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The Meaning and the Impact of the Tesco-Vodafone CJEU Cases in Respect of the Digital Service Tax

by

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Abbreviation list

AG	Advocate General
BEPS	Base Erosion and Profit Shifting
CJEU	Court of Justice of the European Union
DST	Digital Service Tax
EC	European Commission
EU	European Union
MSs	Member States
OECD	Organisation for Economic Cooperation and Development
TFEU	Treaty of the Functioning of the European Union

1. Introduction.

Background.

The European Union is standing at the point where more and more countries are introducing new measures to tax the digital economy. The current position is EU Member States impose the Digital Service Tax (DST), which is based on legislative proposal from the European Commission (EC): the proposal on The Digital Service Tax Directive[1]. One of the major problems with the implication of the new tax is that is considered (by the OECD, the EC and the majority of researchers) as an interim measure to tax the digital economy and prepare the world before the global tax reform. It is especially important to follow all the possible legislative intentions from all the countries and organizations, which make new projects and proposals.

No less important to follow the actual case law in this field. On 3 March 2020 the Court of Justice of the European Union (the CJEU) delivered judgment on two cases – *Tesco Global*[22] and *Vodafone*[3]. This judgment drew significant attention because it touched upon the Hungarian telecommunications tax. And the tax on digital services was designed in a form of a special unilateral tax. Judgment of court would mean that any future suits against the DST would be regarded in the same manner as Tesco-Vodafone.

[1] Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services. (PCD) https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf (last access april 5). Herein after Council Directive.

[2] Judgment of the Court (Grand Chamber) of 3 March 2020 Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, Case C-323/18, EU:C:2020:140

[3] Judgment of the Court (Grand Chamber) of 3 March 2020, Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, Case C-75/18, EU:C:2020:139

The CJEU ruled, in both Vodafone and Tesco Global, that the special Hungarian tax on telecommunications does not preclude the freedom of establishment just because the tax burden falls mostly on foreign-owned taxable persons, nor does it prevent Member State legislation from imposing taxes using progressive turnovers when the effect of that legislation is that the tax burden falls mostly on foreign-owned taxable persons.

However, the judgement raised significant disputes among the researchers and practitioners. One perspective is that the ruling is a clear and convincing victory for the DST supporters, completely another view is the decision is not that obvious and the Court lacks a number of serious points. It is a popular point of view that this ruling prepares ground for future approval of indirect discrimination concerning the DST. Despite the fact, that Tesco-Global and Vodafone are not connected directly to the DST topic and are rather limited, they are still relevant to discussion.

1.1. The Research question and aim.

The aim of this work is to investigate the judgment of the Vodafone and Tesco cases in the light of their correlation with the proposal of the Digital Service tax. This is made due to the fact, that the Hungarian telecommunication tax and the DST have common features which gave a basis to consider that the judgment in both Tesco and Vodafone would mean that the future litigations on the DST would be treated the same or be considered as inadmissible.

And the research question is to figure out the impact of the Tesco-Vodafone cases on the European Digital Service Tax and whether the reasoning of the cases would be enough to dismiss any future challenges on the EDST.

1.2. Method and material.

The thesis is based mostly on the traditional research method as it based

on legislative acts, case law and doctrinal literature. Primary EU law and the case law of the CJEU is the main scope of the thesis. The paper will also investigate doctrinal literature which commented the topic of the DST and Tesco-Vodafone cases

The doctrinal literature takes place in this paper, the author accessed the books and articles from IBFD Tax Research Platform, Kluwer Online, EC Tax Review, Google Books. The case law was accessed on the Curia web-site.

1.3. Delimitations.

This research starts from the assumption that the reader has a general knowledge of European and international tax law and has a basic knowledge of the development of the taxation of the digital economy.

However, the author does not investigate all the aspects of the DST which are at dispute. The scope of the paper is only the context of cases and there is no deep research of the legislation and doctrinal sources and concepts.

1.4. Outline.

The meaning of the Tesco-Vodafone cases for the Digital Service Tax is the topic of the research.

First, the author will give a short overview of developing of the taxing of the digital economy within the European Union.

Secondly, there will done a deep analysis of the cases and their correlation with the DST.

Thirdly, it will be slightly touched the issue of the State Aid relating to the cases mentioned above.

2. The European Union and Taxing the digital economy.

2.1. The EU struggles in taxing the digital economy.

During the past few years, the world has faced the new reality, where the majority of revenues started to be generated not in so-called "real sector" of the economy. We have seen the rise of tech-giants such as Google, Apple, Amazon, Facebook and the number of smaller internet start-ups and undertakings, which started to create significant value. At first, it was not so problematic to tax those companies as they were operating business mostly in their home countries (the most common location is obviously the USA), but the real challenge began, when those businesses started to carry out business internationally and expanded their presence worldwide. The problem is they do not need physical presence for expansion. The main issue in connection with taxation of such companies is that all the taxation of foreign companies under the OECD Model Convention 2017[4] is based on the concept of physical presence, i.e. the Permanent Establishment (PE)[5]. Which is irrelevant to tax a digital undertaking, which makes profits on territory of any state, but is situated in its home country and there is no chance make any residence test and, consequently, there are no options to tax such income.

