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Digital Services Tax

- A feasible solution for Taxation of the Digital Economy?

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Summary

During the 21th century, digitalization is considered the most important development of the modern global economy. Tax avoidance is a growing issue for governments globally, that are loosing lots of tax money to finance public welfare systems supporting healthcare, educational institutions and infrastructures. Value creation in digital business models generates profits different than traditional business models and the current international tax rules are not fit for the digital era. Today's rules facilitate the possibility for multinational enterprises to establish digital business models in various jurisdictions and are shifting their profits into low tax jurisdictions. A digital business can have minor or no physical presence in the state where the actual business activity takes place, which causes disagreements about which government has the right to tax.

Multinational digital tech enterprises like Amazon, Google, Apple, Facebook etc., often with headquarters in third countries such as the US, are currently shifting their profits, generated from business activity in EU jurisdictions, into low tax countries such as Ireland or Luxemburg. A case that has brought a lot of public attention is a case between Ireland and the Commission in T-778/16, which illustrates the issues related to illegal state aid and EU competition law.

The OECD and the EU are working on a solution on both international and European level. The EU has presented concrete measures and a proposed Digital Services Tax, that is the main focus of this thesis. The situation has brought unilateral action among member states within the EU, trying to solve the issue by implementing domestic regulations, causing potential threat to the internal market.

Sammanfattning

Digitalisering är utan tvekan 2000-talets viktigaste bidragande orsak till utvecklingen av den globala ekonomin. Skatteplanering och skatteflykt bland multinationella bolag urholkar nationers skattebas som finansierar det offentliga välfärdssystemet såsom sjukvård, utbildningsinstitutioner och infrastruktur.

Digitala affärsmodeller genererar intäkter annorlunda än traditionella affärsmodeller och rådande internationella skatteregelverk är inte längre i fas med de affärsmodeller som är aktuella under den digitala eran. Dagens skatteregler möjliggör för multinationella bolag att etablera digitala affärsmodeller i flera olika jurisdiktioner och skiftar vinster in till lågskatteländer. En digital affärsmodell kan ha mycket liten eller ingen närvaro alls, i den jurisdiktion där den faktiska affärsverksamheten råder, vilket skapar oenigheter bland länder om vilken nation som ska ha rätt att beskatta bolaget. Multinationella digitala Tech bolag såsom Amazon, Google, Apple, Facebook etc., vanligtvis med huvudkontor i tredjeland, såsom USA, skiftar sina vinster, genererade från affärsverksamhet i EU jurisdiktioner, till lågskatteländer såsom Irland eller Luxemburg. Ett rättsfall som har fått stor offentlig uppmärksamhet är Irland mot Kommissionen i T-778/16, ett fall som illustrerar skatterättslig problematik relaterad till konkurrensrättsliga EU regler om olagligt statsstöd.

OECD och EU är två institutioner som länge har arbetat för en lösning på både internationell och europeisk nivå. EU har presenterat olika konkreta åtgärder och har lagt fram ett förslag om införande av en Digital Services Tax, vilken den här uppsatsen huvudsakligen behandlar. Den rådande situationen har gett upphov till att flera EU medlemsländer har vidtagit enskilda åtgärder. De försöker lösa beskattningsproblematiken på egen hand genom att implementera egen inhemsk lagstiftning, vilket skapar potentiella hot mot EUs inre marknad.

Preface

TACK till alla som har stöttat mig genom mina fyra och ett halvt år vid Lunds Universitet och ett år vid University of California, Santa Barbara. Familj och vänner från Varberg och Schweiz, lärare, professorer och kurskamrater som delat börda och glädje med mig genom åren. Min mentor Mariya Senyk samt nya vänner från hela världen under min tid som internationell mentor och utbytesstudent i Kalifornien. Tack för alla minnen vi delar!

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Abbreviations

BEPS	Base erosion and profit shifting
EU	European Union
ECJ	European Court of Justice
DST	Digital Services Tax
DAT	Digital Advertisement Tax
GATS	General Agreement on Trade in Services
MNE	Multinational digital tech enterprise
MS	Member States
OECD	Organization for Economic Co-operation and Development
SMNE	Multinational Social Media Enterprises
VAT	Value Added Tax
WTO	World Trade Organization

1 Introduction

1.1 The problem

Fair taxation of the digital economy has been a topical issue for several years and is one of the most difficult and contentions issues on international taxation, that are to be illustrated in this thesis.[1] During the 21th century, digitalization is considered the most important development of the modern global economy.[2] Digital technologies are key drivers of innovation, economic growth and social change. It is transforming the way we interact, communicate, consume and do businesses on the international market. It creates new jobs and contributes many benefits to society.[3] However, tax avoidance is a growing global problem for governments that are loosing lots of tax money to finance public welfare systems, supporting healthcare, educational institutions and infrastructures. Multinational digital tech enterprises (MNE's) for example Amazon, Google, Apple, Facebook etc., often with headquarters in third countries such as the US, are currently shifting their profits, generated from business activity in EU jurisdictions, into low tax countries such as Ireland or Luxemburg. Tax avoidance or "tax shopping" by large multinational digital companies has brought several cases up for debate, for example the Apple case Ireland vs. the Commission, that is to be presented further below.[4]

Digitalization of the economy is about unifying national realities into a single digital jurisdiction, by transgressing the borders of trade, but it is also a major challenge for the international tax system, when existing

[1] User Value and Taxation of the Digital Economy, Jim Stewart (Trinity Collage Dublin) May 9, 2019.
[2] Report of the Commission Expert Group on Taxation of the Digital economy, European Commission (May 2014), p. 5, Executive Summary.
[3] International taxation in the Digital Economy: Challenge Accepted? Article by Marcel Olbert and Christoph Spengel, World Tax Journal February 2017 and OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", p. 12. Chapter 1.1., no.1; M. Olbert/C.Spengel, „International Taxation in the Digital economy: Challenge Accepted?", World Tax Journal 2017 (Vol.9 No.1), p. 4.
[4] Case T-778/16.

international corporate tax rules are becoming obsolete.[5] The existing tax rules for international corporate taxation were conceived in the early 20th century, and define what triggers the right to tax for a government and how much of the corporate profit is allocated to a jurisdiction. Existing international tax rules where mainly designed for traditional "brick and mortar" businesses, built on the principle that profits should be taxed where business activity is carried out. Today's rules facilitates the possibility for multinational enterprises to establish digital business models in various jurisdictions, with minor or no physical presence in the state where the actual business activity takes place.[6] Due to the fundamental principle of state sovereignty in the international tax system, each nation has the right to decide over its own domestic tax rules. Tax residence is usually based on the fact that the business is having a physical presence in the jurisdiction. A government's right to tax a business is usually followed by where it is registered, or if it is considered having a permanent establishment in the jurisdiction. A permanent establishment is defined for example; in the US-Germany tax treaty, as a fixed place of business through which the business of an enterprise is wholly or partly carried on.[7] However, for corporations providing digital services, a physical presence is no longer necessary to do business anywhere in the world.[8] Digital businesses have characteristics that differs from traditional ones, in terms of how value is created, when intangible assets and user participation is becoming essential for the business. Highly digitalized business models contain several varieties of e-commerce, app-stores, online advertisement, cloud services, networks platforms, high speed trading and online payment services.[9]

