU)+2016%252F1164+as+regards+hybrid+mismatches+with+third+countries].

[125] See Impact assessment, supra n.47, p. 80.

[126] See Impact assessment, supra n.47, p. 78.

[127] Even if one takes into account that the Court may be more lenient in assessing compliance with this requirement, examining the existence of a manifest disproportionality. See UK, Judgment of the CJEU of 13 November 1990, Case C-331/88,. - The Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health.

the Commission ends up (although not intentionally) providing the key to ascertaining the lack of proportionality of the proposal.

According to the Commission (and again, by reference to the three ZEW studies), there are mainly three reasons for the computed differences: i) "expenses for the creation of software and other intangible goods, which play a much bigger role for digital businesses are often immediately deductible whereas physical assets are used in the traditional business models are depreciated over time"; ii) "business active in digital activities typically spend relatively more on R&D activities, for which many countries apply tax incentives"; and iii) "an important number of countries offer lower tax rated for earnings derived from intellectual property ('Intellectual Property boxes')". [128]

In short, the Commission maps the measures that are responsible for the different results of the "tax benchmarks". One should note that not all Member States have these type of rules. This seems not to matter for the Commission since the DST is levied on all digital companies, regardless of their residence and of effective access to the identified tax incentives.

However, and more importantly, the Commission had a much restrictive approach to act on an EU-wide basis: to regulate these incentives, by harmonising or prohibiting them in the territory of the Union.

This proportionality deficit is also identified by the EU's Regulatory Scrutiny Board, in its opinion of the 9 February 2018[129] regarding an earlier version of the impact statement. According to this board "the analysis of impacts is insufficiently developed, especially as regards the thresholds, compliance costs and thus does not demonstrate the proportionality of the measure"[130]. The later versions of impact assessment have not addressed this issue[131].

By ignoring this less restrictive approach, the Commission infringes the proportionality requirement.

5 – Compatibility with WTO Law

5.1 Introduction

There is limited literature and case law on the impact of WTO rules on tax issues. This makes it harder to assess if a national measure creates an obstacle to trade and investment in goods and services and, as such, is incompatible with the rules of said organisation.

As the proposal is limited to services, it shall be considered in the framework of the General Agreement on Trade in Services (from now on GATS)[132]. This is a multilateral

[128] Impact Assessment, supra n.47, p. 136.
[129] As reported in the Impact Statement, supra n. 16, p. 83.
[130] Impact Assessment, supra n.47, p. 83.
[131] Also reported on p. 83 of the Impact Assessment, supra n. 47.
[132] Annex 1B of the World Trade Organisation Agreement, 1869 U.N.T.S. 183; 33 I.L.M. 1167 (1994), signed on 15.04.1994 and entered into force on 1.01.1995. The full text of the agreement can be found here: https://www.wto.org/english/docs_e/legal_e/26-gats.pdf (last access: 15 January 2019).

instrument signed by all WTO countries regulating trade and investment in services. Two provisions are of particular relevance for taxation: i) the most-favoured-nation clause, and; ii) the national treatment clause. Both are subject to qualifications and exceptions and, for that reason, a prima facie infringement of the rules does not necessarily result in incompatibility with WTO law.

The most favoured nation clause states:

> "*1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country*".[133]

According to the Auto-Industry Appellate body, this covers de jure and de facto discrimination.[134]

The national treatment clause determines that:

> "*1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers*
>
> *2. A Member may meet the requirement of paragraph 1 by according to service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.*
>
> *3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of service suppliers of the Member State compared to services or service suppliers of any other Member*."[135]

In the author's view, this provision also covers de jure and de facto discrimination, namely due to the similitude of the wording of both clauses.[136]

Compatibility with WTO law encompasses mainly two issues: i) the de facto discrimination eventually created by the revenue-thresholds; ii) the discrimintion created by the deduction system, as preconized by the preamble. The author will start by assessing the scope of protection of WTO; subsequently will focus on the discrimination issues; finaly, will enquire the applicability of one of the listed justifications.

5.2. Covered digital services and WTO schedules

[133] Art. II of the GATS, supra n. 132.
[134] See WTO Doc WT/DSI39/AB/R (Auto Industry Appellate Body Report), § 234.
[135] Article XVII of the GATS, supra n.132.
[136] See W. Zdouc, *WTO Dispute Settlement Practice Relating to the GATS*, 2 Journal of International Economic Law 2, p. 295 (1999).

First one should check whether the measure falls within the scope of protection of WTO law. This will be done by firstly determining the applicable (sub)schedule and secondly if the alleged infringing jurisdiction has decided to commit to the liberalisation of those services.

