Tax and the Digital Economy

Challenges and Proposals for Reform

Edited by

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Georg Kofler & Julia Sinnig[*]

§6.01 INTRODUCTION AND BACKGROUND

[A] Tax Challenges of the Digital Economy

In the 'Rome Declaration' of March 2017, twenty-seven of the Member States of the European Union (EU), the Council of the European Union (EU Council), the European Parliament (EU Parliament), and the European Commission (EU Commission) pledged to work toward 'embracing technological transformation', such a transformation being an essential element for ensuring a prosperous and sustainable future.[1] Indeed, technological transformation and digitalization profoundly affect a great many of society's elements – jobs, industries, education, and social welfare systems.[2] However, they also create challenges for existing tax systems.

The new business models of the so-called digital economy are based on modern information and communication technologies and the exploitation of large amounts of data, which frequently blur the lines between goods and services and vary widely in their approach, form, impact, and monetization (e.g., online retailers, social media

* This chapter was finalized in November 2018 and, with minor differences, was previously published in 47 Intertax 176–200 (2019).

1. EU Council Press Release, *Declaration of the Leaders of 27 Member States and of the European Council, the European Parliament and the European Commission*, 25 March 2017, consilium.europa.eu, http://www.consilium.europa.eu/en/press/press-releases/2017/03/25/rome-declaration/ (accessed 12 November 2018).
2. For an instructive analysis, *see, e.g.*, OECD, *Measuring the Digital Economy – A New Perspective* (OECD Publishing 2014).

platforms, subscriptions to digital services, and collaborative platforms[3]). Nevertheless, they have a common view that value creation is largely decentralized and decoupled from a 'physical presence'. Especially in times of intensifying international tax competition, those new business models reveal possible weaknesses in the current international direct tax framework, which was originally designed for 'brick and mortar' businesses and still largely relies on physical presence as a threshold for the international allocation of taxing rights. Thus, it comes as no surprise that such weaknesses have entered the limelight of international policy discussions.[4]

Recently, the United States (US) Supreme Court, in *South Dakota* v *Wayfair, Inc.*,[5] added fuel to that discussion by abandoning its long-standing physical presence test under its Commerce Clause case law. Overruling its prior line of reasoning regarding an out-of-state seller's obligation to collect and remit sales tax, which culminated in its 1992 *Quill Corp.* v *North Dakota* opinion,[6] the Court found that a US State could oblige out-of-state sellers with no physical presence in that State to collect and remit sales taxes on goods the seller ships to consumers in that State. Although addressing a sales tax question, the Court's finding that a 'substantial nexus' to a particular State does not depend on its physical presence therein could be extended to political and policy considerations related to the broader, direct tax challenges posed by the digital economy.[7]

Policymakers, including EU policymakers, struggle to 'find solutions which would ensure fair and effective taxation as the digital transformation of the economy

3. For the EU's fundamentally positive approach to the sharing economy, *see, e.g.*, Giorgio Beretta, *The European Agenda for the Collaborative Economy and Taxation*, 56 Eur. Tax'n 400 et seq. (2016).
4. For a general analysis of policy options, *see, e.g.,* Michael Devereux & John Vella, *Implications of Digitalization for International Corporate Tax Reform*, 46 Intertax 550 (2018). *See also* the authors' earlier contributions to that discussion: Georg Kofler, Gunter Mayr & Christoph Schlager, *Digitalisierung und Betriebsstättenkonzept*, 36 RdW 369 (2017); Georg Kofler, Gunter Mayr & Christoph Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?*, 57 Eur. Tax'n 523 (2017); Georg Kofler, Gunter Mayr & Christoph Schlager, *Taxation of the Digital Economy: A Pragmatic Approach to Short-Term Measures*, 58 Eur. Tax'n 123 (2018); Daniela Hohenwarter, Georg Kofler, Gunter Mayr & Julia Sinnig, *Qualification of the Digital Services Tax Under Tax Treaties*, 47 Intertax 140 (2019); Julia Sinnig, *The Reflection of Data-Driven Value Creation in the 2018 OECD and EU Proposals*, 27 EC Tax Rev. 325 (2018); Jens Schmittmann & Julia Sinnig, *Aktuelle Entwicklungen im Steuerrecht in der Informationstechnologie 2017/2018 – Teil 1*, 22 Kommunikation & Recht 88 (2019); Julia Sinnig, *Die steuerrechtlichen Herausforderungen der digitalen Wirtschaft – Was passiert in Europa?, in Tagungsband Herbstakademie 2017: Recht 4.0 – Innovationen aus den rechtswissenschaftlichen Laboren* 903, 915 (Jürgen Taeger ed., OlWIR 2017); Julia Sinnig, *Besteuerung der digitalen Wirtschaft in Großbritannien, Italien und Ungarn – ein europäischer Rechtsvergleich*, 6 ISR 408 (2017); Julia Sinnig, *Tax and the Digital Economy – Bericht zur Konferenz vom 20.4.2018, Universität Luxemburg*, 7 ISR 225 (2018). Parts of this contribution are based on these earlier works.
5. *S.D.* v *Wayfair, Inc.*, No. 17-494, 585 U.S. ___ (2018).
6. *Quill Corp.* v *N.D.*, 504 U.S. 298 (1992).
7. Compare Reuven S. Avi-Yonah, *Designing a 21st Century Taxing Threshold: Some International Implications of* South Dakota vs. Wayfair (Univ. of Mich. Public L. Res. Paper No. 611, 2018), *available at* https://ssrn.com/abstract=3201418 (accessed 12 November 2018) (arguing broader implications) with Ruth Mason, *Implications of Wayfair*, 46 Intertax 810 (2018) (arguing for a more cautious reading of *Wayfair* with regard to direct taxation).

accelerates'.[8] They argue that nothing less than global '[economic] efficiency is at stake, as well as tax fairness and sovereignty'.[9] Thus, debates regarding the 'fitness' or 'outdatedness' of the current international tax system in the digital age substantially overlap discussions regarding the tax avoidance and aggressive tax planning practices of well-known technology corporations.[10] Such discussions, as well as the perceived global 'undertaxation' of digital business models,[11] however, should not inform the policy decisions lying ahead, as the economy as a whole has been, and will continue to be, digitalized: reports from the Organisation for Economic Co-operation and Development (OECD) and the EU have impressively outlined the various new business models, their growth, their size, and their impact on the global economy, as well as the differences in tax burden between companies that offer classic cross-border physical services and companies that offer digital ones.[12] Given the increasingly pervasive nature of digitalization, however, it might be difficult, if not impossible, to 'ring-fence' the digital economy from the rest of the economy for tax purposes.[13] Indeed, attempts to single out the digital economy always raise a question as to whether they comply with the established so-called Ottawa Taxation Framework, according to which, *inter alia*, '[t]axation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce'.[14] While

8. EU Comm'n, *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,* COM(2017) 547 final, 2 (hereinafter '2017 EU Comm'n Comm. on Fair/Efficient Tax').
9. *Political Statement–Joint Initiative on the Taxation of Companies Operating in the Digital Economy* (9 September 2017), *available at* http://www.mef.gov.it/inevidenza/banner/170907_joint_initiative_digital_taxation.pdf, which has originally been signed by France, Germany, Italy and Spain and to which six more Member States – Austria Bulgaria, Greece, Portugal, Romania and Slovenia – have acceded (hereinafter 'Political Statement–Joint Initiative').
10. *See, e.g.,* the State aid procedure against Ireland with regard to purported tax benefits for Apple Inc. in Eur. Comm'n Press Release, *State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to €13 Billion*, *available at* http://europa.eu/rapid/press-release_IP-16-2923_en.htm (accessed 12 November 2018) and the pending cases *Ireland* v *Comm'n*, T-778/16, Action for annulment and *Apple Sales Int'l* v *Comm'n*, T-892/16, Action for annulment.
11. For an in-depth discussion of the worldwide level of taxation of digital businesses and the argument that the picture drawn in public debate is misleading, as there is no systemic difference in income taxes paid by digital corporations compared to their traditional peers, *see* Matthias Bauer, *Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions* (ECIPE Working Paper No. 3, 2018), *available at* http://ecipe.org//app/uploads/2018/02/ECI_18_OccasionalPaper_Taxing_3_2018_LY08.pdf.
12. *See, e.g.,* Eur. Comm'n, *Report of the Commission Expert Group on Taxation of the Digital Economy* (Eur. Union 28 May 2014); OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report* (OECD Publishing 2015) (hereinafter '2015 OECD BEPS Action 1 Report'), and OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS* (OECD Publishing 2018) (hereinafter '2018 OECD Interim Report'); 2017 EU Comm'n Comm. on Fair/Efficient Tax, *supra* note 8. Impressively, in 2017, for example, nine out of the top twenty companies by market capitalization were technology companies, with Apple, Alphabet, Microsoft, and Amazon taking the first four spots (compared with only one technology company, Microsoft, was in the top twenty in 2006), and between 2008 and 2016 revenue of the top five e-commerce retailers grew 32% per year on average (compared with a 1% annual growth of the entire EU retail sector). *See, e.g.,* 2017 EU Comm'n Comm. on Fair/Efficient Tax, *supra* note 8 at 4.
13. 2015 OECD BEPS Action 1 Report, *supra* note 12, paras 115 & 364.
14. OECD Committee on Fiscal Affairs, *A Borderless World: Realising the Potential of Electronic Commerce* (OECD 1998) (hereinafter '1998 OECD Electronic Commerce Potential Report'); *see*

some argue that specific taxation based on digital presence would not give rise, per se, to an infringement of the neutrality principle,[15] others take the opposing view.[16] Apart from those direct and indirect tax challenges, the new business models also raise a number of additional tax issues connected with mobility and dematerialization, among them the potential to decrease the States' ability to collect revenues from payroll taxes, environmental taxes, real property taxes, and wealth taxes.

The current international tax framework – even after the modifications by the OECD Base Erosion and Profit Shifting (BEPS) project[17] – still puts emphasis on physical presence in the form of a permanent establishment (PE) in the source country as a nexus-defining criterion (*see, e.g.,* Article 5 OECD Model[18]). While that concept has generally proven successful for reasons of (relative) clarity, certainty, and enforcement, the prevalence of the digital economy has certainly triggered the question if an expansion or reconsideration of this traditional concept or, perhaps, even some other form of source taxation is warranted. Indeed, many States take the position that traditional approaches largely fail in levying a (presumed) adequate level of tax on the digital economy and, further, that neither the OECD BEPS project nor the EU Anti-Tax Avoidance Directive (ATAD)[19] addresses that issue comprehensively. While some of

also 2015 OECD BEPS Action 1 Report, *supra* note 12; para. 7, with an overview of the subsequent developments in appendix A.

15. *See, e.g.,* Peter Hongler & Pasquale Pistone, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy* 41 et seq. (IBFD White Paper, Working Paper, 2015), *available at* https://www.ibfd.org/sites/ibfd.org/files/content/pdf/Redefining_the_PE_concept-whitepaper.pdf.
16. *For example*, AmCham EU, *in* OECD, *Comments Received on Public Discussion Draft: BEPS Action 1: Address the Tax Challenges of the Digital Economy* 3 (OECD Publishing 2014).
17. Action 7 of the OECD BEPS project (OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 – 2015 Final Report* (OECD Publishing 2015)) regarding the artificial avoidance of PEs relates to the definition of 'PE' (particularly with respect to commissionaire structures and warehouses), barely touches on the basic structural problems: To be sure, it lowers the threshold – under treaty law – from which the source country can start taxing business profits (*see also* Arts 12–15 of the Multilateral Instrument) (*see* OECD, Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, oecd.org, http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (accessed 12 November 2018)). However, this does not address the basic question of business models under which the company needs no physical presence in the country in which sales are made, contractual relationships arise without the involvement of personnel, value is created (e.g., through advertising) based on uncompensated user contributions (particularly in 'multi-sided' business models) or by collecting and exploiting data (especially user data). *See also* Lisa Spinosa & Vikram Chand, *A Long-Term Solution for Taxing Digitalized Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Right Mechanism?*, 46 Intertax 476 (2018).
18. OECD, *OECD Model Tax Convention on Income and on Capital (Condensed Version)* (OECD Publishing 2017) (hereinafter 'OECD Model'). The OECD Model includes, among other things, article-specific commentaries, and for the purposes of this chapter, said commentaries will be referred to as the 'OECD Model Commentary' (if not referring to specific articles) or the 'OECD Model Comm. on Art. [*X*] [the relevant article]' together with the relevant paragraphs thereof, as appropriate.
19. Council Directive 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193/1 (2016), as amended by Council Directive 2017/952 as regards hybrid mismatches with third countries OJ L 144/1 (2017) (hereinafter 'ATAD').

those challenges may be addressed, at least in part, by adjustments to or refinements of the transfer pricing framework and approaches to profit allocation in general,[20] a broader policy debate remains.

There is a visible and increasing trend in political and technical discussions to operationalize the so-called utility theory or to view income taxation as being connected more to the demand component of the market jurisdiction and less with the supply component of the residence jurisdiction,[21] as is, for example, evidenced by the existing broad discussion of a destination-based corporate tax (focusing on the customer's residence)[22] and the introduction of a new distributive rule for fees for technical services in the 2017 update of the United Nation's Model.[23] Indeed, the lines between the objects of income taxation and those of consumption taxation might become increasingly blurred. As one of the largest potential challenges facing national and international taxation, ideas and viewpoints on those issues are abundant[24] and its political momentum has become enormous over the last few years.

20. Marcel Olbert & Christoph Spengel, *International Taxation in the Digital Economy: Challenge Accepted?*, 9 World Tax J. 3 (2017).
21. Hongler & Pistone, *supra* note 15, at 15 et seq.
22. *For example*, Alan Auerbach et al., *Destination-Based Cash Flow Taxation* (Oxford Univ. Centre for Bus. Tax'n, Working Paper No. 17/01, 2017); *see also Commission Expert Group on Taxation of the Digital Economy*, *supra* note 12 at 50.
23. United Nations, *United Nations Model Double Taxation Convention Between Developed and Developing Countries: 2017 Update* 1, 322 et seq. Art. 12A (New York, 2018). For further discussion on the topic, *see, e.g.*, Franziska Sixdorf & Sebastian Leitsch, *Taxation of Technical Services Under New Article 12A of the UN Model – Improved Taxation or a Step in the Wrong Direction?*, 57 Eur. Tax'n 234 (2017).
24. For more recent discussions in literature, *see* the contributions in this volume and, e.g., Walter Hellerstein, *Jurisdiction to Tax in the Digital Economy: Permanent and Other Establishments*, 67 Bull. Int'l Tax'n 346 (2013); Hongler & Pistone, *supra* note 15; Yariv Brauner & Andres Baez, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy* (IBFD 2015); Daniel Blum, *Permanent Establishments and Action 1 on the Digital Economy of the OECD Base Erosion and Profit Shifting Initiative – The Nexus Criterion Redefined?*, 69 Bull. Int'l Tax'n 314 (2015); Eva Escribano Lopez, *An Opportunistic, and yet Appropriate, Revision of the Source Threshold for the Twenty-First Century Tax Treaties*, 43 Intertax 6 (2015); Olbert & Spengel, *supra* note 20; Kofler, Mayr & Schlager, *Digitalisierung und Betriebsstättenkonzept, supra* note 4; Claus Staringer, *Virtual? Reality!*, 27 SWI 341 (2017); Kofler, Mayr & Schlager, *Taxation of the Digital Economy: A Pragmatic Approach to Short-Term Measures*, *supra* note 4; Sinnig, *The Reflection of Data-Driven Value Creation in the 2018 OECD and EU Proposals*, *supra* note 4; Wolfgang Schön, *Ten Questions About Why and How to Tax the Digitalized Economy*, 72 BIT 278 (2018); Johanna Hey, *'Taxation Where Value Is Created' and the OECD/G20 Base Erosion and Profit Shifting Initiative*, 72 BIT 203 (2018); Stephan Eilers & Florian Oppel, *Die Besteuerung der digitalen Wirtschaft: Trends und Diskussionen*, 27 IStR 361 (2018); Lee Sheppard, *Digital Permanent Establishment and Digital Equalization Taxes*, 72 Bull Int'l Tax'n (2018); Barry Larking, *A Review of Comments on the Tax Challenges of the Digital Economy*, 72 Bull Int'l Tax'n (2018); Spinosa, *supra* note 17; Alessandro Turina, *Which 'Source Taxation' for the Digital Economy?*, 46 Intertax 495 (2018); Devereux & Vella, *supra* note 4; Ana Paula Dourado, *Digital Taxation Opens the Pandora Box: The OECD Interim Report and European Commission Proposals*, 46 Intertax 565 (2018).