The EU Commission's opinion is that today's corporate tax rules are no longer in harmony to fit digital business models, as there is a misalignment between the place where profits are taxed and the place where the business

[5] COM(2018) 148 final p.2. and Taxing the Digital: Unilateralism Vs. Multilateralism, Piergiorgio Valente (Crowe Valente/Valente Associati GEB Partners; Link Campus University, Rome)/October 8, 2018.
[6] Study of the European Parliament-Think Tank requested by the TAX3 Committee,
[7] Article 5 of the US-Germany tax treaty, www.irs.gov/pub/irs-trty/germany.pdf, April 23, 2018.
[8] Impact of Digitalisation on International Tax Matters- Challenges and Remedies" (15.02.2019), p.10. and COM(2018) 148 final p.1.
[9] OECD, "Addressing the Tax Challenges of the Digital Economy", BEPS Project 2015, Action 1: Final Report, p. 11.

activity takes place.[10] The international tax system needs to be updated and aligned to suit the digital era, reflecting the value created by user participation in that jurisdiction.[11] From a European Union (EU) perspective, issues threatening the competitiveness of EU businesses, compared to non-EU businesses have given rise to unilateral measures by Member States (MS), trying to solve the problem on a domestic level to get a fair share of tax.

1.1.1 T-778/16 “The Apple Case” – Ireland vs. the Commission

A case that has brought a lot of public attention is a case between Ireland and the Commission in T-778/16. This case will be described to illustrate the problem with taxation of MNE’s that shows how profits are shifted into low tax jurisdictions under current tax rules, threatening EU competition law in the internal market. The organizational structure of Apple, operating globally, has managed to shift their profits into Ireland and paid a very low share of tax for several years in a row. The Commission’s case is not about how much Apple pays in taxes, but rather about which government collects the tax and fairness within the EU internal market. It is an example of selective treatment of Apple in Ireland that is illegal under EU state aid rule. The case also demonstrates the bigger picture of the issue that is about fair competition in the internal market and the aim for legal certainty. It exemplifies how differences in government’s corporate tax rates has triggered a race to the bottom and are used as an incentive to be a popular jurisdiction for establishment of businesses.

The background facts are that Apple inc., a US registered company, owns the intellectual property (IP) licenses for Apple products. The American company Apple inc. sells IP to operating companies in different countries, spread around the globe, in regards to royalty payments. Apple Sales International is Apple’s headquarter, registered in Ireland, Europe. The

[10] https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en, 5th of February 2020.
[11] COM(2018) 147 final s.1.

company holds the right to intellectual property and to sell and manufacture Apple products outside of North and South America. In exchange of the rights, Apple Sales International makes payments to Apple inc. in the US to contribute to the development of the intellectual property, often more than 200 billion US dollars per year. Apple Sales International buys the Apple product from their manufactures and sells the products through out Europe, the Middle East, Africa or India. All the profits from sales of the products are recorded in Ireland, collecting a very low amount of corporate tax. The way Apple decided to set up their business structure, no matter where the consumer buys it's products, it is contractually bought from Apple Sales International in Cork, Ireland. The profits have been shifted into Apple Sales International, the so-called head quarter registered in Cork, Ireland. However, the company exists only on paper, with no employees or ongoing operating business activity.[12]

The EU Commission argues that there has been a selective treatment of Apple Sales International in Ireland. The fact that Irish authorities had allowed the management of Apple's business structure, given Apple a significant advantage to other businesses in the EU was illegal under EU state aid rule. Illegal state aid harms the competition in the single EU market, as it gives an unfair advantage to certain businesses. The tribunal decided that Apple gets a back tax of 13 billion US dollar plus interest, to restore fair competition in the single EU market. The Irish registered company was under investigation for over 2 years and is the one that accounts for all the unpaid taxes. It is up to the Irish authorities to ensure that companies pay taxes in line with both the national tax laws and European union law.[13]

[12] https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2923, 4th of February 2020 and T-778/16.
[13] Ibid.

1.2 Value creation in the digital economy

Nowadays, a digital company can earn revenue and make profits from the supply of digital services in a jurisdiction, without being physically present there or even anywhere. A digital business model can operate globally and is normally dependent on users spread around the world, contributing to value creation. One issue for the international tax regime is that, when it comes to transnational companies that operate in several countries at the same time, the tax jurisdiction is not clearly defined. Another one is, how to allocate profits among different jurisdictions and potential issues of international double-taxation. A handful of Internet tech companies and social media platforms, like Facebook, Instagram, Amazon, Google control billions of minds every day and are examples of MNE's operating cross-boarder. A headquarter can be registered anywhere in the world, and depending on their business structure and business model, the business activity is not necessarily tied to a specific geographical location or jurisdiction.[14] Business models of social-media-platforms are especially challenging for the international tax regime. Multinational active Social-Media-Enterprises (SMNE), for example Instagram, Facebook or Twitter, all have in common that their business model is a platform providing free access to a network, in exchange for personal data, used to deliver personalized advertisement to users. The supply of personalized advertisement is particularly difficult to fit in current international tax framework, as the whole process can be completely digital.[15]

According to the source principle, the income produced by an economic activity can be taxed in the jurisdiction where it is actually produced. Elsewise, by referring to the residence principle, in the jurisdiction where the entity which receives the income has it residence.[16] Based on the OECD, as well as the EU Commissions proposition that profits should be taxed

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[14] Adaption and simplification of the figure of the OECD by the author: OECD, "Tax Challenges Arising from Digitalization – Interim Report 2018", Chapter 2.4.1, Schematic on No.60 at no.107.
[15] The European Commission, "Communication from the Commission to the European Parliament and the Council – A Fair and efficient tax system in the European Union for the Digital Single Market" (21.09.2017), COM (2017) 547 final, p.3. No. 12 at p. 5; Ibid. No. 10 at p. 54-64, Chapter 4.2; Ibid. No.1 at p. 21, Chapter 2.2.
[16] http://www.oecd.org/tax/tax-policy/31743059.pdf, p.4.

where value is created, first it needs to be identified what that value is and how to measure where it was created to know what government has the right to tax.[17] The issue with existing corporate tax rules, is that value creation from user contribution is not necessary taken in account when deciding where profits are being taxed, as a digital company can be registered in one place and operate worldwide. In the digital economy, value is created from a combination of algorithms producing personal advertising based on user data, knowledge and sales functions. Value is created when a user shares with the company their preferences, e.g. by liking a page. The company uses this data, either by selling it to other companies, or monetizing it by allowing target advertisement from other companies on their platform. However, profits are not taxed in the country of the user, but usually where the advertiser is resident for tax purposes. This is typically in the country where the advertising algorithms have been developed, commonly the US.[18]