5.2.1 Advertisement services

The first group of DST taxable services are digital advertisement services. For WTO law purposes, two schedules should be taken into account.

The first one is n.º 871 of the UN provisional central product classification (hereinafter CPC), "advertisement services", a sub-category of "Other business services"[137]. These services have been included in the commitments of around 80% of the WTO members[138]. It covers a broad range of services. According to the background note elaborated by the secretariat,[139] it comprises three main elements:

> *"(i) Sale or leasing services of advertising space or time (services provided in soliciting advertising space or time for newspapers, other periodicals, and television stations);*
>
> *(ii) planning, creating and placement services of advertising (planning, creating and placement services of advertisements to be displayed through the advertising media); and*
>
> *(iii) other advertising services (other advertising services not elsewhere classified, including outdoor and aerial advertising services and delivery services of sample and other advertising material.*"

According to this note, this covers both the services and the planning and preparation for those services. It includes all advertisement services, regardless of the form and extension of the advertisement output. The EU has liberalised this schedule with no relevant exceptions, in what concerns national treatment[140].

Another schedule should be taken into account: CPC 9611 "motion picture and video tape production and distribution services." as it includes sub-schedule 96111 dealing with "promotion and advertisement services". There are no further indications about its scope and it may overlap with the previous one, which has relevance since the number of countries that committed to this sub-schedule is much more reduced and the author has not found any EU committement on this matter. According to the Secretariat, there are three main ways of interpreting this schedule (CPC 96111) and, consequently, delimit its scope vis a vis CPC 871. This one can be considered as covering:

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[137] World Trade Organization, Services Sectorial Classification list – note by the secretariat, MTN.GNS/W/120 (10.07.1991).
[138] Information available at https://www.wto.org/english/tratop_e/serv_e/advertising_e/advertising_e.htm (last access: 15.01.2019).
[139] Council for Trade in Services of the WTO, Background Note by Secretariat on advertisement services, S/C/W/47 (9.07.1988), p.2, box 1.
[140] See GATS, European Communities and their Member States – schedule of specific commitments, GATS/SC/31, 15.04.1994 (94-1029), p. 39. This was done regardless of the way to provide those services (i.e. incorporating mode 1 "cross border sales", mode 2 consumption abroad and mode 3 "commercial presence". Quite interestingly, by contrast, India has not committed to national treatment for this type of services, so that any WTO compatibility issue with regard to the Indian Equalisation Levy, whose scope of application has so far exclusively targeted online advertisement, even though such scope could prospectively be broadened. For further analysis of the trade law implications of the Indian Equalisation Levy. See Turina, supra n. 55, p. 518.

"(i) production and circulation of advertisements for audiovisual services;

(ii) broadcast of advertisements through audiovisual media; and/or

(iii) production of audiovisual advertisements, e.g. for TV commercials".[141]

In the author's view, digital services are primarily covered by CPC 871. CPC 9611 will only cover services that are so intimately related with "motion picture and video tape production and distribution services" so that it does not make sense to treat them separately (also following the consideration that this is a subschedule and not an autonomous schedule). Subschedule CPC 9611 was introduced for practical reasons: where advertisement services are contracted and paid together with the "production and distribution services of motion pictures and videotapes" it does not make sense to fragment the contracts treating its different parts separately, merely for WTO purposes.

5.2.2 Other services

The proposal also covers digital intermediation services and sale of data. Both services fall under CP84 "computer and related services" which covers services provided through computers (that should be understood as covering all computerised systems) and all related services (even if they are not, in themselves, computerised). In certain cases, one should also take into account CPC 843 "data processing services". The EU has committed to liberalise services mentioned in 843 and, in general, all services covered by the CP84 category[142].

Some conflicts of qualification may arise in delimiting the scope of the related services. As mentioned previously, they should be considered here if they are so intimately related to the computer services that it does not make sense to treat them separately.

The reverse problem may also occur as other subschedules refer to computer services. This is namely the case of computer reservation systems of air transport or of financial data processing, included in the schedules of air transport or financial services respectively. In those cases, the computer service needs to be considered in the framework of those services.

The issues described in this and the previous section show that the determination of the applicable schedule is, on its own, an interpretative challenge. Moreover, not all services will be under the national treatment clause and on the scope of protection of WTO Law.