In fact, every undertaking, which make main profits on the Internet, need to have servers as close as possible to their customers in order to provide its services as fast and accurate as possible. The issue is it is rather simple to give them the status of "auxiliary or preparatory"[6] works, so it gives an opportunity to go below the PE threshold and consequently, avoid taxation.In the framework of the OECD BEPS Project[7], researchers started to design new means of taxation digital undertakings. The most common point of view that the world and the international tax law need global

[4] OECD Tax Model Convention On Income and On Capital of 21 November 2017
[5] OECD Tax Model Convention On Income and On Capital of 21 November 2017 art. 5
[6] Carlo Garbarino, 'Permanent Establishments and BEPS Action 7: Perspectives in Evolution, INTERTAX, vol. 47, issue 4
[7] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing. http://dx.doi.org/10.1787/9789264202719-en (last accessed march 30)

reform to set completely new rules. Another perspective, provided by some researchers (for example W. Schön[8]) that there is no need for global tax reform, as there is a certain risk it would be unsustainable and can miss some significant issues which can be a danger for the future.

The official position we have at the current moment, there are new measures which are developed under the OECD and the latest proposal to be expected in summer 2020, but, regarding current situation with the COVID-19 outbreak, it is hard to say when the public will see the final OECD report on the DST project.

Another position we have from the European Commission, there are two proposals called Pillar-I and Pillar-II on taxing the digital economy. As an interim measure it is proposed to adopt the Digital Service Tax.

The DST is a gross turnover tax which hit narrower income sources and proposes to tax not "in-country" made revenue, but determines tax rates according to worldwide revenue. The general criteria are:

- EUR 750 million worldwide revenue;
- EUR 50 million profits gained in the European Union;
- Digital footprint in the European Union.

The DST also introduces the concept of the Significant Digital Presence (SDP). It proposes to levy tax burden on companies, which make profits in a certain state, without being physically presented there.

Those criteria raised the major dispute for several reasons:

Firstly, it touched the category of terms. The term of the SDP is not included in the OECD Model Tax Convention. It is discussed in the scientific field whether it should be included in Article 5 of the Convention[9], or become an independent term, or even replace the PE? Secondly, how countries should define the SDP of the company?

[8] W. Schön, 'Ten Questions about Why and How to Tax the Digitalized Economy', Max Planck Institute for Tax Law and Public Finance Working Paper 2017 – 11

[9] OECD Tax Model Convention On Income and On Capital of 21 November 2017 art. 5

Thirdly, are revenue criteria really relevant in connection with the second question?
Fourthly, can it construe the State Aid?

Not surprisingly, all those questions raised by researchers and practitioners, reflected in a number of articles, researches and tax blogs. Yet another question was how to challenge the DST? Which fundamental freedoms can it infringe? Does it preclude the freedom of establishment? Consequently, every case from the CJEU on the common issues had to draw special attention.

That what happened to the Hungarian cases. Both touched upon the unilateral special tax, one of them raised State Aid question, while another asked directly whether the telecommunications tax preclude the freedom of establishment.

It is necessary at some point distinguish the DST from the telecommunication tax, but at the same time the cases are still relevant for this topic. As Ruth Mason writes in her article: "although digital taxes are distinguishable from the Hungarian taxes just upheld, the reasoning in Tesco-Global and Vodafone suggest that the CJEU will not be receptive to digital tax challenges; indeed, to uphold the Hungarian taxes required the CJEU to ignore its own precedent"[10].

2.2. The possibility of discrimination.

As it was stated before, the DST is an interim measure before the international consensus how to modify the nexus requirement in the tax treaties. Although, there is a major agreement that the tax treaties and the nexus requirement should be modified in order to respond to challenges of the modern economy, it is still uncertain on the question of how to do it. Nowadays, states are actively involved in finding a "Unified Approach"[10].

[10] *Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pilar One* (OECD Publishing, 2019)

Nevertheless, even an interim measure, within the EU, should be designed in a manner not preclude conducting of business and not to create unlawful restrictive measures i.e. to preclude fundamental freedoms and contradict State aid rules.

The most significant issue of the DST is its targeting. There is a quite narrow scope of the taxable persons. However, the fact that these are mainly U.S. companies does not create any legal difficulties within the European Union as it is not prohibited to impose any restrictions in respect of the foreigners under the EU law. Consequently, it is impossible to challenge the DST without a proper EU plaintiff[11].

It is rather arguable whether the DST can be challenged as the State aid, because if the DSTs all across the Member States are implemented into the national law as a DST Directive, it would mean that there is no State aid, according the EU law. However, the DST Directive has not come into force yet and everything we have are unilateral initiatives of the Member States such as France, Spain Czech Republic, etc. It means that the only way to challenge the DST is to bring an action on the fundamental freedoms case.