1.3 The OECD work in the field of taxation of the digital economy

Between the years of 2013-2015, the Organization for Economic Cooperation and Development (OECD) and the G/20 countries worked on a change of the international tax framework that was presented in the Base Erosion and Profit Shifting Project (BEPS) - Addressing the Tax Challenges of the Digital Economy Action 1 Final report. For the first time in a century, a suggested plan was set up of an international framework to combat tax avoidance by MNEs. The BEPS project aims at preventing government's tax bases from being eroded by international companies, taking advantage of different countries' national tax laws and thus allocating profits to countries with low or no tax at all. It is based on the key principles that underlie the taxation of cross-boarder activities. These are the jurisdiction to tax, transfer pricing, leverage and anti-avoidance. According to the BEPS project, tax avoidance harms not only governments and the people, but

[17] OECD, "Addressing the Tax Challenges of the Digital Economy", BEPS Project 2015, Action 1: Final Report, p. 11.
[18] https://ec.europa.eu/taxation_customs/business/company-tax/fair-taxation-digital-economy_en, 10th of February 2020.

businesses as well, as it creates bad reputation and distorts the competition in the international market. It also destroys integrity and public trust in the tax system.[19]

In 2014, a BEPS package of new tax measures was delivered in an interim form. At current state, 15 action plans have been introduced to create a single set of consensus-based international tax rules to address BEPS, The action plans aims at securing revenues by realigning taxation with economic activities and value creation.[20] The Action 1 Report is mentioning the introduction of equalization levies as a potential approach to remedy the situation. Equalization taxes are special excise taxes intended to compensate for "lost" profit taxes in a jurisdiction with the purpose to place domestic and foreign providers on a par. It targets economic actors with a significant economic presence in the taxing jurisdiction.[21] The Action 1 report discusses a number of necessary design features for any such tax, but there is not yet an international consensus on the need for equalization taxes.[22]

In 2018 the OECD delivered Tax Challenges Arising from Digitalization - the Interim report, as a follow up on the BEPS Action 1 plan. The interim report is a key milestone of developing a durable, long-term solution to the challenges posed by digitalization of the economy. It describes the complexities of the issues involved, the positions that different countries are in and which drive their approach to possible solutions. The Interim Report confirms the widespread consensus on the need for international solutions, but the lack of it at current stage.[23] A statement was presented in the end of January 2020 with the intention to provide a consensus based long-term

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[19] See Barford, Vanessa & Holt, Gerry. *Google, Amazon, Starbucks: The rise of 'tax shaming'*, BBC News Magazine, May 21, 2013, available at: http://www.bbc.com/news/magazine-20560359, 15 of February 2020.
[20] OECD/G20 Base Erosion and profit Shifting Project, *Addressing the Tax Challenges of the Digital Economy,* Action 1 Final report, p.3.
[21] Equalization Taxes and the EU's Digital Service Tax, article by Georg Kofler & Julia Sinnig, p.183.
[22] OECD/G20 Base Erosion and profit Shifting Project, *Addressing the Tax Challenges of the Digital Economy,* Action 1 Final report.
[23] Taxing the Digital: Unilateralism Vs. Multilateralism, Piergiorgio Valente (Crowe Valente/Valente Associati GEB Partners; Link Campus University, Rome)/October 8, 2018.

solution of a new taxing right. The OECD is now working on two pillars to come up with a suggested solution.[24]

1.4 Measures taken in the EU

A number of international proposals address the challenges with taxation of the digital economy. At EU level, there is already a concrete plan of measures and some jurisdictions have already, either implemented or planed unilateral measures. The European Commission has put on the table a Digital Tax Package, including two EU proposals.[25] This thesis is focusing on one of the solutions used by a number of governments, both by non-EU countries and MS, which is the introduction of a specific Digital Services Tax (DST). Among the 28 MS of the EU, no common opinion exists today whether this could be considered as reliable solutions. Under the current tax rules, a growing number of EU MS no longer gets a fair share of tax, due to their inability to tax profits that in their opinion, are derived to its jurisdiction. Since some EU governments have introduced domestic tax measures already, it has caused concerns within the EU, threatening the goal of fair competition in the internal market.[26]

The G20/OECD and EU's initiative against aggressive tax planning strengthens the nexus between economic activity and profit allocation, identifying the "economic substance" of value creation. As mentioned above, existing tax rules requires that a company have a physical presence within the state or by attributing the company a permanent establishment to the state willing to tax.

[24] https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf. 5th of February 2020.
[25] https://ec.europa.eu/commission/presscorner/detail/en/IP_18_2041, 14 of February 2020. COM(2018) 147 final and COM(2018) 148 final.
[26] European Commission, COM (2018) 148 Final-2018/0073 (CNS).and https://europa.eu/european-union/topics/competition_en, 5th of February 2020.

2 Purpose

The purpose of this thesis is to identify issues with taxation of the digital economy by illustrating the problematic within the current international tax system. Several of the EU MS has already implemented regulations to solve the problem on a domestic level. The purpose is also to present the measures undertaken with the objective to solve the issue, by the EU level and by some MS. The thesis aims at analyzing issues related to unilateral measures undertaken by MS and the internal market, and also to discuss whether the EU has competence to harmonize regulations for a DST. Another purpose is to analyze whether the DST proposed by the EU Commission could be regarded as a feasible solution to tackle the problem with taxing the digital economy. The thesis is written from the perspective of compliance of the EU proposal on the DST with Union law and international law.

To fulfill the purpose, the thesis will addresses in particular the following questions:

1. What legal issues arise with taxation of the digital economy?
2. How are the unilateral actions undertaken by Member States threatening the internal market?
3. Does the EU have a competence to adopt a common DST?
4. Can the DST proposed by the EU be regarded as a feasible solution to tackle the problem of taxation of the digital economy?

In order to evaluate what is a "feasible solution", in section 7 potential issues related to the DST proposal will be illustrated and analyzed in regard to fundamental tax principles of state sovereignty, Union principles of subsidiarity and proportionality, WTO non-discriminatory provisions and also the EU's competence to legislate on a DST.

3 Method and material

For the purpose of writing this thesis, the method that will be used is a traditional legal dogmatic method with a European Union perspective. The two biggest stakeholders in the questions of a DST are the OECD and the EU. Therefore, documents and actions from these institutions will be used as main materials of the illustration. The descriptions in the introduction are mainly coming from the OECD 2018 Interim Report - Tax Challenges Arising from Digitalization: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project. Case law from the European Court of Justice (ECJ) is also presented to illustrate the problematic. The focus of the thesis is the DST proposal by the EU Commission. Other legal sources used for the purposes of writing the thesis are EU primary law, fundamental tax principles as well as non-discrimination obligations stemming from treaty law in article II and XVII of the General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO), which are binding for the EU. Tax journals from several authors with different nationalities are also used, to get a broad perspective of potential issues that could follow with potential introduction of DST.

4 Delimitation

4.1 Evaluation criteria

In order to evaluate what is a "feasible solution", in section 7 potential issues related to the DST proposal will be illustrated and analyzed in regard to fundamental tax principles of state sovereignty, EU law principle of subsidiarity and propornality, WTO non-discriminatory law and also the EU's competence to legislate on a digital services tax.