[B] Potential Approaches: OECD and EU

As exemplified by the various business models in the digitalized economy (e.g., online retailing and Internet advertising) and the different modes of value creation (i.e., chain, network, and shop),[25] any attempt to redefine nexus (from the perspective of domestic law as well as from tax treaty law) will, of course, face the question of what intensity of domestic value creation or market participation must exist to conclude that taxation in the non-residence State is justified, with the latter being, for example, the State of consumption, the State of users' residence or, perhaps more generally, the destination or 'market' State.[26] Hence, if profits should be taxed 'where value is created',[27] one needs to identify what that value is and how to measure it, before deciding where it was created. This is already a troublesome endeavour.[28] The OECD addressed a number of these points most recently in its 2015 OECD BEPS Action 1 Report[29] – particularly with regard to the concept of a 'significant digital presence (SDP)'. That report discusses three possibilities to cover 'digital added value' based on the characteristic challenges of the digital economy:

(1) conceptualizing a 'significant economic presence' as a threshold for source taxation;[30]
(2) creating a withholding tax for digital transactions (i.e., on payments by residents and local PEs of a country for goods and services purchased online from non-resident providers);[31] or
(3) introducing 'equalization taxes or levies' in order to ensure equal treatment of foreign and domestic suppliers.[32]

However, the OECD did not issue a recommendation for any such measure[33] but rather left it to the States to take unilateral measures if treaty law obligations are met

25. For comprehensive analysis, *see* 2018 OECD Interim Report, *supra* note 12, paras 30 et seq.
26. It must be pointed out that the traditional notion of 'source country' does not necessarily coincide with the concept of 'market country' as discussed in the context of the digitalized economy. First, the notion of source country is generally used when a taxpayer has established a presence which goes beyond the supply of goods and services, whereas the market country might be the mere country of destination, consumption or users' residence (*see, e.g.*, Schön, *supra* note 24 at 288–289). Second, even when a traditional source country is present (e.g., because of a PE in that State), it does not necessarily mean that this is also the 'market' State (e.g., because the PE deals with customers in yet other countries).
27. Which alone seems to be a new concept in international tax law. *See, e.g.,* Hey, *supra* note 24, at 203; Schön, *supra* note 24, at 280.
28. *See, e.g.,* Hey, *supra* note 24.
29. *See also* the OECD's extensive analysis in the Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits, *Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce? – Final Report* (June 2004).
30. 2015 OECD BEPS Action 1 Report, *supra* note 12, paras 277 et seq.
31. *Ibid.* paras 292 et seq.
32. *Ibid.* paras 302 et seq.
33. This non-recommendation was based on a number of reasons: First, that certain BEPS measures will mitigate some aspects of the broader tax challenges, and that consumption taxes will be levied effectively in the market country, and, second, that all discussed options would require substantial changes to key international tax standards and would require further work. *See* 2015

(usually, they would not be met in cases involving 'virtual' PEs and withholding taxes for digital transactions). Nevertheless, the potential options identified in the 2015 OECD BEPS Action 1 Report dominate the current discussion,[34] and some jurisdictions have already taken unilateral action.[35] However, also the 2018 OECD Interim Report on 'Tax Challenges Arising from Digitalisation' clearly showed that there is no international consensus on either the merit or need of such measures.[36] While the existence of three frequently observed characteristics of digitalized businesses – (1) cross-jurisdictional scale without mass, (2) reliance on intangible assets (including intellectual property), and (3) the relevance of data, user participation, and their synergies with intellectual property – is generally acknowledged, 'there is no consensus on their relevance and importance to the location of value creation and the identity of the value creator'.[37] Indeed, the need for a new or restructured international tax regime is also a heavily discussed topic in legal and economic scholarship.[38]

That difference in perspective is clearly demonstrated in the 2018 OECD Interim Report, according to which the more than 110 countries in the Inclusive Framework can be largely divided into three groups:[39]

– The first group of countries share the view that, taken together, some characteristics frequently observed in certain highly digitalized business models – in particular, reliance on data and user participation – may lead to misalignments between the location in which profits are taxed and the location in which value is created; being generally supportive of the broad principles underpinning the existing international tax framework, these challenges are, according to that group, confined to certain business models and may be addressed through targeted changes to the existing tax rules, including a reconsideration of the rules relating to profit allocation and nexus.

OECD BEPS Action 1 Report, *supra* note 12, at 13 & paras 243 et seq. & para. 357, also noting that '[c]ountries could, however, introduce any of these three options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties'.

34. *See, e.g.,* Turina, *supra* note 24.
35. *See* §6.01[C] *infra*.
36. 2018 OECD Interim Report, *supra* note 12; for brief analyses, *see, e.g.,* Eilers & Oppel, *supra* note 24; Dourado, *supra* note 24.
37. 2018 OECD Interim Report, *supra* note 12, para. 36.
38. For a generally critical position, *see, e.g.,* Schön, *supra* note 24. For critical assessments of equalization levies, compare, e.g., Johannes Becker & Joachim Englisch, *EU Digital Services Tax: A Populist and Flawed Proposal*, kluwertaxblog.com, http://kluwertaxblog.com/2018/03/16/eu-digital-services-tax-populist-flawed-proposal/ (accessed 12 November 2018); Fred van Horzen & Andy van Esdonk, *Proposed 3% Digital Services Tax*, 25 Int'l Transfer Pricing J. 267 et seq. (2018). For a rather positive view, *see,* however, Dourado, *supra* note 24, at 565, 568 et seq. For a defence of the DST as a tax on location-specific rent earned by digital platforms, see W. Cui, *The Digital Services Tax: A Conceptual Defense* (26 October 2018), *available at* SSRN: https://ssrn.com/abstract=3273641 (accessed 12 November 2018).
39. 2018 OECD Interim Report, *supra* note 12, paras 388 et seq.

- The second group of countries take the view that the ongoing digital transformation of the economy and, more generally, trends associated with globalization present challenges to the continued effectiveness of the existing international tax framework for business profits, with these challenges not being exclusive or specific to highly digitalized business models; those challenges relate to the allocation of profits as well as the nexus issue.
- The third group of countries consider that the BEPS package has largely addressed the concerns of double non-taxation, although these countries also highlight that it is still too early to fully assess the impact of all the BEPS measures; these countries are generally satisfied with the existing tax system and do not currently see the need for any significant reform of the international tax rules.

Against this background, the EU has started along a progressive path on the issues. The 2014 report of the Commission Expert Group on Taxation of the Digital Economy advocated for improvement in the tax environment for young, innovative (especially digital) companies while simultaneously speaking out against a new concept of 'digital taxable presence',[40] and the call for new taxation approaches to the digital economy has gained enormous political momentum in the last years: the Estonian Presidency put digital economy tax issues at the forefront of its tax agenda and Austria while initially pushing for the introduction of a digital PE concept[41] followed the conclusion of the EEconomic and Financial Affairs Council (ECOFIN) ministers to pursue the Digital Services Tax (DST) in a first phase during its Presidency in the second half of 2018.[42]

The European Parliament also exercises significant political pressure of taxing digitalized business models.[43] In the Fall of 2017, France, Germany, Italy, and Spain called for the introduction of an equalization levy based on the turnover generated in Europe by digital companies as a 'quick fix' (without ruling out other long-term solutions),[44] and six more Member States joined that call at the informal ECOFIN meeting held in Tallinn on 16 September 2017.[45] At that meeting, some Member States

40. *See Commission Expert Group on Taxation of the Digital Economy*, *supra* note 12, at 47, noting that it had 'extensively considered this question and has come to the conclusion that there is currently no valid justification for such a fundamental change specifically for digital activities', and rather recommending to counter revenue concerns through the VAT system.
41. *See* Austrian Presidency of the Council of the European Union, *Programme of the Austrian Presidency*, 8; Bundesministerium für Finanzen, *Schelling-Plan zur Schließung der internationalen Steuerflucht-Routen: Europäische und internationale Maßnahmen zur Vermeidung von Gewinnverschiebungen und des internationalen Steuerbetruges* (BMF 2017) & for critical analysis, *see* Staringer, *supra* note, 24, 341 et seq.
42. *See* para. 5 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018).
43. *See, e.g.,* Paul Tang & Henri Bussink, *EU Tax Revenue Loss from Google and Facebook* (September 2017), https://static.financieel-management.nl/documents/16690/EU-Tax-Revenue-Loss-from-Google-and-Facebook.pdf (accessed 12 November 2018).
44. *See* Political Statement–Joint Initiative, *supra* note 9.
45. These are Austria, Bulgaria, Greece, Portugal, Romania & Slovenia.

expressed strong opposition to, and concerns about, changing the tax framework for the digital economy while other Member States argued for a comprehensive and robust approach to taxation of the digital economy, one based on the time-tested rules of the current international corporate tax framework.[46] That would require a (general) recalibration of the nexus required for the source State to tax and would also entail a modification of the PE concept (and the rules of attributing profits reflecting the value created) as an amendment to the established international tax framework.[47] Such a 'digital business establishment' could (also) be included in the Common (Consolidated) Corporate Tax Base (C(C)CTB);[48] in early 2018, the EU Parliament had already put concrete proposals forward for its inclusion in the CCCTB[49] as well as for a needed revision of Article 5 OECD Model,[50] including an approach that weighs the collection and exploitation of data (data factor) in the CCCTB's apportionment formula.[51]

In September 2017, the Commission issued a Communication on 'A Fair and Efficient Tax System in the European Union for the Digital Single Market',[52] discussing background issues, objectives, and – on a rather abstract level – various options for both the long and short term. The Commission ultimately called 'for a strong and ambitious EU position on taxing the digital economy',[53] which would either feed into ongoing international work or occur within the EU Single Market. The Commission, however, raised two important questions:

– First, the question of nexus – that is, 'how to establish and protect taxing rights in a country where businesses can provide services digitally with little or no physical presence despite having a commercial presence' (i.e., 'where to tax?').[54]

46. Presidency Issues Note for the informal ECOFIN Tallinn, 16 September 2017 – Discussion on corporate taxation challenges of the digital economy, paras 10 et seq., eu2017.ee, https://www.eu2017.ee/political-meetings/ecofin (accessed 12 November 2018).
47. *See* the Estonian Presidency, *EU Finance Ministers Agreed to Develop New Digital Taxation rules* (16 September 2017), noting that 'Estonia is of the opinion that when bringing the tax rules up to date, it is important to abandon the requirement that companies have to be physically present in a country or own assets there, and replace this with the concept of a virtual permanent establishment'.
48. Eur. Comm'n, Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685; Eur. Comm'n, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2016) 683.
49. Eur. Parliament Committee on Economic and Monetary Affairs, Draft Report on the proposal for a Council directive on a Common Corporate Tax Base (COM(2016)0685 – C8-0472/2016 – 2016/0337(CNS)), Amendments 9, 19, 36, 37 & 38 (13 July 2017); Committee on Legal Affairs, Opinion for the Committee on Economic and Monetary Affairs on the proposal for a Council directive on a Common Corporate Tax Base (PE 602.948v03-00) Amendments 6, 12, 15, 16, 19, 26 (19 September 2017); and the amendments in the European Parliament legislative resolution of 15 March 2018 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB), P8_TA(2018)0087 (hereinafter '2018 EU Parliament CCCTB Resolution').
50. *See* Tang, *supra* note 43, at 11.
51. 2018 EU Parliament CCCTB Resolution, *supra* note 49.
52. 2017 EU Comm'n Comm. on Fair/Efficient Tax, *supra* note 8.
53. *Ibid.* at 10.
54. *Ibid.* at 7.

– Second, the question of value creation – that is, 'how to attribute profit in new digitalized business models driven by intangible assets, data and knowledge' (i.e., 'what to tax?').[55]

To address these issues, the Commission favoured a long-term approach that would 'entail reform of international tax rules on permanent establishment, transfer pricing and profit attribution applicable to digital technologies', including the identification of '[a]lternative indicators for significant economic presence [that] are therefore required in order to establish and protect taxing rights in relation to the new digitalised business models'.[56] Accordingly, its CCCTB 'proposal offers a basis to address these key challenges'.[57] Alongside the work on this longer-term strategy, the Commission explicitly mentioned three 'more immediate, supplementary and short-term measures that should be considered to protect the direct and indirect tax bases of Member States' (i.e., an equalization tax on turnover of digitalized companies, a withholding tax on digital transactions, or a levy on revenues generated from the provision of digital services or advertising activity).[58] Indeed, one of those alternative options for shorter-term solutions mentioned by the EU Commission was an '[e]qualisation tax on turnover of digitalised companies', which the EU Commission described as a:

> tax on all untaxed or insufficiently taxed income generated from all internet-based business activities, including business-to-business and business-to-consumer, creditable against the corporate income tax or as a separate tax.[59]

A potential subset of such equalization taxes, the EU Commission argued, could be more 'targeted' levies on, for example, revenues generated from the provision of digital services or advertising activity. Moreover, such separate levies 'could be applied to all transactions concluded remotely with in-country customers where a non-resident entity has a significant economic presence'.[60] The EU Commission, however, was well aware of some of the disadvantages and shortcomings of all short-term measures.[61]

[C] EU Directive Proposals: SDP and DST

The ideas presented in the September 2017 Commission Communication were eventually incorporated in a two-prong legislative proposal in March 2018. Prefaced by the EU Commission Communication entitled 'Time to Establish a Modern, Fair and

55. *Ibid.*
56. *Ibid.* at 9.
57. *Ibid.*
58. *Ibid.* at 10.
59. *Ibid.*
60. *Ibid.*
61. Indeed, the 2017 EU Comm'n Comm. on Fair/Efficient Tax notes that '[q]uestions about the compatibility of such approaches with the double-taxation treaties, State aid rules, fundamental freedoms, and international commitments under the free trade agreements and WTO rules would need to be examined'; *ibid.*

Efficient Taxation Standard for the Digital Economy',[62] the EU Commission proposed two digital economy directives:[63]

- the first proposed directive[64] offers a long-term solution based on the creation of a SDP as a supplement to existing PE rules and was accompanied by a recommendation for Member States to renegotiate their tax treaties with third countries accordingly;[65] and
- the second proposed directive,[66] the focus of this article, offers a short-term (intermediate) solution in the form of a 3% turnover tax on certain digital services (the so-called DST), which represents, effectively, an equalization tax tailored to address value creation through user participation and not, for example, through consumption or data.