5.3 Discrimination

5.3.1 De facto discrimination created by the threshold

Some argue that the thresholds of the proposal create a discriminatory treatment that infringes WTO Law[143]. In this context, the main issue is to consider whether there is likeliness

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[141] See Background Note on Advertisement Services, supra n. 139, p. 2, box 1.
[142] With restrictions that are not relevant for the current analysis. See supra n. 140, p. 31-33.
[143] The US Senate Committee considers that "the turnover thresholds for the proposal are discriminatory, putting in-scope companies at a competitive disadvantage without objective justification. This raises concerns about the EU DST's Proposal's compliance with the EU's

of services or of services providers (understood disjunctively). Are the taxable and non-taxable services or service providers "likely"?

In the author's view, the issue mainly concerns service providers and not services, as the threshold aims to delimit the concept of taxable entity[144]. For the Commission, there is a relevant difference since only big players (above the threshold) would benefit from the user-contributed value creation (which would legitimise taxation by that State). This was already addressed supra and the author believes that there is no empirical evidence supporting that conclusion.

Anyhow, the Commission may also argue territoriality. According to the scheduling guidelines:

> "(…) *There is no obligation in GATS which requires a Member to take measures outside its territorial jurisdiction. It therefore follows that the national treatment obligation in Article XVII does not require a Member to extend such treatment to a service supplier located in the territory of another country*".[145]

As sustained by Weiss, "national treatment means treating all service providers – in a given sector and mode of supply – located within the territory of a Member in a non-discriminatory manner, irrespective or nationality or ownership"[146]. Accordingly, insofar as the services are offered remotely (outside the boarders of the EU) a different and worse treatment would not be unlawful and the DST would be compatible with EU Law.

In the light of the above, it seems that the current system is not able to eliminate all cases of difference in treatment between service providers. In an increasingly digitalised world, this can be used by States to introduce systems that discriminate against foreign non-established service providers. This can also be used to force foreign and non-established service providers to establish some presence in the territory, either through a subsidiary or a PE, allowing the State of location to tax its business profits.

De facto discrimination is also prohibited in the framework of Art. VI, n. 4 and 5. However, in the author's view, the thresholds cannot be equated to "measures relating to qualification requirements and procedures, technical standards and licensing requirements". A threshold is just an objective numerical requirement of the tax that does not amount to any technical standard or requirement of the service or the service provider. It is also not a procedure that needs to be followed by the service provider to enter the market or to offer a specific service.

5.3.2 Compatibility of the deduction system preconized by the preamble

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national treatment commitments under the World Trade Organization General Agreement on Trade in Services". See letter of the US Committee on Finance of the United States Senate to the President of the European Council and to the President of the European Commission, signed by Senators O Hatch and R. Wyden, of 18.10.2018. See also G. Hufbauer & Z. Lu, *The European Union's Proposed Digital Services Tax: a de facto Tariff*, Peterson Institute for International Economics, Policy brief 18-15, June 2018.

[144] WTO Panel Report, EC – Regime for the Importation, Sale and Distribution of Bananas, WTO/DS27/R, 25.09.1997, § 7.322 stating "to the extent that entities provide these like services, they are like service providers".

[145] Council for Trade in Services of the WTO, Guidelines for the Scheduling of Specific Commitments under the general agreement on trade in services (GATS), adopted in 23.03.2001, S/L/92, 28.03.2001, § 15.

[146] F. Weiss, *The General Agreement on Trade in Services 1994*, 32 Common Market Law Review 5, p. 1206 (1995).

The deduction preconized by the preamble may not be available to the non-EU service providers (again, the recital is not hard law and does not create any obligation upon Member states or non-EU States). That being the case, one could claim that residents and non-residents may be on a different footing and that this infringed the national treatment clause.

In the author's view, that is not the case. The above-mentioned difference is merely a result of the way how corporate tax systems are designed. Residence States are the ones that tax the worldwide income and ensures the deduction of the overall expenses of a taxpayer. Thus, in the current framework, it is always up to the residence countries to determine which costs can be deducted to the tax base and, in particular, to determine whether a certain foreign tax cost can be deducted. In other words, State cannot be considered in breach of its international commitments due to the actions (including legislation) of another State[147].

If hypothetically, this was to be considered as an infringement, and in what concerns the national treatment clause, it would still be necessary to assess the applicability of any of the exceptions. This will be examined in the next segment.

5.4 Exceptions for the national treatment clause

The national treatment clause does not offer absolute protection since it contains exceptions, namely regarding: i) measures within the scope of a tax treaty, and; ii) measures "aimed at ensuring the equitable or effective imposition or collection of direct taxes"[148].

The first one can be easily dismissed since the different treatment does not result from tax treaty.