Issues related to taxation of the digital economy are global. On an international level, the (OECD) examined them in the context of the BEPS project report.[27] At the current stage, no common solution has been reached at global level, and this thesis will be written from the European Union perspective. Due to limitations in time and scope of the thesis, the purpose is only to examining one of the EU Commission's suggested proposals on DST. Unilateral measures are provided for illustration purposes only, not for comparison reasons. The purpose is neither to conclude whether DST is in compliance with WTO law or Union law, only to discuss potential legal complications in relation to the EU commission's DST proposal.

[27] OECD report on BEPS Action 1"Addressing the Tax Challenges of the Digital Economy", 2015.

5. Unilateral action undertaken by the Member States

5.1 Member State initiatives

An emerging “tax war” has developed in the EU whereby certain governments try to get their fair share of tax and solve the issue on their own, by imposing specific taxes. While the EU and the OECD strive for a multilateral solution, a number of EU MS have already taken unilateral action, by introducing equalization levies in their domestic legislation. National solo runs from various MS, inspired by the EU DST proposal, concerns the EU, as MS initiatives might threaten the fair competition in the internal EU Single Market. As a quick fix solution, France, Germany, Italy and Spain called for an introduction of an equalization levy in 2017, based on turnover generated in Europe by digital companies.[28] France has been a leading effort to get the EU MS to embrace a digital tax on large online platforms. In 2003, the French government introduced a tax on online and physical distribution of audio-visual content, to finance its domestic movie and audio-visual production. The tax applies to both resident and non-resident enterprises and is imposed at a flat rate of 2 %, working as a retail tax on the value of a number of defined transactions concluded with final customers.[29] The Spanish government also recently announced its own version of a DST. Other examples of unilateral action are Italy’s levy on digital transactions and Hungary’s advertisement tax.[30] In total, twelve Member States have already adopted or are planning to adopt interim direct or indirect tax measures to target digitalized activities in their jurisdiction.[31]

In the United Kingdom (UK), though they are no longer part of the EU, a diverted profit tax (DPT) was introduced on 1 of April 2015, also called “the Google tax”. It is a flat 25 % levy on all profits that companies have

[28] *JointPolitical statement, supra*, n.9.
[29] 2018 BEPS Interim report, *supra* n.12, Boxes 4.4. to 4.6.
[30] Equalization Taxes and the EU’s Digital Service Tax, article by Georg Kofler & Julia Sinnig, p.182.
[31] 2018 EU Staff Impact Assessment, *supra* n.63, 54-55.

made, but have moved artificially overseas. The British government explicitly mentions that the main target group for the tax is digital companies and in particularly large multinational companies.[32] From 1 of April 2020 the UK government will also introduce a new 2 % specific tax on the revenue of search engines, social media platforms and online marketplaces, which derive value from users in the UK. The targeted digital businesses have in common that they derive value from their interaction and engagement with a user base. The measure aims to ensure that large MNE's operating in the UK contributing to a fair share of tax, to support vital public services.[33]

5.2 State aid issues related to unilateral measures

5.2.1 Legislative provisions

Article 107 TFEU, is part of EU primary law and prohibits Member States from illegal state aid, in the meaning of a measure that has been granted out of state resources, while conferring a selective economic advantage to certain undertakings. Regardless of its legal status and the way it is financed, the term undertaking covers any entity engaged in an economic activity.[34]

Cited from Article 107(1) TFEU:

> "Any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the provision of certain goods shall be incompatible with the common market, in so far as it affects trade between Member States".[35]

The State aid rule has been enforced since 1958 and applies to all companies, members of the European Union as well as non-European

[32] https://www.gov.uk/government/publications/introduction-of-the-digital-services-tax/digital-services-tax, 20th of February 2020.
[33] https://www.gov.uk/government/publications/introduction-of-the-new-digital-services-tax/introduction-of-the-new-digital-services-tax, 20 of February 2020.
[34] C-41/90 Höfner nd Elser V Macroton (1991) ECR-I1979.
[35] Article 107(1) TFEU.

businesses, that decide to operate in the EU single market. The rule is part of the EU competition law and protects European taxpayers. It ensures that companies can compete on equal terms in the internal market. Illegal state aid from a Member State can come in any form, no matter if it is through free land, beneficial loan or a tax benefit for particular companies.[36] For example, if a domestic tax rule gives advantages to certain enterprises in the way of a lighten tax burden, it can be stated as illegal state aid. Any measure meeting the two following conditions are qualified as prohibited sate aid. First, the measure has to be granted out of state resources, secondly, while also conferring a selective economic advantage to certain undertakings. These measures are prohibited in the Single Market as they lead to a distorted competition affecting the intra EU-trade.[37]

5.2.2 Case examples

The European Court of Justice (ECJ) has had a few cases disputing MS domestic laws and it's compliance with EU state aid rule, when allowing MNE's to shift profits artificially into their low tax jurisdiction. Tax breaks to selected companies, is prohibited by EU illegal state aid rule as MS cannot give an unfair tax benefit to selected companies, neither if they are European or foreign, large or small, part of a group or not.[38] Ireland and Luxemburg are two jurisdictions popular as residence for tax purposes for MNE's, because of its low corporate tax rate. In the EU, Ireland has one of the lowest statutory income tax rates of all MS, set to 12,5 % or 6,25 % for revenues tied to a company's patent or intellectual property.[39] For several years, multinational corporations such as Facebook, Google and Apple managed their business structure to keep a corporate income tax rate around 1-2 %, for profits received from sales outside the US.[40] As mentioned in the introduction section 1.2, Apple Sales International, an Irish registered

[36] Margrethe Vestager, Commission européen Européen Commission, press Conference. http://ec.europa.eu/avservices/video/...3th of February 2020.
[37] Decision of the Commission of 07.11.2012, SA.34466 (2012/N), „Cyprus“, para.18/19.
[38] https://ec.europa.eu/competition/publications/kd0216250enn.pdf, p.12.
[39] https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html 5 of March 2020.
[40] See de Graaf, Arnaud, de Haan, Paul & de Wilde, Maarten. Fundamental Change in Countries' Corporate Tax Framework Needed to Properly Address BEPS, INTERTAX, Volume 42, Issue 5, 2014 Kluwer Law International BV, The Netherlands, p.312.

company, paid as low as 0,005 % in corporate tax in 2014.[41] Apple's so-called head quarter registered in Ireland, a company existing only on paper was held responsible for illegal state aid after a two yearlong investigation. The tribunal found that the Irish tax authorities had given Apple a significant advantage to other businesses in the EU and therefor Apple got a back tax to Ireland.[42]