While the DST Directive Proposal is discussed in much greater detail below,[67] it should be mentioned here that the EU Commission argued that such measures are needed to alleviate potential fragmentation within the Internal Market. Such national measures, it argued, 'can be of a very diverse nature', and 'are already in place or are being planned by Member States',[68] which would make EU action necessary 'in order to mitigate the fragmentation of the Internal Market and the creation of distortions of competition within the Union due to the adoption of such divergent unilateral actions at national level'.[69] Moreover, it suggested that 'an EU solution rather than different

62. Eur. Comm'n, *Communication from the Commission to the European Parliament & the Council, Time to Establish a Modern, Fair and Efficient Taxation Standard for the Digital Economy*, COM(2018) 146 final & Annex.
63. *See also* EU Comm'n Staff, *Impact Assessment Accompanying the Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence & Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services* SWD(2018) 81 final/2 (hereinafter '2018 EU Staff Impact Assessment'). For a brief analysis of the proposals, *see, e.g.*, Larisa Gerzova et al., *Taxation of the Digital Economy: The EU's Outlook* (IBFD White Paper, Working Paper, 2018), *available at* https://www.ibfd.org/IBFD-Tax-Portal/News/New-White-Paper-Taxation-Digital-Economy-EU-s-outlook.
64. EU Comm'n, *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence, COM(2018)147 & Annexes* (hereinafter '2018 SDP Directive Proposal').
65. For a more detailed analysis, *see* Peter Bräumann, Chapter 7 in this volume.
66. EU Comm'n, *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services*, COM(2018) 148 (hereinafter '2018 DST Directive Proposal'); for a critical assessment also from a political perspective, *see, e.g.*, CFE Tax Advisors Europe, *Opinion Statement FC 1/2018 on the European Commission proposal of 21 March 2018 for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services* (CFE Tax Advisers Europe, 2018), also *available at* http://taxadviserseurope.org/wp-content/uploads/2018/06/CFE-Opinion-Statement-EU-Digital-Services-Tax.pdf (accessed 12 November 2018).
67. *See* §6.03, *infra*.
68. 2018 DST Directive Proposal, *supra* note 66, at 5.
69. *Ibid*.

national policies entails a reduction in the compliance burden for businesses subject to the new rules'.[70]

Such reasoning certainly has a number of shortcomings[71] and raises numerous issues as to the Union's competence in that area,[72] yet it is also true that, while the OECD and the EU strive for a multilateral solution,[73] a number of States have already taken unilateral action.[74] EU examples of such equalization levies are: Italy's levy on digital transactions, Hungary's advertisement tax, and France's tax on online and physical distribution of audiovisual content;[75] Spain, the United Kingdom (UK) having recently announced their own 'DSTs'.[76] Non-EU examples include, of course, India's 6% levy on payments to foreign companies for online advertising services, the most prominent international illustration of an equalization levy.[77] All such levies aim at collecting tax from foreign-based entities that are not physically present in the taxing jurisdiction such that, in general, they cannot be reached by that jurisdiction's

70. *Ibid*.
71. For one, it is not clear how the DST could avoid the potential fragmentation of the Internal Market if – unlike Art. 401 of the VAT Directive – it would not exclude that additional similar or overlapping unilateral taxes are created on the level of the Member States, and if would therefore be 'harmonization'. Moreover, it might even be doubted that the proposed DST is an 'indirect tax' within the meaning of Art. 113 TFEU in the first place; *see* van Horzen & van Esdonk, *supra* note 38.
72. It might, for example, be asked if the danger of potential distortions is enough to trigger the competence to harmonize under Art. 113 (or Art. 115) TFEU, and if, in any event, unilateral non-discriminatory destination-based taxes could lead to relevant distortions of the Internal Market at all.
73. *Compare* Angel Gurria, OECD Secretary-General, Opening Remarks at 16 September 2017 ECOFIN Meeting on International Taxation, *available at* http://www.oecd.org/about/secretary-general/ecofin-international-taxation-opening-remarks.htm with 2017 EU Comm'n Comm. on Fair/Efficient Tax, *supra* note 8, at 8 et seq.
74. For an instructive overview of the current trends, *see* Sagar Wagh, *The Taxation of Digital Transactions in India: The New Equalization Levy*, 70 Bull. Int'l Tax'n 538, 539 et seq. (2016), and the brief overview of the unilateral actions taken by Australia, China, France, India, Israel, Italy, and the United Kingdom by the UN Committee of Experts on Int'l Cooperation in Tax Matters, *The Digitalized Economy: Selected Issues of Potential Relevance to Developing Countries*, E/C.18/2017/6, un.org http://www.un.org/ga/search/view_doc.asp?symbol=E/C.18/2017/6 (accessed 12 November 2017).
75. For a brief description of these regimes, *see* 2018 OECD Interim Report, *supra* note 12, boxes 4.4.–4.6.
76. Spain and the United Kingdom are in the process of introducing levies on digital services that resemble the EU DST proposal. For details on the Spanish Draft Budget Plan for 2018, which was published on 23 October 2018 and is currently open for public consultation, *see* Gobierno de Espana, Ministerio de Hacienda, *Punto de acceso para facilitar la participación pública en el procedimiento de elaboración de normas*, *available at* http://www.hacienda.gob.es/es-ES/Normativa%20y%20doctrina/NormasEnTramitacion/Paginas/normasentramitacion.aspx (accessed 12 November 2018). For a description of HM Treasury's digital services tax, see HM Treasury, *Budget 2018 Digital Services Tax*, *available at* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752172/DST_web.pdf (accessed 12 November 2018). In total, twelve Member States have already adopted or are currently planning to adopt interim direct or indirect tax measures to target digitalized activities, *see* 2018 EU Staff Impact Assessment, *supra* note 63, 54–55.
77. *See* Wagh, *supra* note 74, at 543 et seq.

corporate tax system. Such an approach is not, however, entirely novel, as unilateral taxes for certain transactions or branches of the digital economy are already common features in existing tax systems; indeed, many countries already levy taxes on online gambling and betting or employ special tax rules for the so-called sharing economy (e.g., to collect tourist taxes).[78] Nonetheless, such unilateral action (whether broad or narrow) might not be a sensible alternative for every State, depending on its legal structure (e.g., its tax treaty obligations) or its economic situation.[79] From an EU perspective, moreover, '[d]ivergent national approaches within the EU can fragment the Single Market, increase tax uncertainty, destabilise the level playing field and open new loopholes for tax abuse'.[80]

At this juncture, it should also be noted that the EU Commission is as well outspoken about one meta-policy goal inherent in its DST proposal: it 'gives a strong sign to the international community as to the commitment of the EU to act when it comes to ensuring the fair taxation of the digital economy,'[81] which might explain why the Commission has been pushing a tax that (optimistically) might only bring in revenues of EUR 5 billion for all Member States combined.[82] Smaller Member States, in particular, with a minimal revenue stream from a DST might question the sensibility of such a measure, particularly in light of its unclear administrative and compliance costs.[83] That path to a potential EU directive (and even more so to a global approach) is not only fraught with numerous policy and technical questions but also beset with the political realities and diverging interests of the relevant (Member) States.[84]

78. For an overview on this subject, see EU Comm'n Staff, *European Agenda for the Collaborative Economy – Supporting Analysis* 41 et seq. (Working Paper, SWD 184 final 2016); *see also* Beretta, *supra* note 3, at 400 et seq.
79. *See* Kofler, Mayr & Schlager, *Digitalisierung und Betriebsstättenkonzept*, 376 et seq. (Austria), *supra* note 4; *see* Staringer, *supra* note 24, at 341, 343.
80. *See* EU Comm'n, *Fact Sheet, Questions and Answers on the Communication on a Fair and Efficient Tax System in the EU for the Digital Single Market*, http://europa.eu/rapid/press-release_MEMO-17-3341_en.htm (accessed 12 November 2018).
81. 2018 DST Directive Proposal, *supra* note 66, at 5.
82. *See* EU Comm'n Press Release, *Digital Taxation: Commission Proposes New Measures to Ensure That All Companies Pay Fair Tax in the EU*, IP/18/2041, http://europa.eu/rapid/press-release_IP-18-2041_en.htm (accessed 12 November 2018) ('An estimated EUR 5 billion in revenues a year could be generated for Member States if the tax is applied at a rate of 3%'). According to the 2018 EU Staff Impact Assessment, *supra* note 63, at 70, the expected revenues are between EUR 4.7 to EUR 6 billion.
83. *See* the Regulatory Scrutiny Board Opinion SEC(2018) 164, 2–3, available in Doc. 7419/17 ADD 4 FSIC 150 ECOFIN 276 (23 March 2018).
84. This may also raise the subsequent issue whether enhanced cooperation might provide a suitable tool to move forward in only some and not all Member States. On the other hand, a directive would have a double harmonizing effect: It would oblige Member States to amend their domestic laws and would arguably 'override' (pre-existing and new) provisions in tax treaties between Member States. *See* Yariv Brauner & Georg Kofler, *The Interaction of Tax Treaties with International Economic Laws*, *in Global Tax Treaty Commentaries* ch. 2.3.3 (Richard Vann et al. eds., IBFD 2014).

§6.02 THE IDEA OF EQUALIZATION TAXES: ASSESSMENT AND CRITICISM

[A] Equalization Taxes in OECD BEPS Action 1

Since the 1998 Ottawa Ministerial Conference on Electronic Commerce,[85] it has become commonplace to argue that the digital economy cannot be separated from the traditional economy. While this might be true when it comes to classic value chains (e.g., production and/or distribution of tangible and intangible products), new business models that are prevalent in the digital economy place greater emphasis on value creation through mediating technology in multi-sided markets (e.g., social networks, online marketplaces, and sharing economy platforms) and highly specialized services in single-sided markets (e.g., cloud computing and diagnostics).[86] If one takes the position that some or all of these business models create a significant economic presence in a jurisdiction but are (or are at least perceived to be) 'undertaxed' in that State for lack of physical presence,[87] a potential option to address such 'undertaxation' is an equalization levy. Indeed, the 2015 OECD BEPS Action 1 Report mentioned the introduction of equalization levies as a potential approach to remedy that situation.[88] While there is no international consensus on either the merit of, or need for, equalization taxes,[89] the 2018 OECD Interim Report discussed, at length, a number of necessary design features for any such tax.[90]

Essentially, equalization taxes are special excise taxes – intended to compensate for 'lost' profit taxes – that target foreign economic actors with a significant economic presence in the taxing jurisdiction; their purpose is to place domestic and foreign providers on a par. Presently, several countries collect excise taxes, for example, on premiums paid to non-resident insurance providers that would otherwise remain untaxed. Another example might be the equalization levy on online advertising introduced by India in 2016, under which business-to-business (B2B) payments to non-resident taxpayers for online advertising are subject to taxation at a rate of 6%.[91] The OECD has noted that, in the digital economy, such an equalization levy serves as

85. 1998 OECD Electronic Commerce Potential Report, *supra* note 14, noting, *inter alia*, that 'taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce'.
86. *See, e.g.*, the discussion in HM Treasury, *Corporate Tax and the Digital Economy: Position Paper*, gov.uk https://www.gov.uk/government/consultations/corporate-tax-and-the-digital-economy-position-paper (accessed 12 November 2018) (hereinafter 'HM Treasury Position Paper'). Indeed, as a starting point, the 2015 OECD BEPS Action 1 Report provides an overview of the various business models of the digital economy and analyses four typical structures: (1) online retailing, (2) Internet advertising, (3) cloud computing and (4) Internet app stores. 2015 OECD BEPS Action 1 Report, *supra* note 12, at 51 et seq. with a summary in box 4.1 at 64.
87. It should be noted that the market State (i.e., where consumption takes place) and the source State within the meaning of the international tax framework are not necessarily the same. Take for example a PE: The profits attributable to it may be taxed in the State of its location (Arts 5 and 7 OECD MC), whether or not its customers are also resident in that State.
88. 2015 OECD BEPS Action 1 Report, *supra* note 12, paras 302 et seq.
89. 2018 OECD Interim Report, *supra* note 12, para. 404.
90. *Ibid.* paras 403 et seq. & §6.02[B][2] *infra*.
91. For an overview, *see* Wagh, *supra* note 74, at 543 et seq.

a way to tax a non-resident enterprise's significant economic presence in a country while simultaneously avoiding profit attribution problems arising from a nexus based on a 'virtual' PE concept.[92] Nevertheless, a significant economic presence would be required for applying such an equalization tax because it provides clarity, certainty, and equity to all stakeholders, and avoids undue burden on small- and medium-sized businesses.[93] Hence, the baseline definitional problem (i.e., when does such 'significant economic presence' exist?) also arises in the context of equalization taxes.

As for the potential scope of such a tax, the OECD discusses a number of variations depending on the respective policy priorities:[94] if, for example, the policy priority lies in taxing remote sales transactions with customers in a market jurisdiction, one possibility is to apply the levy to all transactions concluded remotely with in-country customers; if, however, the policy priority is to tax the value considered to be directly contributed by customers and users, then the levy would be imposed on data and other contributions gathered from in-country customers and users. However, as with the scope of an equalization levy, there is currently broad consensus that, at least within the international taxation framework,[95] neither the mere consumption of goods or services in a country[96] nor the deductibility of payments for goods or services received from non-residents in that country[97] should, by itself, entitle that country to tax the profits of the business providing the goods or services.