Moreover, as it will be described below, the Hungarian Supreme Court asked in both Tesco and Vodafone questions on both fundamental freedoms and the possibility of the State aid, so it was not a surprise when the Court of Justice decided that one of two legal questions with very similar legal core would be inadmissible.

Another issue that the DST, according to the directive, is designed to be neutral, however, the high thresholds significantly the scope of the taxpayers and hence create doubts whether they really neutral or not. It is prohibited to use selective proxies to indirectly discriminate foreigners and it is the position which supported by the CJEU in several cases such as Humbolt[12], Gibraltar, etc.

Using proxies, in respect of taxation, means that “facially neutral” criteria are used to protect domestic goods or services, which is

[11] R. Mason, L Parada “The Legality of Digital Taxes in Europe” – p 10.
[12]

prohibited under the EU law and precludes the functioning of the internal market. It is rather arguable whether the turnover threshold is a such proxy. Yes, it highlights foreign companies among domestic EU undertakings, but on the other hand it does not affect consumers behavior. It is hard even to imagine that an average customer would, for example, Spotify music subscription instead of Apple Music on the basis of the DST. On the other hand, the DST is not a consumption tax Hence, the tax burden is not levied on the consumer and it cannot affect a customer. However, in Humbolt, the engine size was not, formally speaking, a consumption tax, but it influenced the final customer to choose domestic car manufacturers instead of foreign cars.

A user usually is not bound by the price of a subscription (as prices are usually the same and cost around $10) and does not pay for an access to a social network. Moreover, until the worldwide consensus on adopting new rules of taxing the digital economy is not reached, it is hard to set the borders for the “internal market” in respect of the digital economy.

2.3. Possible basis for discrimination.

However, there are still some reasons how the unilateral (not the European) DSTs imposed by the Member States can be challenged.

The basis for discrimination can be group membership or a size of a company. As it was stated before, foreign companies need EU plaintiff to challenge a tax for a discrimination. Every U.S. company, liable to pay the DST, has at least one EU subsidiary which makes possible to bring an action.

There is a possibility to ask whether the discrimination on the basis of the group membership. It draws a distinction between domestic undertakings which usually do not use a group membership to conduct business within the European Union whereas foreign companies need to establish a subsidiary to carry on business. Discrimination against groups can construe overt discrimination based on nationality.

According to the thresholds set in the Directive, group companies are liable to count the global turnover generated by the whole group, while stand-alone company counts only its in-state revenue which is not enough to pass the DST threshold.

The same concerns a company size criterion. According to the statistics provided by R. Mason and L. Parada, it is clear that the "vast majority" of the companies liable to pay the DST have the place of seat outside the EU[13]. Also, the turnover is not only revenue gained, it is much broader thing, so the fact that only the giant foreign companies surpass the DST threshold creates selectivity in itself. Even the first project of the Commission proposed to exclude EU companies from the scope of the DST. However, only the quantitative criterion is not enough to construe discrimination, it still worth mentioning.

2.4. The using of the turnover criterion.

The most serious issue regarding the DST is its targeting. The tax is aimed mainly at the American tech-giants as it has been mentioned above. The Commission decided to use turnover criteria designing this tax. What is more interesting that the proposal levies tax burden on the gross turnover rather than net turnover. And it is rather relevant to set the rules the way the Commission did. In fact, it is impossible for the

[13] R. Mason "What the CJEU's Hungarian Cases Mean for Digital Taxes" SSRN database (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3550757), [last accessed on may 10]

DST to become fully either income tax or fully consumption tax (such as the VAT). The point is that, due to the business model of the tech-giants, it is impossible to legally tax the revenue raised from the digital activities.

First of all, the most valuable activity is simply selling advertisement online. The issue is that a user does not pay for using Facebook or Google or any other social network/search engine. However, the user sees and 'consumes' large amount of different ads. And due to its worldwide user base, the tech giants create significant value from advertising. As it was mentioned by R. Avi-Yonah and N. Fisbien, there is no need for the digital companies to sell any kind of subscription i.e. special payment for the right to use their platforms[14]. It is becoming obvious why it is impossible to calculate exactly income from the revenue created from advertising.

The other relevant thing that the Commission could not have used any consumption criteria as there is obviously would have risen the collision with the VAT directive, which also has provisions concerning digital trade.

However, if it is more or less clear why the turnover criteria is used, it is still relevant to understand the thresholds set by the Commission. The high amount of the worldwide turnover, on the first thought, leads to a conclusion that it is made in order to protect EU undertakings. Moreover, it is not forbidden by the European Union legislation to discriminate against foreign-based (in this case non-EU) companies. The problem arises only when the discrimination touches upon European subsidiaries of the non-EU corporations, which is much more relevant for the research. This point is also relevant because that unlawful protection of the 'home companies' causes not only infringement of the fundamental freedoms but also can be considered as the State Aid.