5.2.2.1 T-20/17 Hungary vs. The Commission

Already in 2014, the Hungarian government introduced a Digital Advertisement Tax (DAT's). It is a special tax applied on advertisement turnover derived from the broadcasting or publication of advertisements in Hungary. The tax is designed as a 5 % tax on net sales from advertising above approximately EUR 3 million.[43] The DAT's was disputed in OJ L 49/36 (25 feb.2017) where Hungary challenged a decision made by the EU Commission regarding illegal state aid rule. The EU Commission claimed that the DAT's was an illegal state aid, due to the fact that the DST "lays down a progressive rate of taxation that apply to the annual turnover derived from publication of advertisement in Hungary, depending on the brackets into which an undertakings' turnover falls".[44] The tax rates had the progressive character with the effect that the percentage of tax levied on an undertaking's turnover increases progressively depending on the number of brackets within which that turnover falls. These result in the consequence that an undertaking with low turnover is taxed at substantially lower average rate than undertakings with high turnover. The Commission argues that being taxed at a substantially lower rate mitigates the charges that undertakings with low turnover have to carry, as compared to undertakings with higher turnover. Therefor, it must be illegal state aid as the DST constitutes an advantage to the benefit of smaller undertakings over larger undertakings for the purposes of Art. 107 (1) of the Treaty. The General

[41] https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2923 , 5 th of March 2020.
[42] Case T-778/16.
[43] International taxation in the Digital Economy: Challange Accepted? Article by Marcel Olbert and Christoph Spengel, World Tax journal februari 2017.
[44] T-20/17.

Court later on denied the decision, made by the EU Commission.

In T-20/17 Hungary against the Commission, the General Court solved the dispute. The EU Commission continues arguing that the DTS, with it's characteristic of having a progressive tax rate, is to be seen as illegal state aid. The Hungarian authorities however stated that the purpose of the tax was to promote the principle of public burden sharing. The General Court came to the conclusion that the Commission hadn't identified a discriminatory element contrary to the advertisement tax's objective. The Commission had not shown a selective advantage characteristic of state aid. The structure of the advertisement tax, with a progressive nature, could not be considered as illegal state aid. Weather a tax includes state aid does not depend on the reasons which justify the basic structure underlying it.[45]

[45] T-20/17.

6. Proposals on the Digital Services Tax (DST)

6.1 European Union and the Digital Single Market

At European Union level, challenges within the tax system were identified by the EU Commission in the Communication of "A Fair and Efficient Tax System in the European Union for the Digital Single Market", adopted on 21 September 2017.[46] The Digital Single Market is one of the political priorities of the European Commission, aiming at opening up digital opportunities for the people and businesses in the internal market of over 500 million EU consumers.[47] The EU Commission strives for a strong and ambitious EU position on taxing the digital economy and the report discusses background issues, objectives and various options for both the short-term as well as long-term perspective.[48] Two important questions raised by the Commission are the question of nexus and the question of alignment of value creation with taxation. The first one is about how a country establishes and protects taxing rights in its jurisdiction, where businesses can provide services digitally without being physically present. The second question answers what to tax, in the meaning of how to attribute profits from new digitalized business models driven by intangible assets, data and knowledge.[49] Since existing tax rules are no longer fitted to the realities of the current economy, several initiatives for an effective solution have been considered and discussed by the European Council, to implement new regulations at EU level. To avoid fragmentation in the Digital Single Market due to the introduction of digital services taxes by MS, the European Commission has put on the table a Digital Tax Package including two proposals on EU directives.[50] The purpose is to update the tax framework in

[46] COM(2017) 547 final.
[47] COM(2015) 192 final.
[48] 2017 EU Comm'n. On Fair/Efficient Tax. Supra n. 8.
[49] Ibid.
[50] European Council meeting (19 October 2017) – Conclusions (doc. EUCO 14/17) and Council Conclusions of 5 December 2017 – Responding to the challenges of taxation of profits of the digital economy (FISC 346 ECOFIN 1092).

the EU and potentially internationally so that digital business models are being effectively taxed.[51] The proposals are addressing the issue of fair taxation of digital business models and a long-term solution suggests an implementation of a new nexus based on significant digital presence in a certain MS jurisdiction.[52] This thesis deal with the short-term solution proposed by the EU Commission, that is to be discussed in the section below.

6.2 The DST proposal

On the 21th of March 2018 the EU Commission launched a proposal of a concrete solution in the directive On the Common System of a Digital Services Tax on revenues resulting from the provision of certain digital services.[53] Fair taxation of the digital economy is part of the European Commission's agenda on a fair and efficient tax system in the European Union, with the purpose of protecting fair competition in the internal market. The DST is an interim tax, a temporary short-term solution until a more comprehensive solution is in place. The proposal establishes a common system of a Digital Services Tax that is focusing on revenues stemming from the supply of certain digital services that currently escape taxation in the EU. The DST aims at harmonizing taxation of digital services in the single market by targeting revenues from certain digital services. The tax will function as an equalization tax tailored to address value creation through user participation instead of through consumption or data.[54] It is designed as a 3 % turnover tax that applies on gross revenue from certain digital services. The DST proposal addresses several types of digital services where user-created value is central, such as digital advertising and intermediation activities and from the sale of data from users' engagement with digital interfaces.[55] In 2017, the current average tax

[51] Taxing the Digital: Unilateralism Vs. Multilateralism, Piergiorgio Valente (Crowe Valente/Valente Associati GEB Partners; Link Campus University, Rome)/October 8, 2018
[52] Examensar.
[53] COM(2018) 148 final.
[54] The Digital Service Tax and Fundamental Freedoms: Appraisal Under the Doctrine of Measures Having Equivalent Effect to Quantitative Restrictions, article by Christina Dimitropoulou, s.201.
[55] COM(2018) 148 final. p.22.

rate on digital business was an effective tax rate of 9,5 % compared to 23 % on traditional businesses models.[56] Google and Facebook, both with headquarter in the US, are among the world's largest transnational advertising corporations, with tax residence overseas. In form of a duopoly, they dominate the online advertising market and control about two third of global advertising revenue, but avoid paying what could be seen as adequate taxes.[57] The objective of the DST proposal is to close the gap between taxation of digital revenue and traditional revenue. The goal is to level the playing field and simplify the administration and application of the tax. The ambition is also to respect proportionality and minimize the impact on start-ups, business creation and small business more generally, a revenue thresholds is therefor necessary.[58] Further below, elements set out by the DST proposal will be defined, in particular the taxable revenues (what is taxed), the taxable person (who is taxed), the place of taxation (what proportion of taxable revenues is deemed to be obtained in a Member State and when).[59]

For the purpose of the proposal, article 3(1) states what to tax by defining the revenues resulting from the provision of certain digital services that would qualify as taxable revenue:

> (a) the placing on a digital interface of advertising targeted at users of that interface;
>
> (b) the making available to users of a multi-sided digital interface which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users;
>
> (c) the transmission of data collected about users and generated from users' activities on digital interfaces.[60]

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[56] Communication from the commission (2017), p. 6.and https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html.
[57] The online advertising tax "A digital policy innovation" by professor Christian Fuchs, University of Westminister, p. 4.
[58] OECD 2018 Interim Report, *supra* n. 1, para. 450 et seq.
[59] COM(2018) 148 final (8) p.16.
[60] COM(2018) 148 final. p.24.