Nevertheless, the recent focus is not on mere consumption, but is, rather, on the utilization of passively provided user-related data (e.g., search and surfing history for

92. The 2015 OECD BEPS Action 1 Report, *supra* note 12, para. 302 describes that idea as follows: To avoid some of the difficulties arising from creating new profit attribution rules for purposes of a nexus based on significant economic presence, an 'equalization levy' could be considered as an alternative way to address the broader direct tax challenges of the digital economy. This approach has been used by some countries in order to ensure equal treatment of foreign and domestic suppliers. For example, in the area of insurance, some countries have adopted equalization levies in the form of excise taxes based on the amount of gross premiums paid to offshore suppliers. Such taxes are intended to address a disparity in tax treatment between domestic corporations engaged in insurance activities and wholly taxable on the related profits, and foreign corporations that are able to sell insurance without being subject to income tax on those profits, neither in the State from where the premiums are collected nor in State of residence. As discussed below, an equalization levy could be structured in a variety of ways depending on its ultimate policy objective. In general, an equalization levy would be intended to serve as a way to tax a non-resident enterprise's significant economic presence in a country. In order to provide clarity, certainty and equity to all stakeholders, and to avoid undue burden on small- and medium-sized businesses, therefore, the equalization levy would be applied only in cases where it is determined that a non-resident enterprise has a significant economic presence.
93. *Ibid*.
94. *Ibid*. paras 303 et seq.
95. For broad policy discussions, e.g., with regard to a destination-based corporate tax (focusing on the customer's residence), *see, e.g.*, Auerbach, *supra* note 22; Devereux, *supra* note 4, at 550 et seq.
96. *See generally* for the lack of source taxation rights with regard to services rendered by non-residents Art. 5 para. 139 OECD Model Convention Commentary 2017 (hereinafter 'OECD MC Comm.').
97. There are, however, some notable exceptions, such as the introduction of a new distributive rule for fees for technical services in the 2017 update to the UN Model. For discussion, *see, e.g.*, Sixdorf & Leitsch, *supra* note 23, at 234 et seq.

targeted advertising) and of more active contributions to value creation by users (e.g., through active user participation in social media platforms, online marketplaces that match suppliers to purchasers, or user-generated content on streaming platforms),[98] regardless of whether or not those users are identical to the business's customers. It is frequently argued that the value generated by user data, participation, and creation of content 'is not captured under the existing international tax framework, which focuses exclusively on the physical activities of a business itself in determining where profits should be allocated for corporate tax purposes', meaning that significant value can be generated from a market without the profits derived therefrom being subject to tax there.[99] That said, however, it is heavily disputed whether and, if so, to what extent, data and user participation represent a contribution to value creation by the enterprise:

– Indeed, some countries hold the view that user participation is a unique and important driver of value creation in digitalized businesses, being something genuinely new and going beyond the mere consumption of a service (i.e., the provision of access to the business model).[100] This position is also endorsed by the EU Commission, which believes that:

  > [i]n the digital economy, value is often created from a combination of algorithms, user data, sales functions and knowledge. For example, a user contributes to value creation by sharing his/her preferences (e.g. liking a page) on a social media forum. This data will later be used and monetised for targeted advertising. The profits are not necessarily taxed in the country of the user (and viewer of the advert), but rather in the country where the advertising algorithms has been developed, for example. This means that the user contribution to the profits is not taken into account when the company is taxed.[101]

– Other countries strongly reject the suggestion that data and user participation should be considered value creation by the business in the user's jurisdiction and take the position that data collection from users, user participation, and the provision of user-generated content as transactions should be viewed as barter transactions: businesses provide financial or non-financial compensation (e.g., data hosting, email services, or digital entertainment) to the users in exchange for such data/content.[102] From their perspective, there should be no

98. *See, e.g.*, HM Treasury Position Paper, *supra* note 86, at paras 3.14 et seq.
99. *See, e.g.*, *ibid.* para 3.21 & HM Treasury, *Corporate Tax and the Digital Economy: Position Paper Update*, paras 2.1 et seq., gov.uk https://www.gov.uk/government/consultations/corporate-tax-and-the-digital-economy-position-paper (accessed 12 November 2018) (hereinafter 'HM Treasury Position Paper Update') (also distinguishing between user participation and the mere collection of data from users or customers).
100. 2018 OECD Interim Report, *supra* note 12, para. 38. *See also* the conclusions in HM Treasury Position Paper Update, *supra* note 99, and in Australian Government, The Treasury, *The Digital Economy and Australia's Corporate Tax System*, Treasury Discussion Paper (October 2018).
101. *See* Eur. Comm'n Fact Sheet, *Questions and Answers on a Fair and Efficient Tax System in the EU for the Digital Single Market*, http://europa.eu/rapid/press-release_MEMO-18-2141_en.htm (accessed 12 November 2018).
102. 2018 OECD Interim Report, *supra* note 12, paras 39 & 393.

profit allocated to the sourcing of data from users, as the user's supply of data is no different from other business inputs sourced from an independent third party in the business' supply chain (e.g., data storage, broadband access, or electricity).[103] Moreover, although the argument has not yet been made, applying that same perspective to equalization taxes can be intellectually justified, not as a proxy for the taxation of corporate profits, but rather as a proxy for taxing the nearly impossible-to-tax imputed income the users (arguably) accrue from all such small barter transactions (i.e., the in-kind value they receive from using, e.g., 'free' services).

These differences in perspective on a business' value creation through data and user participation, as well as the more general disagreements about whether and what changes might be needed in light of digitalization, will certainly inform the international and EU discussion on all of the issues concerning the broader tax challenges posed by the digital economy.

Additionally, there are, of course, fundamental objections to 'quick fixes' as they are likely to be temporary solutions.[104] Such a piecemeal approach only succeeds in 'patching-up' particular issues, without providing a reliable, long-term policy solution. They might not even be a reliable source of tax revenue if monetization models change. Moreover, it is not entirely clear that equalization taxes will be beneficial for the EU and its Member States (especially if third countries react by enacting similar taxes), nor is it clear how such taxes could affect growth and investment. Finally, issues of tax incidence are uncertain: ultimately, the likelihood that such equalization tax would be shifted by the intended taxpayers (i.e., digital companies) to European consumers seems high, particularly given that some digital economy players operate as quasi-monopolies. The OECD explored some of those challenges in the 2018 OECD Interim Report, but the EU Commission's DST Proposal hardly addressed them.

[B] Policy and Technical Challenges of Equalization Levies

[1] Broader Economic Risks and Challenges

While the 2018 OECD Interim Report clearly showed that there is no international consensus on either the merit of, or need for, equalization taxes,[105] the OECD nevertheless devoted a whole chapter therein to 'Interim Measures to Address the Tax Challenges Arising from Digitalization'.[106] It noted that a number of countries opposed such measures on the basis that they give rise to risks and adverse consequences irrespective of their design. While other countries acknowledge such challenges, they

103. Countries that support this view agree that the interaction between users and the digitalized business is a transaction that could be subject to income taxation, although they also observe that income tax systems today rarely capture these types of barter transactions where there is no financial compensation (i.e., cash payment) on either side of the transaction. *Ibid.* para. 39.
104. *See also* Presidency Issues Note for the informal ECOFIN Tallinn, *supra* note 46, para. 8.
105. 2018 OECD Interim Report, *supra* note 12, para. 404.
106. *Ibid.* paras 403 et seq.

did not believe they outweighed the need to implement interim measures and instead believed that at least some of the potential adverse consequences could be mitigated through the measures' design.[107]

Against this background, the OECD noted the potential risks and adverse consequences that could arise with respect to equalization taxes but also identified a number of ameliorating design considerations for them. The broader risks and challenges largely relate to the adverse economic impacts of equalization taxes.[108] The OECD, in this regard, mentioned the following considerations:[109]

- Impact on investment, innovation, and growth – any tax on the supply of particular services is likely to increase the cost of capital, reducing the incentive to invest with a resulting negative effect on growth. Moreover, a gross-basis tax only applicable to digitalized sectors would risk slowing down investment in innovation for those businesses that are subject to the tax or indirectly affected by it, and thus, could effectively penalize start-ups and other growing firms with losses or limited profitability.
- Impact on welfare – a gross-basis tax is equivalent to a tax on inputs, which implies that it is likely to distort firms' choices of inputs, thus distorting production itself, which is likely to have a negative impact on the overall welfare of an economy and on its output.
- Potential economic incidence of taxation on consumers and businesses – depending on the price sensitivities of the seller and customers, and the structure of the market, the incidence of taxation could be fully or partially passed on to local consumers in the form of higher prices for goods or services.
- Potential for overtaxation – in order to comply with its international obligations, a country could be required to apply the tax to both residents and non-residents and to limit any credit mechanism against other taxes, which could create issues of overtaxation (e.g., if payments are subject to both corporate taxation and an equalization tax) and economic double taxation via cascading effects (e.g., if a taxable service is incorporated in a taxable onward supply).
- Potential difficulties in implementing such a tax as an interim measure – taxes, once introduced, are often difficult to repeal and given the time that may be needed to develop and implement an interim measure, that raises a question as to whether it is worth introducing a completely new set of rules (with all of the related administrative procedures that necessitates) that might apply only for a limited period of time.

107. *Ibid.* paras 408–411.
108. *See also, e.g.*, Schön, *supra* note 24; Matthias Bauer, *Five Questions about the Digital Services Tax to Pierre Moscovici* (ECIPE Working Paper No. 04/2018, 2018), *available at* http://ecipe.org/app/uploads/2018/06/Five-Questions-about-the-Digital-Services-Tax-to-Pierre-Moscovici.pdf.
109. 2018 OECD Interim Report, *supra* note 12, para. 407.

– Compliance and administration costs – an interim measure could also give rise to significant compliance and administration costs that could be disproportionate to the amount of tax raised under the measure, particularly given that the measure is only intended to be temporary. The taxing jurisdiction might also encounter difficulties in auditing and verifying the accuracy of the returns filed and payments made by non-residents.

[2] Necessary Design Features of Equalization Taxes

[a] Compliance with International Obligations (Tax Treaties, EU Law, and WTO Law)

Compliance with international obligations (i.e., tax treaties, EU law, and World Trade Organization (WTO) law) is a primary objective of tax measures addressing the digitalized economy.[110] Indeed, if equalization taxes are structured to raise the revenues expected, they would likely create cases of (domestic[111] and international) double or even multiple taxation. Indeed, existing equalization taxes, such as the Indian tax on online advertising, are viewed as being indirect taxes falling squarely outside the scope of existing tax treaties.[112] Their imposition is neither barred in the imposing State nor subject to any relief from double taxation in the taxpayer's residence State.[113]

Nevertheless, it is sometimes undeniable that a 'connection' to corporate tax exists, either because the direct tax system serves as a backstop[114] or because double taxation with regular corporate tax and the equalization levy is mitigated (e.g., through a credit).[115] The OECD, therefore, gave considerable thought to the scope of Article 2 (Taxes Covered) OECD Model, which provides that the Convention applies to 'taxes on income' or on 'elements of income', 'irrespective of the manner in which they are levied', and that it will also apply to all new taxes that are identical or 'substantially

110. *Ibid.* paras 413–431.
111. The 2017 EU Comm'n Comm. on Fair/Efficient Tax, *supra* note 8, explicitly notes that an equalization tax might either be structured as 'creditable against the corporate income tax or as a separate tax'. If structured in the former way, however, that seems to imply that the equalization tax could be credited against the domestic corporate tax, if any. That, of course, would raise a number of technical issues, e.g., with regard to the cross-crediting of taxes over various entities in the group or over various activities within one entity.
112. *See* for India's position, e.g., Wagh, *supra* note 74, at 543 et seq. *Contra*, Roland Ismer & Christoph Jescheck, *Taxes on Digital Services and the Substantive Scope of Application of Tax Treaties: Pushing the Boundaries of Article 2 of the OECD Model?*, 46 Intertax 573, 575 (2018). Whether falling outside of the scope of tax treaties or overriding these, the result–double or multiple taxation–remains the same.
113. 2015 OECD BEPS Action 1 Report, *supra* note 12, para. 307.
114. In India, the non-resident advertiser is the taxpayer, but the Indian client has an obligation to withhold the tax; if it violates that obligation, no direct tax deduction is allowed for the advertising expense. *See* Wagh, *supra* note 74, at 543 et seq.
115. 2015 OECD BEPS Action 1 Report, *supra* note 12, para. 308.

similar' to the taxes listed.[116] However, 'a tax that is covered by tax treaties is generally one that is focusing on the supplier, rather than on the supply',[117] and arguments for a tax being outside the scope of Article 2 OECD Model may:

> be stronger where [such a tax] is: (i) levied on the supply of a certain defined category or categories of e-services and imposed on the parties to the supply without reference to the particular economic or tax position of the supplier; (ii) charged at a fixed rate, calculated by reference to the consideration paid for those services (without reference to the net income of the supplier or the income from the supply); and (iii) not creditable or eligible for any other type of relief against income tax imposed on the same payment.[118]

The borderline, however, is not clear-cut. One could, for example, argue that a typical equalization tax levied on a gross amount is close to one falling under Article 2 OECD Model if the equalization tax rate implicitly takes into account lump-sum expenses to accommodate 'different profit margins'.[119] Also, any equalization tax structured as 'creditable against the corporate income tax'[120] would likely create a 'risk' that it will fall under Article 2 OECD Model, suggesting that any such equalization tax should not be creditable, but only be tax deductible for corporate tax purposes,[121] as envisaged by the 2018 DST Directive Proposal.[122] And, even if the application of Article 2 OECD Model (and the treaty limitations to taxation) could indeed be avoided, from a policy point of view, an equalization tax would likely be at odds with the initial balance inherent in any particular tax treaty. From another perspective, however, the 2018 OECD Interim Report concluded that applying an equalization tax to non-residents would not, generally, give rise to discrimination under Article 24 OECD Model (which provision applies also to taxes not covered by Article 2 OECD Model) because such tax would not relate to one of the precise circumstances addressed by Article 24 OECD Model.[123]

Moreover, it remains to be seen if an equalization tax should only apply to cross-border transactions (i.e., only to non-resident enterprises) or to domestic transactions, too; the former approach may raise all kinds of WTO and EU law objections,[124]

116. For a detailed discussion of Art. 2 OECD MC in light of the features of equalization taxes, *see* Ismer & Jescheck, *supra* note 112, at 573 et seq.
117. 2018 OECD Interim Report, *supra* note 12, para. 421.
118. *Ibid.*
119. *See* 2018 DST Directive Proposal, para. 35 and for a critical perspective in light of Art. 2 OECD MC, *see* van Horzen & van Esdonk, *supra* note 38.
120. *See, e.g.*, 2017 EU Comm'n Comm. on Fair/Efficient Tax, *supra* note 8, at 10.
121. *See* Kofler, Mayr & Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?*, *supra* note 4, at 531 & 532.
122. The 2018 DST Directive Proposal does not contain a rule that deduction must be granted, but rather expresses the expectation 'that Member States will allow businesses to deduct the DST paid as a cost from the CIT base in their territory, irrespective of whether both taxes are paid in the same Member State or in different ones' (Preamble to 2018 DST Directive Proposal, para. 27).
123. 2018 OECD Interim Report, *supra* note 12, paras 425 & 426.
124. *Ibid.* paras 427–431.

while the latter might create the necessity to mitigate double imposition of regular corporate tax and the equalization levy.[125] Furthermore, the OECD pointed out that:

> [i]n 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.[126]

Indeed, to comply with EU and constitutional non-discrimination requirements, as well as EU State aid rules, the potential threshold for the application of an equalization tax (e.g., a revenue threshold) must likely be set for both comparable cross-border and domestic situations,[127] an approach taken by the 2018 DST Directive Proposal.[128] However, the mere introduction of such thresholds (e.g., EUR 750 million of worldwide revenues) may already raise questions with regard to EU non-discrimination rules and EU State aid law,[129] although it is not entirely clear whether and in what circumstances measures based on an EU directive could violate these rules.[130]

Finally, the OECD noted that, for EU Member States, 'the interim measure should also be designed such that it is not a value added tax that would be inconsistent with the EU Directive on the Common System of Value Added Tax'.[131] It is, however, not entirely clear why such a potential inconsistency argument would be relevant from a legal perspective if the relevant equalization tax were based on an EU directive. First, it can be argued that a revenue-based equalization tax is not covered by Article 401 value added tax (VAT) Directive's[132] prohibition of 'turnover taxes' because it would not be an all-phase input deduction tax that generally applies to transactions relating to

125. 2015 OECD BEPS Action 1 Report, *supra* note 12, para. 306.
126. 2018 OECD Interim Report, *supra* note 12, para. 429.
127. *See, e.g.,* Turina, *supra* note 24, at 509.
128. *See* §6.03[C][1] *infra*.
129. *See, e.g.,* the negative Commission Decision 2017/329 on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, OJ L 49/36 (2016), where the Commission found aid in the fact that Hungarian law 'lays down progressive rates of taxation that apply to the annual turnover derived from the publication of advertisements in Hungary depending on the brackets into which an undertaking's turnover falls. The progressive character of those rates has 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. This has the result that undertakings with low turnover (smaller undertakings) are taxed at a substantially lower average rate than undertakings with high turnover (larger undertakings). Being taxed at this substantially lower average tax rate mitigates the charges that undertakings with low turnover have to bear as compared to undertakings with high turnover and therefore constitutes an advantage to the benefit of smaller undertakings over larger undertakings for the purposes of Article 107(1) of the Treaty.'
130. For a brief discussion of that issue, *see* Turina, *supra* note 24, at 510, and for a detailed analysis based on the idea of covert nationality discrimination based on company size, see Ruth Mason & Leopoldo Parada, *The Illegality of Digital Services Taxes under EU Law: Size Matters* (6 November 2018), *available at* https://ssrn.com/abstract=3279639 (accessed 12 November 2018). *See also* §6.03[D][1][b] *infra*.
131. 2018 OECD Interim Report, *supra* note 12, para. 430.
132. Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347/1 (2006), as amended.

goods or services.[133] Second, that prohibition, which is addressed to the Member States, would not conflict with a tax that is on the same legislative 'level' (i.e., secondary EU law).[134]

[b] Temporary Nature of an Equalization Tax as an Interim Measure

As the OECD noted, '[a]ny interim measure should be introduced recognising the policy intent of it being temporary; ceasing to apply once a global response to the tax challenges raised by digitalisation has been agreed and is implemented',[135] as otherwise, the international preference for comprehensive global solution would be undermined.