The second one requires further consideration, and one should consider the overall modus operandi of the GATS. This agreement was focused on removing obstacles to the trade of services. Traditionally, only indirect taxes fell under this category[149].

In what concerns the threshold, the main discussion relies on the correct classification of the DST. Following a more formalistic approach, it should be considered a turnover tax (indirect tax). If one follows a more substantive approach, this tax is to be regarded as a direct tax, since the real incidence of the tax is on corporate tax profits. In the latter situation, the measure would fall within this exception and would not be considered incompatible with WTO law. The available case law does not allow to anticipate the approach that the WTO appelate body would take. In the author's view, and from a conceptual perspective, given the close interaction with the direct tax system and the real incidence of the tax, the DST should be considered a direct tax.

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[147] Further research needs to be done in this field, in order to ascertain the impact of WTO provisions in the interpretation of the EU treaties and namely of its clauses with a non-executory nature. Moreover, research should clarify how far the national treatment clause is able to extend outside the EU boundaries the non-discrimination requirements of fundamental freedoms.

[148] See art. Article XIV(d) of the GATS, supra n.132.

[149] This allows WTO States to keep their full sovereignty in what concerns tax matters, regardless of whether these taxes would, in the end, create a real obstacle to the trade of services.

Regarding the deduction, the answer is clear: this is an integral part of the direct tax system of any country, and thus, it will always be safeguarded by this exception.

6 – Conclusions

Gary Lineker once said, "Football is a simple game: twenty-two men chase a ball for 90 minutes and at the end, the German always win". This may be no longer true for football (especially taking into account the results of the 2018 world cup), but it surely illustrates the results of adopting this proposal. With the DST, the biggest economies strengthen their position, at the direct cost of the smaller ones. Traditional businesses are protected against disruptive and more innovative business models. The current status quo concerning inter-nation equity is further crystallised, and more obstacles are created to the emergence of new economic players or of new economies. Size matters and will matter more in the future if the proposal is adopted.

DST aims to answer concerns expressed by many EU citizens that were further amplified by non-governmental organisations and media. These concerns are grounded on the shared understanding that big multinationals bear lower taxes in comparison with smaller companies or individuals[150].

However, more recently there was an association between multinationals and digital giants. Somehow the concern (and in some cases anger) was focused on companies operating with digital business models. Suddenly, the problem is no longer the arbitrage that only multinationals have access but the systematic lower taxation of digital business models.

Instead of focusing on the digitalisation of the economy and on the challenges it brings to the tax system, national governments and international organisations started to focus solely on the taxation of digital services' companies. This shift lacks empirical evidence.

In our view, the digitalisation of the economy affects all the economic agents and not those primarily or fundamentally providing digital services. It also affects both corporate and individuals. It is transversal to all economic sectors and players. Moreover, digitalisation is needed[151].

The discussion about the (tax) challenges brought by the digitalisation of the economy should take into account not only the threats but also the advantages of this phenomenon. The new landscape may lead to new forms of tax administration or even revisit the existing taxes[152].

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[150] Of course, this conclusion holds if one checks merely the available statistics. See European Commission, Taxation Trends in the European Union: Data for the EU Member States, Iceland and Norway, 2017 edition, Brussels, available at https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_trends_report_2017.pdf (last access: 15.01.2019).

[151] As Moscovici recognises that there is "a growing and welcome recognition that we need to develop the digital economy to expand its benefits, from business creation to productivity. In Europe the ICT sector generates 25% of total business R&D; the ICT sector and investment in ICT are responsible for 50 % of productivity growth. This is a remarkable achievement – and one on which we must continue to build" – See P. Moscovici, Speech, supra n. 15.

[152] This is as such recognised in the explanatory memorandum accompanying the proposal for a Digital Services Tax. According to the Commission: "Digital technologies bring many benefits to society and, from a tax perspective, they create opportunities for tax administrations and offer solutions to reduce administrative burdens, facilitate collaboration between tax authorities, as well as addressing tax evasion" – See European Commission, Explanatory Memorandum - Proposal for a Council Directive on the common system of a digital services tax on

In the author's view, the EC proposal for a digital services tax is compliant with WTO law. The same cannot be said regarding EU Law. In fact, the proposal raises several issues concerning the adherence to the underlying goals required by its legal basis as well as issues concerning proportionality and subsidiarity. Thus, and even if adopted (something that is highly doubtful), there are sufficient grounds to challenge the legality of the proposal and its compatibility with the EU treaties.

revenues resulting from the provision of certain digital services, SWD(2018) 81, SWD(2018) 82, COM(2018) 148 final, Brussels, 21.03.2018, p. 1.