The DST is a tax with a targeted scope, even though it is a bit vague. It targets three categories of digital services where user value creation plays an important role, rendered by large digital companies established in both EU and non-EU Member States. A taxing right belongs to a Member State where users are deemed to be located, as the users are the ones creating content to the platform, as well as value for the company.

Characteristics of services falling within the scope of the DST are the role played by the users. It targets the transmission for consideration of data obtained from a very specific activity, the users' activities on digital interfaces, in the provision of these digital services, being unique and more complex than the ones traditionally adopted by a customer. Business models captured by the proposal are those, where the participation of a user in a digital activity constitutes an essential input for the business that would not be able to exist in their current form without user involvement.[61] User participation can contribute to the value of a business in several ways, however, it is not the user participation itself that is subject to taxation, but the revenues obtained from the monetization of the user input. It is this activity that enables a business to obtain revenues that would be taxable. These types of services can be provided remotely, without the provider of the services necessarily being physically present in the jurisdiction where the users are, and where the value is created.[62] Business models falling under the scope of the tax are those with high difference between where profits are made and where value is created. For example, a digital business can create value by obtaining data about user's activities on digital interfaces used in order to place a targeted personal advertising at the user, or by transmitting the data to third parties for consideration.[63]

The service covered is based on active involvement of users, allowing users to interact without knowing each other beforehand as software allows for the interaction, creating network effects of which intermediaries benefit. Certain types of revenues will not be subject to the DST, including

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[61] COM (2018) 148 final.p.4. ? art . 3.1?
[62] Ibid.
[63] COM(2018) 148 final, p.4.

subscription fees paid over the Internet and crowd funding revenues. These services are explicitly excluded from the scope of the DST proposal as well as intermediation services with the only purpose of making the interface available to supply digital content, communication services or payment services to users to mention some of the examples. The excluded services are different in the way that user participation plays a lesser role in the value creation process of companies offering these services.[64]

Article 4(1) of the DST proposal states what qualifies as a taxable person for the purpose of the directive. The taxable person is the person providing the service with annual payment and reporting obligations. The digital service tax will apply only to businesses meeting both of the following conditions within a tax period, it targets companies with a total amount of annual worldwide revenues exceeding EUR 750 million and within the EU taxable revenues exceeding EUR 50 million.

The first threshold limits the functioning of the tax to target only companies of a certain scale and with a strong market position. These companies are recognized by taking advantage from network effects and exploitation of big data to build business models around user participation. The DST scope excludes small enterprises and start-ups for which the compliance burdens of the new tax would likely have a disproportionate effect. The second threshold is set at Union level in order to disregard differences in market sizes within the EU. It limits the application of the tax to cases where there is a significant digital footprint in the EU, in relation to the revenues covered by the DST.[65]

A business meeting both of the above conditions would qualify as a taxable person whether the company is established in a Member State or in a third country. DST liability may arise and trigger different scenarios depending on where the taxable person is established. A taxable person established in a non-Union jurisdiction may have to pay DST in a Member State, a taxable

[64] Art. 3(4) The Explanatory Memorandum to the 2018 DST Directive Proposal. and Equalization Taxes and the EU's Digital Service Tax, article by Georg Kofler & Julia Sinnig, p.192.
[65] COM(2018) 148 final p.11.

person in a Member State having to pay DST in another Member State or a taxable person established in a Member State having to pay DST in the same Member State.[66]

Article 5 of the DST directive proposal determines the place of taxation. According to article 5(2) it is where the users are located in any particular MS at the moment they receive a taxable services. This is in compliance with the concept that it is user's value creation that underpins the objective scope of the DST. In respect of the purpose of the DST a taxing right therefore follows MS where the users are deemed to be located, regardless of whether the users have contributed in money to the generation of revenue for the company. Article 4 (5) clarifies that the place from which the payment for the taxable services is made is not to be taken into account for the purposes of determining the place of taxation. It is only the user involvement in the digital activities of a company, such as views of advertising on a digital interface while contributing generating value for the company, not necessary involving payment from the users' side. The establishment of a taxable person or the user is irrelevant for the place of taxation, as well as their place of supply and payment.[67]

The role of users' involvement in the value creation process has changed increasingly since the era of digitalization. The EU Commission points out that the tax would level the playing field for all companies operating in the Single Market, making the system more fair and beneficial to society as a whole.[68] In March 2019 the EU Commission's proposal on the DST was modified for a Council directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services.[69] Currently, the DST proposal has gotten a narrowed scope of the tax to target only advertising services.[70]

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[66] COM(2018) 148 final p.12.
[67] COM(2018) 148 final p.13.
[68] COM(2018)0148 – C8-0137/2018 – 2018/0073(CNS).
[69] On the proposal for a Council directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services (COM(2018)0148 – C8-0137/2018 – 2018/0073(CNS))
[70] COM(2018)0148 – C8-0137/2018 – 2018/0073(CNS).

7. Evalutation criteria

7.1 Legal basis for the DST

The proposed DST directive is based on Article 113 of the Treaty on the Functioning of the European Union (TFEU):

> " The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition."[71]

According to the cited article, the EU may legislate on turnover taxes, excise duties and other forms of indirect taxes, only to the extent that this is necessary for the functioning of the Internal Market and to avoid distortions of competition. This raises questions as if the DST falls under the scope of article 113 TFEU or not. It is to be discussed in the following analyze.

7.2 The subsidarity principle and the principle of state soveregnity

The principle of subsidiarity and proportionality is found in article 5(3) of TEU and Protocol (No 2). The subsidiarity principle governs the exercise of the EU's competence. The principle applies to all EU institutions and defines the circumstances in which it is preferable for action to be taken on Union lever, rather than by the MS, in areas where the Union does not have exclusive competence. The general aim of the principle is to guarantee a degree of independence for a lower authority, in relation to a higher one. It seeks to safeguard the ability of the MS to take decisions and actions, and when the objective of an action cannot be sufficiently achieved by the MS, it authorizes for the Union to intervention. The principle is closely linked

[71] Article 113 of the Treaty on the Functioning of the European Union (TFEU).

with the proximity principle referred in article 10 (3) TEU. The EU treaties aim to ensure that powers are exercised as close to the citizens as possible.[72]

One of the important aims of the BEPS project is to support "the effective fiscal sovereignty of countries over the design of their tax system".[73] The principle of state sovereignty is one of the most fundamental principles in the international tax system. The principle means that each nation has the power to decide about its own national tax laws. This is the principle that gives rise to loopholes in the tax system, enabling legal so called "tax shopping". This is when a MNE maximize the benefits of each domestic tax regulations as exemplified in earlier described cases. By using loopholes in tax treaties and transfer-pricing rules to take detours and increase the costs in high tax jurisdictions and thereby minimize the profits that instead are shifted into a low tax jurisdiction.[74] However, domestic tax laws in each MS have to be in compliance with EU law. A government's authority to decide over its own tax laws are limited by EU regulations such as the state aid rule and VATS policies, reducing the possibility of pursuing independent national tax policy. Collaborations to reduce tax evasion, such as the OECD's BEPS Project further intervene in individual countries' independence, including corporate taxation.[75] The sovereignty principle also has an approach in international law, where it establishes that each nation decides what international treaties to be part. As a member of the EU, MS are being tied to all the treaties that the EU is a party of. All the international trade-agreements between the EU and WTO are legally binding for each individual MS.