[c] Targeted Scope of an Equalization Tax

> Given the potential adverse consequences of introducing an interim measure, it is important that the measure is as targeted as possible at those businesses that are perceived to constitute the highest risk, which for a number of countries are those businesses that combine high levels of scale without mass, and have business models that rely heavily on user participation and network effects.[136]

Thus, the OECD 2018 Interim Report argues that an interim measure should not apply to supplies of physical goods when the supplier is simply the owner of the goods transferring title in those goods to the seller under a contract that is concluded online[137] and, further, should 'be restricted to certain specified e-services and not apply to all services simply on the basis that they are provided over the Internet'.[138] Indeed, a focus of a targeted interim measure could be on Internet advertising and digital intermediation services because those activities are perceived by some countries as categories of e-services businesses that 'typically operate remotely and rely heavily on intangible property, data, user participation and network effects and believe that therefore value is being created in their jurisdiction'.[139] The 2018 DST Directive Proposal largely adopts the same approach.[140]

Scholarly discussion, however, generally argues that the substantive scope of any equalization tax should be further restricted, specifically in light of attempts to

133. *See Banca popolare di Cremona*, C-475/03, Judgment, EU:C:2006:629 (with regard to the Italian IRAP) & for brief analysis Turina, *supra* note 24, at 510 et seq.
134. *See, e.g.,* Kofler, Mayr & Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution? supra* note 4 at 531. However, a turnover tax that is not all-phase might lead to cascading effects and, hence, double taxation.
135. 2018 OECD Interim Report, *supra* note 12, para. 432.
136. *Ibid.* para. 434.
137. *Ibid.* para. 436.
138. *Ibid.* para. 437.
139. *See generally, ibid.* para. 439 & in more detail paras 440–442 for Internet advertising and paras 443–445 for intermediation services.
140. *See* §6.03[A] *infra*.

'ring-fence' certain business models that are unique to the digital economy.[141] In that regard, scholars have argued that the mere use of the Internet to facilitate the sale of goods or services (e.g., retailing), as well as multi-sided intermediaries and market-places (e.g., app stores and platforms in the collaborative economy) seem to be mere extensions of the 'traditional economy' which may well achieve 'scale without mass' that could give rise to a myriad of delimitation issues. In contrast, the intensity of the collection, use, and exploitation of personal data as core part of a business model and value creation might serve as a narrow, but more targeted, indicator.[142] Monetizing user data is the backbone of Internet advertising, but such data plays quite a different role and is prevalent on a different level for multi-sided platforms operating as intermediaries (e.g., in the sharing economy) and, more generally, for businesses that are based on traditional value creation.

[d] Minimizing Overtaxation

The OECD's key objective for an interim measure is 'to balance the underlying policy objective of trying to address the rapidly emerging challenges raised by the digitalization of the economy while avoiding the risk of over-taxation on taxpayers caught by the measure'.[143] This relates to several aspects: First, the broader the scope of the measure, the more likely it will result in overtaxation of certain taxpayers. Second, the rate 'should be set at a low rate that is proportionate to the profit margins of the businesses that it is to apply to',[144] which is indeed a hard task. In a single-rate structure, the different business models would all be taxed at the same turnover-based level, but the profit-based effect on typical B2B and B2C (business-to-consumer) business models –

141. *See, e.g.,* Kofler, Mayr & Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?*, *supra* note 4, at 126 et seq.
142. However, while the mere collection of personal data does neither constitute something new or unique, nor seems 'worth' taxing in itself, the value created through exploitation of personal data for third-party advertisers might well be viewed as giving sufficient claim to tax to the State from whose residents the user data is collected. Indeed, if the political decision for a short-term measure was taken, there are several advantages to a rather narrow approach, i.e., to only apply a short-term measure to situations where user data is exploited to generate revenues from third parties. First, it largely avoids delimitation problems. Many companies collect personal data these days (e.g., food chains, fitness centres, etc.). However, the main business purpose of these companies is not the collection of personal data. Rather, this personal data merely supports the company's main business purpose and is analysed for this reason (e.g., food chains use the data to tailor their offerings to their customers' wishes, which – if successful – results in higher sales). Moreover, the mere collection and analysis of personal data for a company's so-defined own business purposes could scarcely be delimited. Therefore, finding no tax nexus until the personal data is exploited to generate fees from third parties avoids difficult delimitation questions. Second, it would link taxation to the exploitation of data that generates revenues from third parties (i.e., the advertisers) and hence to the value created by such exploitation (i.e., advertising income under the specific business models in question). Thinking in terms of an equalization levy, therefore, a pragmatic approach could focus on advertising and similar activities provided through the Internet that are based on the exploitation of personal data. *See* for that discussion Kofler, Mayr & Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?*, *supra* note 4, at 126 et seq.
143. 2018 OECD Interim Report, *supra* note 12, para. 446.
144. *Ibid.*

which have been extensively discussed in scholarly literature[145] – would be quite different given the different margins. Even a notionally low tax rate on a turnover basis can have huge distortive effects depending on the specific situation of the taxpayer and its profit margins[146] and could, oftentimes, translate in exorbitant tax burdens on profit.[147] Third, a gross-basis tax has the potential to result in economic double taxation, if a mere deduction from the income tax base, rather than a tax credit, is granted.[148] Fourth, cascading effects could arise 'where a supply of e-services is made to a person that incorporates those services into an onward supply that is subject to the excise tax under domestic or foreign law'.[149] That eventuality could only be avoided through special measures (e.g., an exemption) if it is proven that the e-service will be used in an onward-taxable supply.[150]

[e] Minimizing Impact on Start-Ups, Business Creation, and Small Businesses

The design of an interim measure,[151] according to the OECD, 'will also need to be calibrated to limit any undue impact on business creation arising from digitalisation, noting the positive impacts that digitalisation has had on economic growth and productivity'.[152] In light of the potential impact of a gross-basis tax on start-ups and, more generally, small businesses and the burdens caused by compliance obligations, the OECD took the view that 'an interim tax measure would need to have a threshold' to be set by reference to the results of the previous accounting period in order to promote certainty in the application of the threshold.[153] Possible approaches could be (1) to combine a gross-revenue threshold for the group as a whole with a local-country sales threshold or (2) to only apply a local-country sales threshold.[154] A gross-revenue threshold (e.g., based on the CbC-Reporting threshold of EUR 750 million) would provide a bright-line test for businesses that do not have a significant global presence, so 'that smaller businesses entering the domestic market would not need to track their

145. *See, e.g.,* Kofler, Mayr & Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?*, *supra* note 4, at 123 et seq.
146. *Ibid.* at 531.
147. *See* Bauer, *supra* note 108.
148. *See also* 2018 OECD Interim Report, *supra* note 12, para. 447.
149. *Ibid.* para. 448.
150. *Ibid.* para. 449.
151. Similar discussions are, of course, also necessary with regard to when a digital or economic presence should be deemed to be 'significant' (to give rise to source State taxing rights); here, several factors or indicators have been discussed, for example, country-specific turnover from digital transactions, 'digital' factors, such as a local domain name, a local digital platform, local payment options, or user-based factors, such as active, domestic monthly users of a platform. *See, e.g.,* 2015 OECD BEPS Action 1 Report, *supra* note 12, paras 277 et seq., and the more concrete proposal made by Hongler & Pistone, *supra* note 15, at 15 et seq. Although a short-term measure may not focus on 'significant' economic presence, the practical reasons for defining an 'entry criterion' are similar (i.e., lowering tax compliance costs), especially for innovative SMEs.
152. 2018 OECD Interim Report, *supra* note 12, para. 450.
153. *Ibid.* para. 452.
154. *Ibid.* para. 453.

level of sales in each taxing jurisdiction in order to determine whether they were subject to the interim measure'.[155] The additional local sales threshold 'would exclude those e-service suppliers with a low level of supplies of e-services in a particular jurisdiction or geographic market, where the costs of administration and compliance are likely to be too great to justify the imposition and collection of a tax'.[156]

While the 2018 DST Directive Proposal also chose such a double-threshold, alternative approaches could exempt small- and medium-sized enterprises (SMEs) (as defined by the EU Commission[157]) or provide a *de minimis* exception of revenues generated in a specific country (e.g., Hungary's revised advertisement tax provides, for example, a *de minimis* threshold of HUF 100 million, which is approximately EUR 325,000, for sales from marketing activities[158]).[159] In any event, to comply with EU and constitutional non-discrimination requirements, as well as EU State aid rules, any threshold would likely have to be set for both cross-border and domestic situations and across various forms of advertising. This is a specific consideration for countries (such as Austria) that currently levy an advertisement tax on 'offline' commercials, but are considering expanding it to online advertising.[160]

[f] Minimizing Cost and Complexity

Especially for interim gross-basis tax measures, 'administrative cost and complexity should be kept to a minimum',[161] which would, in particular, require a common place-of-supply rule that determines whether the supply of e-services has been made within the taxing jurisdiction.[162] More generally, a short-term measure must be delimited geographically, likely through a proxy for the jurisdiction, to establish which residents participate and/or provide user data. In that respect, the OECD suggested focusing on the various types of digital services. Advertising services should be treated as being supplied in the jurisdiction where the advertising communication is targeted (based, for example, on the internet protocol (IP) address),[163] intermediation services as being supplied in the jurisdiction where the customer of the intermediation service is located (as a proxy for the place of the underlying transaction), with the relevant costumer being the person that contracted for the supply of the intermediation

155. *Ibid.* para. 454.
156. *Ibid.* para. 455.
157. EU Comm'n, *Commission Recommendation concerning the definition of micro, small and medium-sized enterprises*, OJ L 124/36 (2003).
158. For a brief description of Hungary's advertisement tax, *see* Box 4.5 of the 2018 OECD Interim Report, *supra* note 12.
159. Kofler, Mayr & Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?*, *supra* note 4, at 127.
160. It should be noted, however, that the Austrian Constitutional Court recently held that taxation of 'offline' advertisement while not taxing online advertising under the Austrian advertisement tax (*Werbeabgabe*) does not violate the principle of equal treatment. *See* VfGH, 12 October 2017, E 2025/2016, AT:VFGH:2017:E2025.2016.
161. 2018 OECD Interim Report, *supra* note 12, para. 457.
162. *Ibid.* para. 458.
163. *Ibid.* paras 459–462.

services.[164] In the latter respect, the 2018 DST Directive Proposal arguably takes a slightly different approach; it focuses on the revenue stream and the parties' location, irrespective of which party to the underlying transaction is charged a fee by the intermediation service.[165]

§6.03 THE EU'S DST

The 2018 DST Directive Proposal is a concrete example of an equalization levy that would apply within the EU, if adopted. Unlike the OECD, the EU Commission and a number of Member States see a need to implement such an interim measure.[166]

[A] Policy Objectives

To achieve one of its main political priorities – that is, the Digital Single Market[167] – the EU Commission believes it is vital to implement a fair and appropriate tax framework.[168] Hence, it has stated that 'user generated contents and data collection have become core activities for the value creation of digital businesses',[169] which are not reflected in current tax rules. Because of the risk of corporate tax base erosion, as well as the public perception of unfair treatment of digital and non-digital businesses, the EU Commission has urged the Member States to act;[170] it argues that an EU-wide DST, as set out in the 2018 DST Directive Proposal, will avoid fragmentation of the Single Market that would be caused by their implementation of uncoordinated, unilateral measures and ensure that competition is not distorted thereby.[171] Moreover, the 2018

164. *Ibid.* para. 463. The OECD further explained:

> Thus in the case of hotel booking websites, where the commission for the intermediation service is generally paid by the hotel, the supply would then be treated as made to the hotel. Similarly, in respect of the sale of goods where the seller pays a commission to the eservice provider in respect of every sale, the intermediation service would then be treated as supplied to the seller of the goods (and, in this case, the country of residence of the goods supplier would impose the tax, and not the country of residence of the goods buyer). In those cases where the service provider charges separate fees to different parties with respect to different sides of the same transaction (e.g. in the case of an intermediation service, both the seller and the purchaser of the intermediate goods or services) then the supply would be treated as made in proportion to the consideration provided.

165. *See* §6.03[C][2] *infra*.
166. 2018 DST Directive Proposal, *supra* note 66, at 3; 2018 OECD Interim Report, *supra* note 12, para. 514; *see also* §6.01[C] *supra*.
167. 2018 DST Directive Proposal, *supra* note 66, at 1 referring to a Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A Digital Single Market Strategy for Europe, 6 May 2015, COM(2015) 192.
168. 2018 DST Directive Proposal, *supra* note 66, at 1.
169. *Ibid*.
170. *Ibid*. at 3.
171. *Ibid*.; *see also* §6.01[C] *supra*. The Commission notes that ten Member States have already adopted or plan to adopt the concrete implementation of unilateral measures.