[14] R. Avi-Yonah and N. Fisbien. "The Digital Consumption Tax" INTERTAX, Vol. 48, issue 5

These points were raised by the *Tesco-Vodafone* cases. It touched upon the questions of taxing foreign-owned companies, it dealt with turnover taxes and there was also asked a question concerning infringement of the State Aid rules.

2.5. The importance of the Hungarian cases in connection with the DST.

The recent Hungarian cases have become a starting point for laying the ground on the future of the DST. First, the Tesco and the Vodafone challenged the special unilateral tax which levies tax burden mostly on the foreign-owned corporations. It refers us to the statement that the Member States would impose the DSTs on the base of the directive to secure their taxing rights within the EU. As unilateral taxes are much easier to bring an action on. Second, the Hungarian Telecommunications tax used the turnover criterion to levy it. So, these common features drew special attention to the cases. We are not even interested in exactly progressive rates, which was decided by the Court to answer on.

It is also important to look into the proposal of the DST directive[15]. With the help of the proposal, it is possible to sort out common features of both taxes. Article 3 of the directive defines taxable revenues: "The revenues resulting from the provision of each of the following services by an entity shall qualify as 'taxable revenues' for the purposes of this Directive:

(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

[15] Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services

services directly between users;

(c) the transmission of data collected about users and generated from users' activities on digital interfaces.[16]

Article 4 defines taxable persons:

'Taxable person', with respect to a tax period, shall mean an entity meeting both of the following conditions:

(a) the total amount of worldwide revenues reported by the entity for the relevant financial year exceeds EUR 750 000 000;

[16] Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, [art.3]

(b) the total amount of taxable revenues obtained by the entity within the Union during the relevant financial year exceeds EUR 50 000 000[17].

Also, it is worth mentioning both taxes are designed in the facially neutral manner. So only those features led the community to the understanding that the Hungarian cases would obviously mean the same consequences for the DST disputes. But is it really so? Telecommunication activities, indeed, have rather wide meaning. It includes economic activities on the Internet but does not provide (which is obvious) the same categories of activities as the proposal does. Should it lead us to the conclusion that particularly digital activities were the issue of law? Of course not.

Another point that became extremely important that the Telecommunication tax is levied mostly on the foreign undertakings and the Court had to investigate the quantatative criterion. From author's perspective, a majority of future possible DST issues would concern the same issue of the majority foreign corporations. And here it is necessary to distinguish the Hungarian tax and the DST as we are interested in the position of the Court towards discrimination of the companies based on nationality. Moreover, it will be said in advance, that there are not only foreign companies which are subject to the DST. There is a number of EU digital companies which go below a DST threshold while operating business wholly or partly on the Internet. And basing on that it would fair to repeat Leopoldo Parada's words, who does not see the ruling of the *Tesco-Vodafone* as a clear victory of the DST supporters[18].

On the basis stated above, in a form of preliminary analysis of the background and the legal issue of the both cases R. Szudocky formulated the discrimination criteria before the actual judgement:

- when there is inherent or intrinsic connection between the seemingly neutral distinguishing criterion and nationality place of seat of a company;
- where the differentiation based on a seemingly neutral

criterion used by a national tax measure affects foreign taxpayers in the vast majority of cases;

- where the differentiation based on a seemingly neutral criterion affects foreign tax payers in the majority of cases and the legislature‘s intention to discriminate foreign taxpayers through a seemingly neutral criterion can be proven.[17]

[17] R. Szudoczky, “Hungary: “Progressive Turnover Taxes In The Light of the EU Fundamental Freedoms and the State Aid rules”, CJEU - Recent Developments in Direct Taxation 2018: Schriftenreihe IStR, p. 104

3. Analysis of the Tesco-Vodafone.

3.1. Questions before the Court of Justice.

The first thing, which should be done before analyzing the content of the rulings, is to have a closer look on questions before the CJEU. In *Tesco* the CJEU narrowed the first question of the reffering court as follows:

The first question must be regarded as concerning whether Articles 49 and 54 TFEU must be interpreted as precluding the legislation of a Member State in relation to a turnover tax where the consequence of the fact that that tax is steeply progressive is that undertakings controlled directly or indirectly by nationals of other Member States or by companies having their registered office in another Member State mainly bear the actual burden of that tax[18].

The second and the third questions the Court considered as inadmissible[19].

In *Vodafone* considered admissible and answered on the first and the third questions:

By its first question, the referring court seeks, in essence, to ascertain whether Articles 49 and 54 TFEU must be interpreted as precluding the legislation of a Member State in relation to a turnover tax where the consequence of the fact that that tax is steeply progressive is that undertakings controlled directly or indirectly by nationals of other Member States or by companies having their registered office in another Member State mainly bear the actual burden of that tax[20].