[72] https://www.europarl.europa.eu/factsheets/en/sheet/7/the-principle-of-subsidiarity 5th of March 2020.
[73] OECD 2014 p.14.
[74] http://www.oecd.org/tax/tax-policy/31743059.pdf, p.3.
[75] https://www.nationalekonomi.se/sites/default/files/NEFfiler/47-4-åh.pdf 20th of February 2020.

7.3 Non-discrimmination obligation WTO-law

The EU is part of agreements regulated by WTO. Stemming from article II and XVII in the GATS, there is a non-discrimination obligation that forbids EU MS from regulations that discriminate other parties of the treaty, for example the US. Discrimination is defined by well-established case law as treating identical situation differently or treating different situations in the same way.[76] The objectives of the GATS are to create a creditable and reliable system of international trade rules, ensuring fair and equitable treatment of all participants. A difference in the tax treatment can be discriminatory, depending on how the DST proposal treats third country companies. Under article II of the GATS, all members of the treaty have to respect a fair treatment of all other service suppliers that are members of the treaty, cited:

> 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. [77]

[76] Judgement of 31.03.1993, „Kraus", C-19/92, EU:C:1993:125, para. 32. No.128 at para.30; Judgement of 11.08.1995, „Wielockx", C-80/94, EU:C:1995:271, para.
[77] https://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm#2, the 10th of March 2020.

8. Can the DST be regarded as a feasible solution for the EU?

Further below follows an analytical part featuring weather the DST proposal is in compliance with Union law and the WTO non-discriminatory provisions bound for the EU by GATS. Thereafter, a short discussion of the view from the OECD continues before the final conclusion is being presented.

8.1 Possible compliance issues with EU law

8.1.1 EU legislative competence

Taxation is key instrument of public policy at all level of governance as well as an essential function for our society. For many years, the field of taxation has been closely linked to national sovereignty. As a protection of it, decision-making in the field of taxation has been based on unanimity among the MS for a long time, but a discussion towards change has started.[78] The problem of tax avoidance in the digital economy is an issue closely connected to the EU's goal of the Digital Single Market and the protection of fair competition in the internal market. Art. 113 TFEU statues that the EU only has competence to harmonize legislation on indirect tax, such as VAT and excise as these affects the freedom of movement within the internal market. The EU may legislate on indirect taxes only to the extent that this is necessary for the functioning of the Internal Market and to avoid distortions of competition. The reason is to ensure that there is no distortion between different indirect tax rates and systems, giving companies in one MS undue advantage against other MS. In all, to make sure that one country is not receiving unfair advantages over competitors in other countries. This brings to the question whether the EU has legislative competence regarding DST

[78]https://ec.europa.eu/taxation_customs/sites/taxation/files/15_01_2019_communication_towards_a_more_efficient_democratic_decision_making_eu_tax_policy_en.pdf. p.1., 10th of March 2020.

and also whether unilateral non-discriminatory destination-based taxes itself could lead to relevant distortions of the internal market.[79]

The EU tax policy is divided into two categories of direct tax and indirect tax. The legislation of direct taxation falls under the shared competence of MS, as long as it is being exercised consistently with EU law.[80] In the field of direct taxation, the EU has implemented some standard policies for corporate and personal taxation, measures to evade tax avoidance and double taxation.[81] Since the economy became digitalized and boosted globally due to new technology during the last two or three decades, the growing issue of tax avoidance has triggered unilateral actions among MS. It has taken to long too long to agree on a solution on international- or EU-level. The establishment of domestic legislation on certain digital services taxes in several of the MS, as an effect of each nations exercise of its state sovereignty. Each MS has the right to decide on how to design and incorporate its domestic tax laws.

For the Union to legally legislate on a DST based on Art. 113 TFEU, it requires that the DST classify as an indirect tax. It has been debated among authors whether the DST is an indirect tax or a hybrid tax, in between a direct and indirect tax.[82] The DST proposal is a destination-based turnover tax of 3 % levied on gross revenues net of VAT, arising out of certain digital services. In case the modified version of the DST proposal will be applied, only on advertisement services. The objective of the directive is to close the gap between revenues streaming from physical business and digital companies with no permanent establishment. The underlying drive is the change of value creation in the digital era, and that profits should be taxed where value is created. When it comes to digital business models,

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[79] Equalization Taxes and the EU's Digital Service Tax, article by Georg Kofler & Julia Sinnig, p.182.
[80] Judgement of 14.02.1995, "Schumacker", C-279/93; EU:C:1995:31, para. 21.
[81]https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/taxation_internal_market_en.pdf. p.9,11th of March 2020.
[82] http://kluwertaxblog.com/2018/03/16/eu-digital-services-tax-populist-flawed-proposal/; https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/2/462/1539953034/181019-dst-report.pdf and http://kluwertaxblog.com/2020/02/24/spain-has-approved-the-digital-service-tax-the-controversy-is-served/#_ftn6, 1 of March 2020.

value creation is considered where the users are located when consuming a digital service. Although the DST targets MNE's, in the end, it will probably be the consumers of the digital services, the users, that will be the ones paying the price for the cost that the tax would cause for the MNE's, similar to a VAT. If this would be the case, the character of the DST seems to me to, to qualify as an indirect tax. No matter the case, it seems clear to me that the Union has legislative competence to take action. The EU Commission argues that the national measures can be of a very diverse nature and as they are already in place or planed by several MS, action on EU level is needed to alleviate potential fragmentation within the Internal Market and to avoid the creation of distortion of competition. Rather than different national policies, a mutual solution on EU level is preferred, as it would entail a reduction in the compliance burden for business subject to new rules.[83]

In my opinion, there is no doubt that there is an urgent need for a common solution and for action to be taken on EU-level. To protect the Digital Single Market and to ensure that there is no distortion between different indirect tax rates and systems. In the existing situation, I think it is necessary for the EU to harmonize legislation rather than by the MS itself, to replace fair completion in the internal market. As the situation on the internal market accrues today, whit several unilateral initiatives trying to quickly solve the issue by own domestic measures, it speaks for itself, that it causes disparity in the EU market. According to me, there is an urgent threat against the internal market and a need for the Union to take steps to prevent potential fragmentation and potential distortion of competition. The Union may obtain legislative competence outside the field of indirect taxation, even though it falls outside its exclusive competence. Referring to the subsidiarity principle, given the Union legislative power in areas where action is better to be taken at Union level, rather than by MS. I consider the EU to have legitimate reasons for an implementation of the DST proposal.

[83] 2018 DST Directive Prposal, *supra,* n.65, at. 5.