DST Directive Proposal generally aims to achieve sustainable public finances, to ensure 'social fairness' via equal treatment of businesses active in the EU, and to combat aggressive tax planning.[172]

The 2018 DST Directive Proposal's specific objective is to tax – in a manner that is simple to administer – revenues generated by the supply of certain digital services.[173] It is intended to level the playing field until the Member States can agree on a long-term measure (ideally based on a SDP).[174] In that regard, the proposed DST only taxes activities that have a high level of user participation, which, in turn constitutes an important business input factor.[175]

[B] Legal Basis

The 2018 DST Directive Proposal is based on Article 113 TFEU,[176] which provides a special legislative procedure pursuant to which the EU Council may adopt harmonizing provisions on, *inter alia*, turnover taxes after having consulted the EU Parliament and the European Economic and Social Committee (EESC).[177] The proposed instrument is a directive, rather than a regulation, as that is the only instrument permitted under Article 113 TFEU's procedure.[178]

172. 2018 DST Directive Proposal, *supra* note 66, at 3–4.
173. *Ibid.* at 3.
174. *Ibid.*
175. *Ibid.* at 7.
176. It might be noted in passing that there is an intense discussion as to the correct legal basis of the DST proposal, i.e., whether it should be based on Art. 113 TFEU or on Art. 115 TFEU (*see* para. 8 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018)), which largely depends how to understand the terms 'turnover taxes' and 'other forms of indirect taxation' in the former provision. Since the DST Proposal aims at the issuance of a Directive (the only instrument available under Art. 115 TFEU) and both provisions would trigger the same legislative procedure, the choice of legal basis might not have any immediate legal ramification, although it remains to be seen how the European Court of Justice (ECJ) will address that issue. The Court has the authority to review Union acts for the lack of competence or the choice of the wrong legal basis, ruling on the 'legality' or 'validity' of legislative acts (Arts 264 and 267 TFEU). The issue of 'legality' includes, under Art. 263 TFEU, 'jurisdiction in actions brought by a Member State, the European Parliament, the Council or the Commission on grounds of lack of competence' and to declare such acts 'void' (Art. 264 TFEU), but a temporal limit is put on such proceeding, as those 'shall be instituted within two months of the publication of the measure' (after which elapse the lawfulness of the Union act is presumed; *see*, *e.g.*, ECJ, 5 October 2004, C-475/01, *Commission/Greece* ('Ouzo'), EU:C:2004:585, paras 22–23). No such temporal limit is imposed on preliminary ruling procedures initiated by domestic courts under Art. 267 TFEU, where the ECJ reviews the 'validity' 'of acts of the institutions, bodies, offices or agencies of the Union', which may include lack of competence; such a finding by the ECJ, though only addressed to the referring national court, has quite similar effects as an annulment in a procedure under Art. 263 TFEU (*see*, *e.g.*, ECJ, 13 May 1981, 66/80, *SpA International Chemical Corporation*, EU:C:1981:102).
177. 2018 DST Directive Proposal, *supra* note 66, at 5.
178. *Ibid.*

According to the current wording of the 2018 DST Directive Proposal, if approved, the Member States would be obliged to transpose the new directive by 31 December 2019, with substantive application as of 1 January 2020.[179]

[C] The DST's Characteristics

[1] Tax Rate, Taxable Persons, and the Tax Base

The proposed DST is a destination-based turnover tax levied on gross revenues net of VAT (and other similar taxes[180]) arising out of certain digital services. Costs cannot be deducted from the tax base and losses cannot be carried forward. The rate, in turn, is set at 3%,[181] to achieve 'an appropriate balance between revenues generated by the tax' and to account 'for the differential DST impact for businesses with different profit margins'.[182]

DST-taxable persons will be any corporate or transparent entity[183] fulfilling two conditions. The first condition, whose objective is to exclude SMEs and start-ups and, thus, to only target companies of a certain scale able to establish strong market positions,[184] requires the entity to have a total amount of taxable revenues in the relevant financial year that exceeds EUR 750 million.[185] The second condition, whose objective is to capture only subject those entities with a 'significant digital footprint' in the EU to the DST,[186] requires the entity to have a total amount of taxable revenues obtained within the EU that exceeds EUR 50 million.[187]

To avoid potential double taxation caused by corporate tax and DST, the 2018 DST Directive Proposal expects Member States to allow 'businesses to deduct the DST paid as a cost from the corporate income tax (CIT) base in their territory, irrespective of whether both taxes are paid in the same Member State or different ones'.[188] That approach would almost certainly be systematically correct, *de lege lata,* in many of the Member States that employ a worldwide tax system, but might also lead to shifts in tax

179. *Ibid*. Art. 25(1). Note however that the dates are between square brackets, which means that they are in particular subject to change.
180. *Ibid*. Art. 3(2).
181. *Ibid*. Art. 8.
182. *Ibid*. recital (35).
183. *Ibid*. Arts 4(1) & 2(1).
184. *Ibid*. at 10. The arguments for taxing only 'big players' are of mere political nature and cannot explained by any legal rationale.
185. *Ibid*. Art. 4(1)(a).
186. *Ibid*. at 10.
187. *Ibid*. Art. 4(1)(b). These amounts are calculated at the date of when they fall due, not when they are effectively paid/received, *see* Art. 4(5) 2018 DST Directive Proposal. The text of the proposal is however not entirely clear on whether the first bracket of EUR 50 million of taxable revenues is already taxed or whether just the part of turnover above EUR 50 million is taxed (i.e., if the taxable person has a turnover of EUR 80 million, only EUR 30 million would constitute the tax base). From the wording of the proposal, it seems more likely that the first bracket of EUR 50 million is already taxed.
188. Recital (27) of the Preamble to 2018 DST Directive Proposal. The wording 'it is expected that Member States will allow business to deduct the DST' indicates that this cost deductibility is a strongly recommended option.

revenues when DST revenue accrues to one Member State when the business expense deduction is borne by another Member State. As the EU Commission, obviously, did not intend to mandate specific corporate tax rules, this expressed 'expectation' of a cost deduction is merely mentioned in the preamble and is not prescribed in the substantive body of the proposed directive.[189]

[2] Taxable Transactions and Place of Taxation

The 2018 DST Directive Proposal adopts a step-by-step approach to determining services, nexus, and revenue apportionment. First, it defines which revenue streams (i.e., revenues from which precise services) are taxable (Article 3); second, it determines the place of taxation (i.e., the nexus), by references to users' location (Article 5(2)); and third, it apportions the revenue between the relevant Member States based on user-related criteria (Article 5(3)).

The list of covered services in Article 3, which is exhaustive, includes placing user-targeted advertising on a digital interface and providing intermediation services that allow users to access a multi-sided digital interface to find and interact with each other, as well as transmitting collected user data, including data inferred from the users' activities on digital interfaces.[190] Certain services are explicitly excluded from the scope of the DST Directive Proposal, 'the making available of a digital interface where the sole or main purpose of making the interface available is for the entity making it available to supply digital content to users or to supply communication services to users or to supply payment services to users'.[191] The excluded intermediation services are different from covered intermediation services in that covered services allow users to interact without knowing each other beforehand due to software allowing for that interaction,[192] whereas covered services are based on the active involvement of users (e.g., by offering goods or services to other users); thereby creating network effects of which intermediaries benefit.[193] Further excluded services are those provided by a trading venue or a systematic internalizer of services referred to in points (1)–(9) of section A of Annex I to Directive 2014/65/EU[194] and regulated

189. This might be explained by the fact that if the cost deduction was provided for in the substantial part of the proposal, the DST is more likely to appear as a prepayment of CIT, which could lead to incompatibility issues with WTO law and double tax treaties; *see also* §6.03[D][1][a] and §6.03[D][1][c] *infra*.
190. Article 3(1) 2018 DST Directive Proposal.
191. *Ibid*. Art. 3(4)(a). The Explanatory Memorandum to the 2018 DST Directive Proposal clarifies that these services shall not be regarded as intermediation services subject to DST as user participation plays a less important role in the value creation process of companies offering these services; *see* 2018 DST Directive Proposal, *supra* note 66, at 8. This would however not apply if users make available digital content to other users on that digital interface, which would in turn again fall within the definition of services subject to DST.
192. 2018 DST Directive Proposal, *supra* note 66, at 8.
193. *Ibid*.
194. EU Parliament & EU Council, *Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU*, OJ L 173/349 (2014).

crowdfunding services as well as those facilitating the provision of a loan provided by these trading venues or internalizers of services.[195]

Hence, in contrast to the 2018 SDP Directive Proposal, which adopted a broad definition of digital services in its Article 3(5),[196] the 2018 DST Directive Proposal only covered certain digital services. Thus, the 2018 DST Directive Proposal rejected the opinion issued by the EU Commission Expert Group in 2014, which advised, at that time, against any 'ring-fencing' measures.[197]

The 2018 DST Directive Proposal makes no reference to a cross-border requirement in defining the term services so that it applies equally to domestic and international situations. That policy choice diminishes possible discrimination claims, even though in practice, the twofold revenue thresholds would almost certainly result, in a majority of cases, in taxation of cross-border business operations.[198]

The place for such taxation, pursuant to proposed Article 5(2), is to be the location of the users in any particular Member State at the moment they receive the taxable service, irrespective of whether said users have paid for the service or contributed thereto by any other means, such as providing data, whether consciously or unconsciously.[199] The taxable persons' and users' establishments, as well as their places of supply and payment (if different),[200] thus, are irrelevant, which stands in line with the notion that only user involvement as a contribution to value creation is taken into account for DST taxation, irrespective of how or when such users generally pay for a service or if only some users pay therefore.[201] The users' location is determined either by means of the IP address of the device enabling the user to access the taxable service or by any other geolocation method that achieves a more accurate determination of such location.[202]

The 2018 DST Directive Proposal goes on to provide that both the user's location (i.e., the place of taxation) and any revenue allocation among the Member States depend on the different types of services covered:

– *User-targeted advertising on a digital interface* – for advertising services, the Member State in which users viewing the advertising are located at the moment of its display must tax.[203] Taxable revenues generated from such advertising services in more than one Member State are allocated among such Member States in a proportional manner, with the number of times an advertisement has appeared on the users' devices during the given tax period located in that Member State taken into account.[204]

195. Article 3(4)(b) & (c) 2018 DST Directive Proposal.
196. S*ee also* the contribution of Peter Bräumann, Chapter 7 in this volume.
197. *Commission Expert Group on Taxation of the Digital Economy*, *supra* note 12, at 41.
198. *See* §6.03[D][1][ii] *infra* for the analysis of possible issues related to State aid rules in that regard.
199. Article 5(1) 2018 DST Directive Proposal.
200. *Ibid*. Art. 5(4).
201. *Ibid*. at 11.
202. *Ibid*. Art. 5(5).
203. *Ibid*. Art. 5(2)(a).
204. *Ibid*. Art. 5(3)(a).

- *Intermediation services matching users to other users for the supply of goods and services* – with multi-sided interfaces that match users and their peers for the underlying supply of goods and services, the Member State in which the user is located when using a device to access the interface and conclude an underlying transaction on that interface must tax.[205] The number of users having concluded underlying transactions on the digital interface in the relevant tax period determines each Member State's proportionate share of the tax base.[206] The EU Commission's DST proposal presumes that whether a particular user operates as the buyer or the seller in any particular transaction should not impact either the place of taxation or revenue allocation, as both actors equally contribute to value creation by the digital business.[207]
- *Other intermediation services* – in the case of any other intermediating digital interfaces, the Member State in which the user opens his or her account[208] to access the interface must tax, irrespective of how long the user account exists.[209] The EU Commission observed that, in such cases, users usually pay periodic fees to the digital business after having registered or opened an account.[210] The 2018 DST Directive Proposal obliges Member States to tax the proportion of revenues relating to the number of users holding an account allowing them to access the tax period during all or part of the tax period.[211]
- *Transmission of collected user data* – for taxable services relating to the transmission of user data, the Member State in which the users were located when using a device to access an interface resulting in the generation of data in the hands of the business must tax.[212] In that regard, the number of users from whom data have been transmitted as a result of them accessing the interface dictates the proportion of taxable revenues of any particular Member State.[213]

The rules for determining the location of users and allocating the revenue derived from the digital service may be summarized as follows:

205. *Ibid.* Art. 5(2)(b)(i).
206. *Ibid.* Art. 5(3)(b)(i).
207. 2018 DST Directive Proposal, *supra* note 66 at 12.
208. To distinguish from the registration process – it is sufficient to log in in order to be counted as a user of these intermediation services.
209. Article 5(2)(b)(ii) 2018 DST Directive Proposal.
210. 2018 DST Directive Proposal, *supra* note 66, at 12. Examples for this are certain dating websites, such as 'match.com', which make the accessibility of the full service subject to the payment of subscription fees.
211. Article 5(3)(b)(ii) 2018 DST Directive Proposal. Note that this is wider than the requirement of Art. 5(2)(b)(ii) relating to the location of users, where it is prescribed that users have opened the account to access the interface via that account during the tax period to be locatable in that Member State.
212. Article 5(2)(c) 2018 DST Directive Proposal.
213. *Ibid.* Art. 5(3)(c). The reference in this provision to the taxable period as well as previous periods should be understood as neutralizing the moment of data collection and uniquely focusing on the moment of data transmission irrespectively of when they have been collected.

Service	*Location in a Member State (IP or Geolocation)*	*Revenue Proportion*
Placing of advertisements on a digital interface (Article 3(1)(a) DST)	Advertising appears on user's device (Article 5(2)(a) DST)	Number of times an advertisement has appeared on users' devices (Article 5(3)(a) DST)
Making available multi-sided digital interfaces ('intermediation services') (Article 3(1)(b) DST)	User's device for concluding underlying supply of goods or services (Article 5(2)(b)(i) DST)	Number of users having concluded underlying transactions (Article 5(3)(b)(i) DST) –*Place of underlying transaction irrelevant* (Article 5(4)(a) DST)
	User's device for opening account in other cases (Article 5(2)(b)(ii) DST)	Number of users holding an account (Article 5(3)(b)(ii) DST)
Transmission of user data (Article 3(1)(c) DST)	Data generated from the user having used a device (Article 5(2)(c) DST)	Number of users from whom data transmitted has been generated (Article 5(4)(c) DST) –*Tax period irrelevant*

[3] Tax Collection and Enforcement

As a general rule, a taxable person must register in only one Member State in which DST is due, i.e., either in the Member State in which the taxable person is liable to DST for the first chargeable tax period or, if that would be true for more than one Member State, such one of those Member States as the taxable person chooses.[214] Hence, to facilitate tax collection, the 2018 DST Directive Proposal offers a One-Stop-Shop (OSS) mechanism that allows a taxpayer obliged to pay DST in more than one Member State to choose one Member State (the 'OSS MS') for all of its DST interactions (e.g., identifying itself, submitting annual DST returns, and making DST payments).[215] The taxable person's choice of OSS MS is binding for three tax periods, including the tax period in which it made its choice.[216] Despite having chosen an OSS MS, the taxable person remains liable for any DST due in each Member State in which it is imposed.[217]

214. Article 10(1) 2018 DST Directive Proposal. An individual identification number is provided to the taxable person by the Member State of identification; Art. 11(1) 2018 DST Directive Proposal.
215. *Ibid.* Art. 10(3); 2018 DST Directive Proposal, *supra* note 66, at 12. An information exchange is set up between Member States in that regard; *see infra* and Arts 20–23 2018 DST Directive Proposal. It seems, however, that at the Council level 'Delegations agree that, in principle, DST collection should function without the one-stop-shop'; *see* para. 7 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018).
216. Article 13(1) 2018 DST Directive Proposal.
217. Article 18(4) 2018 DST Directive Proposal. This liability may lead to cash flow disadvantages in cases where the Member State of identification does not transmit timely the amount due in another Member State and the latter requests the taxable person to pay the DST due to it again. *See* §6.03[D][1][c] *infra*.