By its third question, the referring court seeks to ascertain, in essence, whether Article 401 of the VAT Directive must be interpreted as precluding the introduction of the tax established by the law on the

[18] Judgment of the Court (Grand Chamber) of 3 March 2020 *Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, Case C-323/18, EU:C:2020:140

[19] Ibid

[20] Judgment of the Court (Grand Chamber) of 3 March 2020, *Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, Case C-75/18, EU:C:2020:139

special sectors[21].

[21] Ibid

Despite the fact that both cases contain slightly different factual circumstances, the Court decides to formulate the same first question in both Tesco and Vodafone. Even more, the answers on these questions are factually the same. This fact is an additional argument that the cases should be read in conjunction and they both have equal meaning for the future. Moreover, it is important to define whether those questions appropriate for the DST disputes.

Here should be done a remark that this paper is not going to argue with the Court of Justice about a correlation between the circumstances of the cases and the questions the CJEU decided to answer. However, it is a well-known point of view that the cases give a full future indulgence for the Member States, which will imply the DST in accordance with the directive. From our perspective, the Court left enough room for maneuver as it is hard to predict how future taxable persons will react on the new provisions. Starting from the questions and the nature of the DST, it is becoming obvious that nobody, even the Court do not have any clear image how the case law about the DST will look like. If we simplify the questions in the cases even more than the Court did, we will see that the real issue of law (according to the ruling) is the lawfulness of progressive rates. And it is clear, without any CJEU positions, progressive rates are not illegal and certainly do not preclude the EU legislation. Abovementioned arguments give a basis to disagree with a position, stated by some researchers, that: "wins for Hungary would imply that challenges to digital taxes would be unsuccessful"[22].

However, there is still the second part of the question, which tell us that the tax burden falls mostly on the foreign-owned companies. This part is more relevant for the research and for the DST fate. The more concrete view on this will be described below.

[22] R. Mason "What the CJEU's Hungarian Cases Mean for Digital Taxes" SSRN database (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3550757), [last accessed on may 10]

3.2. The connection with the Hervis case.

Most of the judgement stick to the same manner of judgement as in *Hervis* case[23]. *Hervis*, an Austrian-parented company, challenged Hungary's determination of which graduated rate would apply under the special tax. Under the law, a Hungarian company had to aggregate its own turnover with the Hungarian turnover of other members of its corporate group (including foreign members) to determine its tax rate. As a result, group members were subject to higher tax rates than non-group members, an effect that the CJEU held violated the freedom of establishment. In *Hervis*, the Court of Justice established a simple majority rule: if a majority of the taxpayers subject to disadvantageous tax treatment resided in other EU Member State or were "linked" to such other-EU companies (an empirical question to be determined by the referring national court), then the challenged Member State rule would be regarded as illegally discriminatory under the fundamental freedoms[25].

In Tesco case before the Court were asked the same question as in Hervis, but the factual circumstances were different. In *Tesco*, the claimant is a Hungarian company in a UK-parented company that owns and operates all the *Tesco* stores in Hungary, which take the form of branches of the company. The difference from the *Hervis* is *Tesco* was taxed on the base of its turnover instead of the form of business[24].

[23] Judgment of the Court (Grand Chamber) of 3 March 2020, *Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, Case C-75/18, EU:C:2020:139

[24] R. Szudoczky, "Hungary: "Progressive Turnover Taxes In The Light of the EU Fundamental Freedoms and the State Aid rules", CJEU - Recent Developments in Direct Taxation 2018: Schriftenreihe IStR

The CJEU stated that the disadvantageous effect of the special tax on group companies resulted from a combination of two elements: the steeply progressive tax rate and the consolidated obligation. Domestically-owned undertakings in the retail trade were either exempt from the special tax or fell under the lowest progressive rates, due to the fact that they ran a franchise model, where the franchisees operations were the independent companies[25]. According to the provisions of the special tax, the branch foreign-controlled companies were in less favorable position.

The claimant, in the *Tesco Global*, challenges the provisions of the special tax, arguing that those rules, based on the form of business, created indirect discrimination, which is prohibited by the fundamental freedoms. It was stated by the claimant that foreign-owned companies carry much heavier tax burden than domestic taxable persons.

Another common feature of the *Tesco-Global* and *Vodafone* is that both involved the UK-based companies, which operated their businesses in Hungary through the Hungarian subsidiaries. They also made the same claim the tax violated EU law because it disproportionately impacted foreign-owned companies and thereby illegally discriminated against them. The Hungarian court that referred *Tesco-Global* to the CJEU noted that:

"All the companies that fall within the lower bands are companies which are owned by Hungarian natural persons or legal persons, and which operate within franchise systems. Conversely, the companies that fall within the highest band are, with one exception, undertakings linked to companies that have their registered office in another Member State.

[25] R. Szudoczky, "Hungary: "Progressive Turnover Taxes In The Light of the EU Fundamental Freedoms and the State Aid rules", CJEU - Recent Developments in Direct Taxation 2018: Schriftenreihe IStR

Accordingly, the companies owned by foreign natural persons or legal persons bear a disproportionate share of the burden of that tax[28].”