Another potential compliance issue is a potential break of state aid prohibition obligations under Article 107 TFEU. The DST is only applicable to certain digital services and the revenue threshold could amount to selectivity, which will be further discussed in the next section.[84] However a strong argument against the DST qualification as illegal state aid is its approval by the Union legislature. If the measure stems from an act of the Union legislator it is not a measure affecting trade between MS. It is more likely that a digital tax implemented at unilateral level by a MS would break the state aid prohibition.[85] Some argue that the DST likely will have a negative impact on cross-boarder trade and investment may lead to a question weather it is effectively capable of contributing to the creation and subsequent reinforcement of the EU-envisaged EU Digital Single Market.[86]

8.2 Possible compliance issues with international trade law

From an international discriminatory point of view, the DST would predominantly target multinational American tech giants such as Google, Facebook and Amazon. In a policy brief written by Gary Clyde Hufbauer and Zhiyao Lu[87], they argue that the DST may have the characteristics of a prohibited tariff under the rules of the WTO-law. Claiming that the DST de facto discriminate against US digital firms, in violation of the European Union's national treatment commitment under GATS. According to them, the new tax proposal arises in a European atmosphere with distrust in successful US firms.[88] Discrimination is defined as, when treating identical situations differently or treating different situations in the same way.[89] The objectives of the GATS are to create a creditable and reliable system of

[84] Turina, *supra*. N. 24, at 510 & 519; Mason & Parada, *supra* n.129.
[85] DE: ECJ, 5 Apr. 2006, T-351/02, *Deutsche Bahn AG v. Commission of the European Communitys*, EU:T2006:104, paras 101-106.
[86] 2018 DST Directive Proposal, *supra* n. 65, at 3.
[87] https://www.piie.com/system/files/documents/pb18-15.pdf, the 27th of February 2020.
[88] Ibid. p.1.
[89] Judgement of 31.03.1993, „Kraus“, C-19/92, EU:C:1993:125, para. 32. No.128 at para.30; Judgement of 11.08.1995, „Wielockx“, C-80/94, EU:C:1995:271, para.

international trade rules, ensuring fair and equitable treatment of all participants.

In order to comply with WTO non-discrimination requirements, one important factor is that the potential threshold for the application of an equalization tax must be set for both comparable cross-boarder and domestic situations. The DST proposal has taken this approach. The DST would target companies with revenues stemming from certain digital services and it is designed to cover both cross-boarder and domestic situations, as it targets both MS and non-MS companies. The DST proposal has a double-threshold targeting corporate or transparent entity fulfilling two conditions. Any digital business with total amount of annual worldwide revenues exceeding EUR 750 million and within the EU taxable revenues exceeding EUR 50 million, within a financial year, will be a DST taxable person. The purpose of the threshold is set to target only companies of a certain scale, able to establish a strong market position. The threshold has raised debate about a potential discriminatory character, breaking the non-discriminatory obligation stemming from the GATS.[90] The first condition gives an approach that exclude small enterprises or start-ups from the scope of the directive. The second threshold has the objective to capture only those entities with a significant digital footprint in the EU. The authors argue that the revenue threshold is set quite high, aiming at targeting specifically US multinational corporations and that the exclusion of certain revenues widely excludes European firms.[91] I have to agree that they have a point; it is highly suspected that American tech giants would only satisfy the revenue threshold and if so, the design of the DST in reality aims at targeting only US registered multinational corporations. If this is the case, there is likely a compliance issue and potential break of the WTO-law because of discrimination based on nationality.

The US government is opposed to any digital services tax proposals and American president Donald Trump is criticizing the French DST, arguing that only the US should tax its tech giants, not France. The French DST

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[90] https://www.piie.com/system/files/documents/pb18-15.pdf, the 27th of February 2020.
[91] Ibid. p.2.

proposal has been especially debated in media, challenged as discriminatory vis-à-vis US companies.[92] France Minister of the Economy and Finance, Bruno Le Maire is arguing that the issue is on a much larger scale, it is not only a fight between separate governments. It is about adaptation of tax regulations to the digital era, as the problem about fair taxation of the digital economy is global. Cites:

> "What I am trying to impress on our American friends is that the fight is not between France and the U.S., or Europe and the U.S. -- the fight is to put in place just taxation on digital activities,"[93]

8.3 The view of the OECD on equalization taxes

The OECD has also given rise to the potential compliance issues. If an equalization tax should apply only to cross-boarder transaction, such as non-resident enterprises, it may raise different kind of WTO and EU-law objections. The OECD has pointed out that:

> "In order to ensure that the measure is not impermissible State aid when applied by individual jurisdictions, the measure would need to be designed not to provide a selective advantage to any group of taxpayers. In other words, an interim measure would need to avoid different treatment of undertakings that are in a legally and factually comparable position." [94]

The OECD also noted that it is important that for EU MS the interim measure should be designed so that it is not a value added tax that would be inconsistent with the EU Directive on the Common System of VAT and that the characteristic of the tax is designed to target both EU member and non-MS.

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[92] https://news.bloombergtax.com/daily-tax-report-international/u-s-weighs-trade-action-over-french-digital-tax-official-says, on 13th of March 2020.

[93] https://www.ibtimes.com/digital-services-taxes-us-france-agree-hold-levies-retaliatory-tariffs-2906135, 12 of March 2020.

[94] 2018 OECD BEPS Interim Report, *supra* n.12, paras 425 & 426.

9. Conclusion

The purpose with this thesis has been to illustrate legal issues related to the DST proposal and analyze potential compliance issues in regard to fundamental tax principles of state sovereignty, Union principles of subsidiarity and proportionality, WTO non-discriminatory provisions and also the EU's competence to legislate on a DST. Potential legal issues raised with taxation of the digital have been described, such as threats towards a fair competition in the Single Digital Market, as a result of unilateral action from MS, when implementing interim domestic measures. Case law describes issues of selective treatment of taxation in regard of illegal state aid rule and non-discrimination obligations stemming from GATS have been discussed.

Can the DST be regarded as a feasible solution to tackle the problem of taxation of the digital economy?

Based on the analyze, my conclusion is that it is that the proposed DST most likely is in compliance with Union law. Although all MS haven't yet agreed on the proposal, it seems to me that the Union would have competence to base the proposal on article 113 TFEU. It is uncertain whether the proposed tax would be qualified as an indirect or direct tax. The EU has exclusive competence to legislate on indirect tax, only to the extent that this is necessary for the functioning of the Internal Market and to avoid distortions of competition. Otherwise, it can also be referred to the subsidiarity principle for the EU to authorize legislative power. I would argue that the DST has the character of an indirect tax, this is not definite to give the EU exclusive competence and the principle of state sovereignty has to be respected. However, there is an urgent situation in the internal market and a need for a solution as soon as possible. I think it is crucial for the EU to take action on the arising issue of tax avoidance followed by competition concerns in the internal market and that this is enough argument and that it can be done without a break of Union law.

The formulation of the DST has been debated to target only American MNE's, as a potential break against non-discrimination WTO-law. The high threshold sets out a limit for which companies are covered by the tax and the way it is designed by now, might be an discrimination under GATS article II. It target only US registered companies and exclude European ones and this could cause compliance issues against international trade law. In order for the DST to be a feasible solution to tackle the problem of taxation of the digital economy, it might need to be modified to make sure it doesn't have a discriminatory character.

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