To further facilitate DST collection, the proposed directive allows consolidated groups to appoint a single entity to act on the group's behalf for all such DST interactions.[218]

A tax return and any DST payment due must be submitted every tax period (i.e., calendar year)[219] within thirty working days following the end thereof (e.g., 31 December).[220] The total DST payable by a taxable person must be paid to the Member State of identification or the chosen OSS MS, if applicable.[221]

The 2018 DST Directive Proposal requires Member States to establish an exchange of information system, through which all relevant information regarding the taxable person's identity, notices, annual DST returns (and amendments thereto, if appropriate), and DST payments must be transferred within ten working days.[222] The 2018 DST Directive Proposal leaves the exact configuration and implementation of the exchange-of-DST-information system up to the EU Commission, which is authorized to adopt relevant implementing acts therefore.[223]

[D] DST Challenges and Practical Issues

There is no consensus on the either merit or the need of 'equalization taxes' or, more generally, interim measures in the OECD 2018 Interim Report of March,[224] and such taxes are met with strong opposition from the US as they would violate 'the long-held principle that taxes on multinationals should be profit-based, not revenue based'.[225] Some States have, however, already moved forward with their own 'equalization taxes'[226] and, e.g., the UK as well as Australia have set out detailed policy ideas on turnover-based taxation of certain digital services.[227] Practitioners, industry and academics are, however, largely sceptical with regard to turnover-based interim solutions,[228] although it is argued that the DST could not only be defended from a political standpoint – i.e., by giving 'a strong sign to the international community as to

218. Article 9(2) 2018 DST Directive Proposal.
219. *Ibid*. Art. 2(7).
220. *Ibid*. Arts 14 & 16(2).
221. *Ibid*. Art. 16(1).
222. *Ibid*. Arts 20–22.
223. *Ibid*. Art. 23(2).
224. OECD 2018 Interim Report, paras 403 et seq.
225. *See* the letter of 18 October 2018 by Orrin Hatch and Ron Wyden from the United States Senate to Donald Tusk and Jean-Claude Juncker regarding the DST Proposal, *available at* https://www.finance.senate.gov/imo/media/doc/2018-10-18%20OGH%20RW%20to%20Juncker%20Tusk.pdf (accessed 12 November 2018).
226. *See* §6.01[C] *supra*.
227. *See* HM Treasury position paper on 'Corporate tax and the digital economy: position paper update' (March 2018), and Australian Government, The Treasury, *The Digital Economy and Australia's Corporate Tax System,* Treasury Discussion Paper (October 2018).
228. For critical assessments of equalization levies, *see, e.g.,* Pasquale Pistone & Yariv Brauner, *Adapting Current International Taxation to New Business Models: Two Proposals for the European Union*, 71 Bull. Int'l Tax 681, 682–683 (2017); Becker & Englisch, *supra* note 38; van Horzen & van Esdonk, *supra* note 38, at 267 et seq. For a rather positive view, *see,* however, Dourado, *supra* note 24, at 565, 568 et seq. For an analysis of the potential impact from a business perspective, see Helge Sigurd Næss-Schmidt, Gerdis Marquart & Palle Sørensen, *The Impact of an EU Digital Service Tax on German Businesses*, Copenhagen Economics Report (19 October 2018).

the commitment of the EU to act when it comes to ensuring the fair taxation of the digital economy'[229] – but also as a way of taxing location-specific rents earned by digital platforms.[230] At the time of writing, it is unclear if agreement on the DST will be reached at the EU level,[231] and, if so, which features will address the concerns raised over the last couple of months. There is indeed a variety of practical implementation challenges arising from the adoption of the 2018 DST Directive Proposal, and three broad groups of challenges – (1) compatibility with the international legal framework, (2) selected policy objections and (3) some broader practical issues – require deeper analysis.

[1] Incompatibility and Lack of Coordination with Existing Legal Frameworks

[a] Relationship with Double Tax Conventions: Double Taxation

'Interim measures' for the taxation of the digitalized economy, such as the DST, also have a tax treaty dimension. They raise, *inter alia*, the question whether they have to be viewed as taxes on 'income' or 'elements of income', which are core notions for the delimitation of the substantive scope of tax treaties. Relating to possible interim measures to address the tax challenges arising from digitalization, already the OECD in its 2018 Interim Report has accentuated the need for compliance of such measures with international law. 'Any new tax that a country introduces must be in compliance with its existing international obligations', including tax treaties,[232] and this compliance with tax treaties is also an essential aim of the DST proposal[233] and subject to discussions in Council.[234] If, conversely, the DST would have to be viewed as a tax on 'income' or 'elements of income' within the meaning of Article 2 OECD MC and hence generally fall within the scope of tax treaties, a possible conflict between the levy of DST and the existing rules of tax treaties, especially with regard to provisions along the lines of Articles 5, 7 and 23 OECD MC, would arise.

229. 2018 DST Directive Proposal, *supra* note 66, 5. For a critical perspective on the argument that 'while consensus is being built interim solutions may be positive to make sure that the debate continues towards a consensus type solution', see Yariv Brauner, *Taxing the Digital Economy Post-BEPS, Seriously*, 46 Intertax 462, 464 (2018).
230. Cui, *supra* note 38.
231. *See, e.g.,* para. 15 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018).
232. 2018 OECD Interim Report, *supra* note 12, paras 413–431.
233. Indeed, the DST proposal is the Commission's reaction to the invitation to adopt proposals responding to the challenges of taxing profits in the digital economy by the ECOFIN conclusions of 5 December 2017. At this time, many Member States had expressed an interest in devising temporary measures aimed at collecting more revenues resulting from digital activities in the Union, while ensuring these measures would remain outside the scope of tax treaties. *See* Council of the European Union, *Responding to the challenges of taxation of profits of the digital economy – Council conclusions,* 15445/17, FISC 346 ECOFIN 1092 (5 December 2017), para. 24.
234. *See* para. 8 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018).

However, based on the criteria set out by the OECD,[235] a balancing of the various factors leads to the conclusion that the DST is not a tax covered by tax treaties,[236] a position – explicitly or implicitly – shared by nearly all commentators.[237] Admittedly, the borderline drawn by Article 2 OECD MC for 'hybrid' taxes such as the DST is blurred, and legal certainty on that issue will only be achieved in the future; if it were eventually to be determined that the DST is covered by tax treaties, EU law would generally override tax treaties, but difficult questions might arise under Article 351 TFEU.[238]

Concluding that the DST would not fall under Article 2 OECD MC also means that unrelieved double burdens occur where revenues are taxed under DST and profits under a – domestic or foreign – CIT: A cross-border taxable person could be subject to double (and, hence, over-) taxation for which no relief is contemplated by Article 23 OECD Model.[239] Further, neither the double tax convention's (DTC's) mutual agreement procedure under Article 25 OECD Model nor the EU dispute resolution directive's dispute resolution mechanisms would apply.[240] Creating a new tax that falls outside the scope of existing DTCs modelled on the OECD Model is a step backwards rather than forwards toward avoiding double taxation.[241]

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235. *See* §6.02[B][2][a] *supra*.
236. *See* for the main arguments and further references Hohenwarter et al., *supra* note 4.
237. *See*, *e.g.,* Ismer & Jescheck, *supra* note 112, at 577 (2018); Turina, *supra* note 24, at 518 (2018); CFE Tax Advisors Europe, *supra* note 66; Tom O'Shea, *Comments on the EU's Proposed Indirect Digital Service Tax*, 90 Tax Notes Int'l 1373, 1377 (2018); Opinion of the European Economic and Social Committee ECO/459 on the Taxation of profits of multinationals in the digital economy (EESC 2018/01556 adopted on 12 July 2018, OJ C 367/73 (10 October 2018), m.nos 1.5 and 2.4 (referring to the DST as turnover tax or indirect tax); Cui, *supra* note 38; Fadi Shaheen, *Income Tax Treaty Aspects of Nonincome Taxes: The Importance of Residence*, 71 Tax L. Rev. (2018) 583, 620 et seq. (with regard to recent examples of turnover and equalization taxes); *contra* Matthias Valta, *Verfassungs- und Abkommensrechtsfragen des Richtlinienentwurfs für eine Steuer auf digitale Dienstleistungen*, 27 IStR 765, 771–772 (2018).
238. More generally, regulating the treatment of non-EU nationals in internal legislation may create conflicts with existing bilateral tax treaties and call for an examination of the scope of Art. 351 TFEU. A potential 'treaty override' can, e.g., already be found in Art. 7 ATAD, which requires the inclusion of foreign, tax treaty exempt PEs in the scope of CFC rules, thereby arguably forcing Member States to override the exemption method in their tax treaties with third countries. On the other, the Union is usually careful not to upset the existing tax treaty network between Member States and third countries. This is clearly visible, e.g., with regard to the Commission's proposal for a significant digital presence (COM(2018) 147), where Art. 2 specifies that the Directive would, 'in the case of entities that are resident for corporate tax purposes in a third country with which the particular Member State in question has a convention for the avoidance of double taxation', only apply 'if that convention includes provisions similar to Articles 4 and 5 of this Directive in relation to the third country and those provisions are in force'. Complementing this delimitation of the Directive's scope, the Commission has simultaneously issued a recommendation to Member States to (bilaterally) amend their tax treaties with third countries and to include provisions on significant digital presences (*see* the Commission's Recommendation of 21 March 2018 relating to the corporate taxation of a significant digital presence, COM(2018) 1650).
239. CFE Tax Advisors Europe, *supra* note 66, at 7.
240. *Ibid*. 7 & 9; Council Directive 2017/1852 on tax dispute resolution mechanisms in the European Union, OJ L 265/1 (2017), at Art. 1.
241. The CFE Tax Advisors recommend the implementation of new taxes within the scope of the existing tax treaty network, *see* CFE Tax Advisors Europe, *supra* note 66, at 10. The difficulty

[b] *Interference with EU Law*

Five EU law domains could pose potential problems for implementing the DST as proposed by the 2018 DST Directive Proposal:

(1) Principles of Union Law: Member States continue to debate the subsidiarity and proportionality of the 2018 DST Directive Proposal; some argue that it does not properly respect those principles.[242]

(2) Fundamental EU Freedoms: Although these are unlikely to cause problems, as the proposed DST applies equally to domestic and cross-border situations,[243] it remains to be seen whether it might be viewed as de facto discrimination of foreign or foreign-owned companies and what consequences would derive therefrom in case of a harmonized regime.[244]

(3) VAT: The proposed DST is unlikely to interfere with Article 401 of the VAT Directive,[245] which generally prohibits other turnover taxes presenting characteristics similar to VAT;[246] the proposed DST is not an 'all-phase, input-deduction tax that generally applies to transactions relating to goods or services'.[247] Moreover, as the proposed DST would be enacted on the same legislative level as VAT (e.g., secondary EU law), it would be difficult to demonstrate that the two taxes were incompatible.[248]

(4) CCCTB: Assuming that both the CCCTB proposals[249] and the 2018 DST Directive Proposals are adopted, one might think there would be a potential conflict in their implementation and application. However, the EU Commission did not provide a detailed explanation as to how the DST fits within the proposed CCCTB framework,[250] likely because of the DST's stopgap, temporary nature, but instead explained how its CCCTB proposal should be adapted to the 2018 SDP Directive Proposal, the EU Commission's the long-term

to achieve an aptly designed equalization levy is also demonstrated by Ismer & Jescheck, *supra* note 112, at 575, comparing the Indian equalization levy and the Italian web tax.

242. *See* the negative parliamentary opinions in PE622.193 (Danish Parliament); Doc. 9139/18 FISC 221 ECOFIN 444 (Irish Parliament), PE622.196 (Maltese Parliament); PE622.197 (Netherlands House of Representatives).
243. Turina, *supra* note 24, at 509.
244. *See* Mason & Parada, *supra* note 130, arguing that DST-like taxes might cause covert nationality discrimination based on taxpayers' size. *See also* Turina, *supra* note 24, at 509, referring to ECJ, *Safir*, C-118/96, Judgment, EU:C:1998:170, where the Court found a violation of the freedom to provide services by a Swedish insurance equalization levy.
245. Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, [2006] OJ L 347/1.
246. As clarified by the case law of the Court of Justice: *Dansk Denkavit*, C-200/90, Judgment, EU:C:1992:152, paras 11–14; *see* for further explanations Turina, *supra* note 24, at 510.
247. Kofler, Mayr & Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?*, *supra* note 4, at 531.
248. *Ibid.* 531.
249. *See also* §6.01[B] *supra*.
250. 2018 DST Directive Proposal, *supra* note 66, at 4.

solution for digital economy taxation.[251] Consequently, no interference between DST and CCCTB is expected.

(5) State Aid: The argument has been raised that State aid prohibitions and obligations under Article 107 TFEU might, potentially, interfere with the implementation of the DST as proposed in the 2018 DST Directive Proposal, as its application to only certain digital services and its revenue thresholds could amount to selectivity.[252] However, a strong argument against the DST's qualification as State aid – despite the necessity of and discretion in implementation by the individual Member States – is its approval by the Union legislator, which, first, implies that the measure cannot be imputed to the Member States (but rather stems from an act of the Union legislature) and, second, amounts to a declaration that it is not a measure 'affect[ing] trade between Member States'.[253]

[c] Interference with WTO Law

It has been argued that the DST, if implemented in its proposed form, might raise issues under the General Agreement on Trade in Services, as it would only cover certain digital services[254] and would, in effect, only target the 'biggest' digital services providers, which happen to be, by and large, third-country players.[255] However, it remains to be seen whether the legal application of the DST to domestic and foreign service providers effectively removes such objections.[256]

[2] Selected Policy Objections

As previously suggested, if the DST were to be adopted in its currently proposed form, its implementation could lead to significant legal uncertainty for a variety of reasons,

251. 2018 SDP Directive Proposal, *supra* note 64, at 3–4.
252. Turina, *supra* note 24, at 510 & 519; Mason & Parada, *supra* note 130.
253. *See* ECJ, 5 April 2006, T-351/02, *Deutsche Bahn AG* v *Commission of the European Communities*, EU:T:2006:104, paras 101–106. This case dealt with the transposition of Directive 92/81 into German law, providing in its Art. 8(1)(b) for an exemption of certain mineral oils from excise duty. The German national railway company, Deutsche Bahn, claimed that this exemption implemented into German law constituted State aid and requested the EU Commission to take measures against it, which has been rejected due to the fact that the exemption finds its origin in EU law. The Court agreed with the Commission, *see* especially para. 102: In transposing the exemption into national law, Member States are only implementing Community provisions in accordance with their obligations stemming from the Treaty. Therefore, the provision at issue is not imputable to the German State, but in actual fact stems from an act of the Community legislature.
254. Article 3(1) 2018 DST Directive Proposal, *see also* CFE Tax Advisors Europe, *supra* note 66, at 6. For a critical analysis from a US perspective, see Gary Clyde Hufbauer & Zhiyao Lu, *The European Union's Proposed Services Tax: A De Facto Tariff*, Peterson Institute for International Economics (June 2018), https://piie.com/publications/policy-briefs/european-unions-proposed-digital-services-tax-de-facto-tariff (accessed 12 November 2018).
255. Frans Vanistendael, *The Level Playing Field in Digital Taxation*, 90 Tax Notes Int'l 867, 868 (2018).
256. *See* for a brief discussion, e.g., Schön, *supra* note 24, at 286.

resulting in a *dis*incentive for cross-border trade and investment in the Member States in which the DST is imposed.[257] Why? Because the proposed DST sits outside of the Member States' 'normal' CIT system, and thus sidesteps the CIT's 'core problem', which is at the very heart of the whole digital tax debate.[258] The DST, rather, would create an additional layer of complexity on top of the already-complex CIT issues, without offering any coordinated solution to any of them.[259] The time and energy spent on developing a well-functioning, well-thought-through DST would probably be better invested in hammering out a coordinated long-term solution that addresses the broader CIT issues, like a SDP, destination-based residual market profit allocation or inbound and outbound minimum taxes,[260] as well as the CIT's subordinate issues.

The DST's likely negative impact on cross-border trade and investment may also lead one to question whether it is effectively capable of contributing to the creation and subsequent reinforcement of the EU-envisaged EU Digital Single Market;[261] its adoption would likely have adverse effects on that market. Moreover, the fragmentation risks likely to arise out of unilateral Member State measures intended to blunt the potential negative impacts of the DST as drafted would have to be carefully assessed and balanced to ensure that it does not make matters even worse.