It was commented by Leopoldo Parada in his article “The Vodafone and Tesco Global decisions: no triumph for EU digital services tax supporters” [30] . He writes: “the inherent difficulty of establishing whether a “majority”, “vast majority”, or whatever other quantum criterion used for this purpose appears *a priori* to be insufficient, and nobody could argue against that (…) it is precisely the recognition that a quantum criterion is not sufficient to conclude that indirect discrimination exists, that raises a more important question, which is what other criteria should be considered. Unfortunately, the CJEU limited itself to confirm a long-standing obviousness without going beyond”[31]. Moreover, in the *Tesco-Global* Court declared that “the fact that the greater part of such a special tax is borne by taxable persons owned by natural persons or legal persons of other Member States cannot be such as to merit, by itself, categorisation as discrimination.”[32]

However, with all respect to the *Hervis* case and to the critics that the Tesco-Vodafone should have been ruled the same, the Court stated it

[28] Judgment of the Court (Grand Chamber) of 3 March 2020 Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, Case C-323/18, EU:C:2020:140

[29] Judgment of the Court (Grand Chamber), 5 February 2014,*Hervis Sport- és Divatkereskedelmi Kft. v Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Főigazgatósága*, C-385/12, EU:C:2014:47

[30] L. Parada “The Vodafone and Tesco Global decisions: no triumph for EU digital services tax supporters”, MNE Tax web site (https://mnetax.com/the-vodafone-and-tesco-global-decisions-no-triumph-for-eu-digital-services-tax-supporters-37883) [last accessed on 25 april]

[31] Ibid

[32] Judgment of the Court (Grand Chamber) of 3 March 2020*, Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, Case C-75/18, EU:C:2020:139

was necessary to distinguish the *Tesco-Vodafone* from the latter. The questions and circumstances in Hervis and Tesco-Vodafone are different, so despite the fact that the CJEU found some common features, it does not automatically mean that the ruling in the new cases would have been the same. Besides, it is quite often situation where the Court can change its opinion based on different circumstances or because of certain reasons. So, the perspective that the Court must have held the same ruling is not sufficient. Otherwise, the Court would have disregarded the case and considered the questions inadmissible on the basis if ruling in the *Hervis* case. For instance, in Hervis the factual circumstances touched upon 'linked' structure of companies operating business. Such companies were subjects to a special tax based on the form of the business. In tesco-Vodafone, the form of the business and a nationality of a company does not play any role. Hungarian tax does not make distinction on its basis. It is rather arguable, how the tax was designed, if the 'vast majority' of the taxable persons were freign businesses, but now we have a clear position of the Court that only quantum criterion is not enough to construe either direct or indirect discrimination.

3.3. The role of the legislative intent.

There is also a point of view that the Court, while investigating any infringements of the fundamental freedoms in this case, did not apply its usual pattern of analysis. As a rule, the Court makes tests on discrimination, proportionality and justification. The critics concerns the lack of tests on proportionality and justification. But this point of view is rather strange as the CJEU makes the full investigation only after discrimination was found and proved.

On the other hand, it is hard to disagree, that the Court of Justice did not pay any attention to the analysis of discriminatory intent. In these cases the CJEU only made a conclusion that progressive taxes were not illegal by themselves, even if the tax burden fell mostly on foreign companies. Here we can ask a question whether the Telecommunications tax is a proxy tax?

As an example, we have judgment from the *Humbolt*[33], where the Court clearly stated that the taxes cannot discriminate directly or indirectly any goods on the internal market. From our perspective, this is the issue. There is clear and understandable criteria of determining these proxies. Of course, in *Humbolt*, the Court of Justice found that France established the classification (engine sizes) 'manifestly' to protect its own car industry, and this is the example of national favoritism. However, it is not obligatory that intentional difference in treatment construes discrimination. For example, there is the *Commission v. Sweden*[34] case, where the subject matter was Swedish progressive tax on alcohol. The Commission decided that differences in rates on wine and beer construed discrimination of wine traders in Sweden. However, the Court supported Swedish government and ruled it was not discrimination on the basis of analysis of consumers behavior and market analysis. Is intentional criterion applicable in the present case? Advocate General Kokott gives an answer on this question:

- In broad terms, the parliamentary debate concerned the problem whereby large multinational groups are able to minimise their profits in Hungary with the result that the tax burden falls mainly to small and medium-sized undertakings, a situation which the Law on the special tax is intended to prevent to some extent. The primary focus was on multinational undertakings whose tax practices were also one of the main reasons for the BEPS debate. As is shown by a further statistic provided to the Court, in 2010, of the 10 undertakings in Hungary with the highest turnovers, only half paid corporate tax. Undertakings owned both by Hungarian nationals and by nationals from other EU countries are affected. Making a link to turnover could certainly attempt to remedy this situation. This is also consistent with the approach taken by the Commission in the planned EU-wide digital services tax. That tax

[33] Judgment of the Court of 9 May 1985, Michel Humblot v Directeur des services fiscaux. C-112/84, EU:C:1985:185
[34] Judgment of the Court (Grand Chamber) of 8 April 2008, *Commission of the European Communities v Kingdom of Sweden*, C-167/05, EU:C:2008:202

too is an attempt to obtain a greater contribution to public costs from multinational undertakings (in that case primarily from certain non-member countries) if they generate profits within the EU which are not, however, subject to income tax there. This cannot form a basis for an allegation of an abuse of rights against Hungary;[35]

- In particular, the Commission relies only on statements made by three members of parliament in the parliamentary debate and on extracts from government documents. This too would appear to be an insufficient basis for an allegation of an abuse of rights against a Member State. If statements made in a parliamentary debate were sufficient, it would be possible for the opposition (or even a single member of parliament) to thwart any decision by the legislature by making a suitable statement;[36]
- Since the government is normally bound by the parliament's decision, and not vice versa, I also have reservations over having regard to individual government documents. Greater importance is attached to the official (legal) explanatory memorandum and not the merely political reasons given to voters for the content of legislation. It is not clear from the former, however, that that tax was aimed primarily at imposing taxation on nationals from other EU countries[37].

The main arguments to pay attention to in these paragraphs are:

- The tax is not intentionally discriminatory;
- The imposing of the tax was an attempt to comply with the Commissions requirements;
- The imposing of the tax was an attempt to collect money from the corporations which did not pay any taxes;
- Nationals are liable to pay the same tax as well as foreign-owned companies;
- There is no abuse of rights.

[35] Opinion of Advocate General Kokott, delivered on 4 July 2019, Tesco-Global Áruházak Zrt. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, EU:C:2019:567
[36] Ibid
[37] Ibid

To conclude with the factual analysis of the judgement it is necessary to say that the ruling is not ground-laying for future discrimination under the DST disputes. There is a number of white spots and analogy of the Hungarian tax and the DST is not that precise. Factually, after the release of the judgement we know that progressive tax rates on turnover for foreign-owned undertakings are not illegal in themselves, especially in the case of Hungarian Telecommunications tax. Are there so much similarities with the DST? The author is rather sure that the Court will be asked to investigate the comparability of situations where under the dispute will be, for instance, European divisions of US-parented digital companies, which carry out business wholly on the Internet, and Spotify ltd, which is wholly European national, operating business on the Internet, to be subject to the DST under these criteria (selling advertisement online, selling premium subscription, collecting users data), but, on the other hand, it has much lower annual turnover, allowing to do under the DST threshold.

Moreover, it is irrelevant to argue that it would EU-subsidiaries which are targeted by the DST. Although, it is forbidden by the fundamental freedoms to preclude the free trade on the internal market, these are not EU-nationals, which are targeted by the tax. That is why the Commission does not use local criteria on turnover. It uses global amount of revenue, so that the tax does not hit EU-nationals and it does not preclude free trade by levying additional tax burden on EU-subsidiaries of the DST payers. And this is the main difference between

3.4. Another side of the cases. Do they solve a question of the State Aid relating to the DST.

Despite the fact that the Court decided the State Aid questions inadmissible in both cases, it is still necessary to analyze this side of the judgment. It is necessary to determine whether the State Aid questions, regarding the DST, will be treated the same as in *Tesco-Vodafone*.

It is interesting that in this case the referring court asked both questions on the infringement of fundamental freedoms and the State Aid. Both have very common legal nature. Those rules target unjustified treatment of objectively comparable situations[39]. The State Aid rules are created in order to eliminate any distortions of competition. It is worth mentioning that if a certain provision of the law gives an ulawful sectoral advantage to the domestic-owned companies, it, on the one hand, infringes fundamental freedoms, and on the other, goes against the State Aid prohibition at the same time. The issue is it can raise a conflict of remedies in such situation.

Particularly in *Tesco-Vodafone* the question, concerning the State aid was whether the distinction between low-turnover and high-turnover enterprises – in terms of being subject to different effective tax rates due to the progressive rate structure of the tax – constitutes State aid granted to low-turnover enterprises[40].

[38] Judgment of the Court (Grand Chamber), 5 February 2014,*Hervis Sport- és Divatkereskedelmi Kft. v Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Főigazgatósága*, C-385/12, EU:C:2014:47

[39] CJEU, 21 December 2016, C-20/15 P and C-21/15 Commission v. World Duty Free Group EU:C:2016:981

[40] R. Szudoczky, "Hungary: "Progressive Turnover Taxes In The Light of the EU Fundamental Freedoms and the State Aid rules", CJEU - Recent Developments in Direct Taxation 2018: Schriftenreihe IStR

As it was stated before, the Court of Justice, found the whole State aid issue in these cases inadmissible. Questioning the admissibility of the issue, it highlighted the complementary competence of the Commission and the national courts in respect of the State aid control: the former is exclusively entitled to decide on the compatibility of an aid measure with the internal market (subject to the review of the CJEU), while the latter has to safeguard the rights of individuals affected by an aid that has been granted in breach of Article 108 (3) of TFEU ('standstill clause'), i.e. without the notification of the Commission of the aid or before the final decision of the Commission is made. This provision has direct effect[41].

The issue of the DST and the State Aid, in respect of the Hungarian cases, is that it does more or less the same thing. For instance. The DST excludes EU-nationals from the paying the new tax. The Hungarian telecommunications tax, according to the ruling, did not make that distinction.

Also, the additional point why the Court decided the State Aid inadmissible is that the investigation of the infringement of the fundamental freedoms and prohibition of the State Aid should be done in relatively the same manner. So future litigations, concerning, the DST should ask ether the question on the fundamental freedoms or the State Aid.

3.5. Do the cases really solve the DST issue?

At the current state Tesco-Vodafone are not the cases which really approve or ruin the DST measures. First of all, the Court of Justice took a convenient position in answering the questions focusing on the progressive rates. Also, it is obvious that only the vast majority of companies does not create a selectivity, which was described above.

Also, it is impossible to conclude that the DST shall preclude free trade within the European Union. The tax is not paid exactly on some physical goods or services and this is why it raises so many issues. This is a new reality when companies can create value, so to speak, from the

air. And that is why it is very hard to find a common solution of how to allocate the taxing rights in this sphere due to huge amounts of value created “out of nowhere”. There are a lot of ideas and proposed means of taxing the digital economy and the content of the DST directive is simply not enough to reflect all the means of making money such as cloud computing, streaming etc., which is only available on the Internet.

Nevertheless, it should be understood that the whole idea of the DST is not only on taking money from the corporation which “underpay” the taxes. The idea is to help with finding possible common nexus and come to a “unified approach”. The idea of taxing the digital services is to bring the Internet operations out of the grey zone.

The problem which seems to be more significant is how to comply all of the unilateral taxes with the DTTs? It is obviously not the issue Tesco-Vodafone pays attention to.

Moreover, as it was stated before, the discrimination of the foreigners under the DST is not prohibited under the EU legislation. The DST can draw special attention under the WTO law and it is yet another reason to come to a new nexus as soon as possible. As any litigations concerning the legality of the tax in respect of the international law can only postpone the adoption of the upcoming tax reform.

However, in the case of the DST and the process of adopting unilateral DSTs all across the European Union, it became clear that the MSs are ready to change the current

4. Conclusions.

The Tesco-Vodafone cases show us, indeed, that it will be impossible to challenge the DST on the questions of infringement of the fundamental freedoms or the State Aid on the same factual circumstances as it was made regarding the Hungarian telecommunications tax. Firstly, the DST is not a progressive tax and

[41] R. Szudoczky, "To Admit, or Not to Admit, That Is the Question – The CJEU's Controversial Stance on the Admissibility of State Aid Questions in Preliminary Ruling Procedures", Kluwer International Tax Blog (http://kluwertaxblog.com/2020/03/31/to-admit-or-not-to-admit-that-is-the-question-the-cjeus-controversial-stance-on-the-admissibility-of-state-aid-questions-in-preliminary-ruling-procedures/?doing_wp_cron=1590241750.8763570785522460937500) [last accessed may 20]

the progressivity was at question. Secondly, the referring court asked about imposition of heavier tax burden of the foreign-owned undertakings and the answer was that the seat of a company does not play any role, in regard of a special tax. Thirdly, the State Aid question was inadmissible according to the Court. All these similarities can lead to an obvious conclusion that the DST litigations in future would suffer the same fate. But it is rather misleading conclusion as the imposition of the DST has a number of other problems. There is still a fundamental question of reworking the Permanent Establishment concept regarding the digital economy. There should be done amendments in the OECD Model Tax Convention about the introducing the SDP concept to the international tax law. Moreover, the Digital Service Tax is still an interim measure before the global tax reform, which will be developed in future.

So to conclude, the judgment of the Tesco-Vodafone, while being relevant, still gives significant opportunities in future, as we still do not know the real practice of levying the DST. The Court left enough room for maneuver and the author is sure that we will have to deal with the bigger issues concerning the digital economy challenges.

However, in the case of the DST and the process of adopting unilateral DSTs all across the European Union, it became clear that the MSs are ready to change the current international taxation system. Also, the lack of the real progress in updating the international tax rules to correspond the challenges of the digital economy.

Another reason why the Tesco-Vodafone judgement is not enough to give the clear understanding the future of challenging of the DST is that the role of the legislative intent was not really touched by the CJEU.

It seems, that from the perspective of discrimination on the basis of the form of business, the Hervis case can become significantly more relevant and defend exactly foreign group-companies. In author's opinion, the future litigations will touch upon more concrete issues such as calculating of the sum to be paid or the process of value creation.

But, it is still should not be excluded that the problem can be seen from the another perspective, and other sides such as deeper investigation of the legal intent would have much greater meaning.

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