The rationale behind the 2018 DST Directive Proposal, and the DST proposed therein, is the EU's quest for a 'fairer distribution of tax revenues between national tax administrations' and the correction of the 'existing misalignment of taxation and value creation'.[262] However, neither the concept of 'fair distribution' nor the scope of such purported misalignment have been clearly established or defined, nor has there been an adequate, transparent assessment of the overall impact of the proposed DST on growth, welfare, revenue distribution, and compliance, much less an assessment of its costs.[263] Indeed, with respect to the balance among Member States, the Opinion of the EESC expressed its concern that the proposed shift in taxation to a revenue-based system 'will benefit larger economies with many consumers at the expense of smaller exporting economies' and underlined 'that any solution, whether short or long term, to the taxation of digital business models must result in fair and equal economic outcome for all economies in the EU'.[264] Despite such concerns, the legislative process seems to

257. Brauner, *supra* note 229 at 465.
258. *Ibid.* at 464.
259. *Ibid.*
260. For a recent analysis of these proposals, *see, e.g.*, Itai Grinberg, *International Taxation in an Era of Digital Disruption: Analyzing the Current Debate* (29 October 2018), *available at* SSRN: https://ssrn.com/abstract=3275737 or http://dx.doi.org/10.2139/ssrn.3275737 (accessed 12 November 2018).
261. 2018 DST Directive Proposal, *supra* note 66, at 3.
262. *See* 2018 EU Staff Impact Assessment, *supra* note 63, at 3.
263. *See also* the critical statements in the Regulatory Scrutiny Board Opinion, Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence & Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=PI_COM:SEC(2018)162&from=EN (accessed 12 October 2018).
264. Opinion of the European Economic and Social Committee of 12 July 2018 on 'Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence', EESC 2018/01556, [2018] OJ C 367/73.

have been driven, mainly, by the political will to set a political milestone with respect to taxation of digital business models; much of that political will being based on a vague 'perceived unfairness'.[265]

Moreover, as proposed, the 'fairness' of the DST clearly has its limits, particularly with respect to turnover taxation for the different business models with their different profit margins. From the perspective of 'profits', the 2018 DST Directive Proposal's turnover basis, of course, fails to incorporate a profitability threshold, which disregards the ability-to-pay principle[266] and creates adverse effects for companies with small profit margins, such as start-ups.[267] The worldwide turnover threshold (EUR 750 million) furthers favour start-ups with low turnover in their first years of business activity compared to already established companies, active in other fields of business, that decide to widen their offer towards digital services covered by the DST proposal. The latter companies tend to easily fulfil the turnover threshold of EUR 750 million and hence to fall within the scope of application of the DST,[268] whereas the first companies may generate higher turnover and profits with their digital activities without being liable to DST. Such outcome seems to contradict the core idea of a 'digital services' tax. To remedy that likely and correct criticism, the DST should be redesigned with respect for fundamental taxation principles firmly in mind. For example, it could be redesigned to constitute a minimum or 'default' tax, similar to the UK's 'diverted profits tax' or India's equalization levy.[269] Such a design would influence taxpayer behaviour and incentivize them to declare and pay CIT rather than to be subjected to a more expensive DST alternative (although one must acknowledge that a closer interrelation between a turnover tax and CIT could lead to stricter scrutiny in light of Article 2 OECD Model).

265. In the 2018 DST Directive Proposal (*supra* note 66, at 3), it is not clearly stated on whose perception the Commission relies. Related documents reveal that it deals with (voting) citizens' perception, *see, e.g.*, 2018 EU Staff Impact Assessment, *supra* note 63, at 3: The solution would improve the perception of fairness for citizens by ensuring that large companies with significant digital activities do not escape their taxes in the EU.
266. Even if the aim of the DST is certainly to tax digital companies that are 'on paper' loss making but where in reality shareholders and other stakeholders still have significant financial benefits, e.g., by the increasing share value. This is however contradictory to fundamental principles of taxation. For further explanation on such principles that also the DST should respect, *see, e.g.*, 2015 OECD BEPS Action 1 Report, *supra* note 12, paras 10 et seq. & 32 et seq.; Thomas Rödder, *Globalisierung und Unternehmenssteuerrecht: Wie ist das ertragsteuerliche Besteuerungssubstrat multinationaler Unternehmen sachgerecht auf die betroffenen Fisci aufzuteilen?, in Festschrift für Joachim Lang zum 70. Geburtstag: Gestaltung der Steuerrechtsordnung* 1147 et seq. (Klaus Tipke et al. eds., Otto Schmidt 2011); Heinz-Jürgen Pezzer, *Rechtfertigung der Körperschaftsteuer und ihre Entwicklung zu einer allgemeinen Unternehmensteuer, in Die Steuerrechtsordnung in der Diskussion – Festschrift für Klaus Tipke zum 70. Geburtstag* 419, 424 (Joachim Lang ed., Otto Schmidt 1995); Joachim Englisch, *VAT/GST and Direct Taxes: Different Purposes*, *in Value Added Tax and Direct Taxation – Similarities and Differences* 1, 3–9 (Michael Lang et al. eds., IBFD 2009).
267. CFE Tax Advisors Europe, *supra* note 66, at 8.
268. Provided that the additional threshold of taxable turnover within the EU (EUR 50 million) is also fulfilled.
269. Both levies do not apply in case the non-resident taxpayers maintain a PE to which the profits may be attributed and which is liable to corporate income tax. Wagh, *supra* note 74, at 549; Sinnig, *Besteuerung der digitalen Wirtschaft in Großbritannien, Italien und Ungarn*, *supra* note 4, at 410.

One particular aspect of legal uncertainty in the DST's practical application (again, assuming it is adopted as originally proposed) would arise out of its distinction between 'covered' and 'not covered' services. That distinction leaves open significant questions with respect to digital economy business models that combine different intermediation services. For any kind of intermediation services, the economic importance of the business grows alongside the number of users, as that reinforces its network effects.[270] The proposed DST, on the other hand, draws a dividing line between different types of intermediation services, attempting to tax only those that rely on value creation caused by user involvement.[271] For example, in the case of some collaborative (or sharing) economy models and online gaming business models, it is difficult to determine if payment or communication services, or the supply of digital content for that matter, are the 'sole or main purpose'[272] of the activity. If they were, such business models would be excluded from DST liability. But, such businesses may also imply an intermediation activity that facilitates the supply of goods and services between users or advertising activities and, hence, may heavily rely on user involvement and value creation on that basis, while simultaneously supplying digital content and other excluded services as an important part of their business model.[273] The definition of 'sole or main purpose', therefore, seems too vague to draw a clear and unambiguous dividing line between services covered by the DST and those excluded from its scope of application.

[3] Broader Practical Issues

Whereas, at least in the short and midterms, potential issues relate more to administrative difficulties, the proposed DST's long-term challenges put the ultimate effect of the DST, on both the market and tax incidence, into question. Of course, the definition of the covered digital services and also the sharing mechanism of revenue collected from DST raise a number of technical questions, and it seems that work on these issues in the Council has made progress to the extent that '[t]here is agreement on most of the definitions used for the purposes of the Directive, including multi-sided digital interfaces and targeted advertising',[274] while there is disagreement on whether the transmission of data collected about users and generated from users activities on digital interfaces (sale of user data) should be covered by the Directive.[275] In any event, the wording of the DST proposal makes one wonder if it overstretches the ability to comply: Revenues from advertising services under Article 3(1)(a) DST proposal, e.g.,

270. 2018 OECD Interim Report, *supra* note 12, para. 42.
271. 2018 DST Directive Proposal, *supra* note 66, at 8.
272. Article 3(4)(a) 2018 DST Directive Proposal.
273. Carrie Brandon Elliot, *Creating Value: Taxing Video Game Companies*, 90 Tax Notes Int'l 831, 833 (2018).
274. *See* para. 7 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018).
275. *See* paras 10–11 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018). For a narrow approach, *see* Kofler, Mayr & Schlager, *Taxation of the Digital Economy: A Pragmatic Approach to Short-Term Measures*, *supra* note 4, 123 et seq.

are effectively allocated to the EU depending on where the advertisement is displayed (i.e., 'appears on the user's device'; Article 5(2)(a) DST proposal), and between the Member States 'in proportion to the number of times an advertisement has appeared on users' devices in that tax period' (Article 5(3)a) DST proposal). Compliance with those provisions might require to divide revenue between the EU (and particular Member States) and the rest of the world and would pose the additional challenge that taxpayers – at least under current business and contractual arrangements – might not even know where the users are located (e.g., with regard to banner advertisements that are sold in bulk and placed on third-party webpages). While it might be understandable that the DST proposal does not focus on the location or 'source' of revenue derived from customers purchasing advertisement placement (information on which might be derived from VAT data) but rather 'user value creation',[276] it should also accommodate situations where compliance is either impossible or would create concerns with regard to data protection.

In the short term, moreover, high administrative costs on both sides (i.e., tax administrations and taxpayers)[277] and the acknowledged tax collection difficulties associated with tax imposed by way of self-assessments handed in by non-residents compared to withholding by resident agents will constitute the proposed DST's main implementation issues. That high cost is not likely to be proportionate to the limited expected revenues.[278] The DST's administration, including each Member State's enforcement rights when it is owed DST,[279] even when the taxable person has chosen an OSS MS pursuant to Articles 10(3)(b) and 13 2018 DST Directive Proposal, is likely to have significant negative effects on taxpayers. If, for example, a taxpayer pays the whole amount of DST due to all Member States to the OSS MS,[280] the taxpayer can still be obliged to pay a Member State's proportionate share thereof to the other Member State when the OSS MS fails to transfer the paid DST sums to other Member States. Taxpayers are thus obliged to answer for the poor practices (or even malpractice) of the OSS MS's tax administration.

For the longer term, one obvious lacuna in the 2018 DST Directive Proposal is its surprising lack of any sunset clause, even though it has been explicitly declared an 'interim' solution.[281] Some fear that, if adopted, the DST would lose its temporary nature once Member States realize that it is an effective way to generate revenue:[282] once a tax is in place, it can be very difficult to repeal it.[283] Indeed, the issue of 'timing' requires some comments:

276. *See* Recital (7) of the Preamble to 2018 DST Directive Proposal.
277. *See* §6.02[B][1] and §6.02[B][2][vi] *supra*.
278. 2018 EU Staff Impact Assessment, *supra* note 63, 2. *See also* §6.01[C] *supra*.
279. Article 18(4) 2018 DST Directive Proposal.
280. In compliance with Art. 16(1) 2018 DST Directive Proposal, which does not seem to be an optional choice for the taxable person.
281. 2018 DST Directive Proposal, *supra* note 66, at 2.
282. Lee Sheppard, *Five Takeaways from the Digital Tax Debate*, 89 Tax Notes Int'l 1251, 1252 (2018).
283. *See* §6.02[B][1] *supra*.

– The DST proposal does not contain any so-called sunset clause, although 'all delegations [in the Council] agree that the Directive should expire once the comprehensive solution at global level is in place'.[284] It is, however, debated if a sunset clause should have a fixed expiry date upon which the DST Directive would expire automatically or whether the expiry of the DST Directive should be linked to developments at the OECD/G20 level.[285] The first option would include a formal end date of the DST Directive. The second solution, i.e., the link to global developments (which are expected until summer 2020), is not unheard of in EU tax legislation[286] and there are certainly a number of technical ways to implement such condition (e.g., by linking the expiration of the DST to a new proposal by the EU Commission, which is contingent on a solution at the OECD/G20 level). However, the question remains if the mere 'sunset' of the DST Directive at the EU level would likewise (legally, not only politically) ban Member States from 'keeping' their domestic implementing legislation or to again introduce similar national taxes. It would certainly seem prudent, from an internal market perspective, that such national taxes would be explicitly 'outlawed', and the approach chosen for the EU-wide abolition of capital duties might serve as an example.[287]
– Conversely, one could also think about a vacatio legis of the DST Directive, linking the entry into force of the Directive to developments at the OECD/G20 level. Such 'inverted sunset clause' – or, more to the point, a 'sunrise clause' – would condition the DST to a non-solution at a global level. However, and apart from a number of technical issues, while such a 'sunrise' provision would potentially increase political pressure towards an international solution, it could politically create an outcome that nobody seems to wish for: That an imperfect measure that was conceptualized to be a short-term, interim solution would become permanent.

Further, as proposed, the DST is a turnover tax without any allowance for cost deduction that might distort the market due to cascading effects[288] and may shift the tax incidence to European consumers rather than to the targeted multinationals, such that the legislative intent to make the latter, and not the former, carry the financial burden

284. *See* para. 12 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018).
285. *See* para. 14 in the Note from the Presidency to the Permanent Representatives Committee/Council, Doc. 13525/18 FISC 427 ECOFIN 968 DIGIT 205 (29 October 2018).
286. *See* Art. 11(6) ATAD, where the obligation to implement the interest barrier under Art. 4 is deferred for Member States which have national targeted rules for preventing BEPS risks at 8 August 2016, which are equally effective to the interest limitation rule set out in this Directive, as those Member States 'may apply these targeted rules until the end of the first full fiscal year following the date of publication of the agreement between the OECD members on the official website on a minimum standard with regard to BEPS Action 4, but at the latest until 1 January 2024'.
287. *See* Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital, [2008] OJ L 46/11.
288. *Ibid*. §6.02[B][1].

of the DST will not be achieved.[289] Cascading effects may occur where taxable services are incorporated in a taxable onwards supply. The DST's cascading effects could also lead to double taxation.[290]

Also, as the scope of the proposed DST's application is very limited, one may wonder about its real impact, considering that monetization or service models can quickly adapt to new rules and, hence, escape the newly adopted DST.[291]

Finally, it is not entirely clear whether national 'equalization levies' with a similar scope as the EU DST, such as Hungary's advertising tax or the announced Spanish DST, would be legally pre-empted by the DST Directive, even though it seems (politically) clear that the DST should harmonize the field and prevent the fragmentation of the Internal Market by a myriad of unilateral taxes. It would therefore seem recommendable that a DST Directive explicitly spells out a prohibition of parallel national taxes, e.g., along the lines of Article 401 of the VAT Directive's prohibition of 'turnover taxes'.

§6.04 SUMMARY AND CONCLUSIONS

The digital economy challenges the very concept of tax territoriality based on physical presence in a fundamental and unprecedented way, and market jurisdictions seem to play an increasingly important role in tax revenue allocation. Proposed measures to modify the existing tax system include a modified PE concept (so as to include significant economic or digital presence), a withholding tax for digital transactions, and equalization levies. To date, no international consensus regarding any one of these measures has been found.

Nevertheless, in March 2018, the EU Commission dared to take the first step toward solving digital taxation issues via its 2018 SDP Directive Proposal for the long term and its 2018 DST Directive Proposal as an interim solution to permit taxation while work on the long-term solutions continues. That interim solution – which might be viewed as an 'equalization levy' from a political perspective – is intended to be a temporary patch over perceived 'undertaxation' of digital businesses in market jurisdictions in which those businesses lack a physical presence. Many perceive such an interim measure as a 'simpler' solution when compared to attempts to define significant economic or digital presence, which in itself is a rather delusive finding, as the question of when a sufficient nexus to tax exists remains the same. Yet, that question is decisive and subject to much debate: States still do not agree on whether or to which extent data and user participation represent a contribution to a business' value creation.

Besides broader implementation issues (such as the impact on investment, innovation, and growth, as well as on social welfare, a shift of the economic incidence of the proposed DST to consumers, the risk of overtaxation, and administrative burdens of implementing and enforcing a new tax), equalization levies raise a number

289. *Ibid*. §6.02[A]; *see also* CFE Tax Advisors Europe, *supra* note 66, at 8.
290. *Ibid*. §6.02[B][1]; CFE Tax Advisors Europe, *supra* note 66, at 8.
291. *Ibid*. §6.02[A]. For the limited expected financial impact so far, *see* 2018 EU Staff Impact Assessment, *supra* note 63, at 70.

of other issues. Concretely, as they are intentionally created to sit in between CIT systems and consumption taxes, they must still comply with existing international obligations, such as DTCs and EU and WTO law. Interim equalization levies should not undermine the development of a coordinated preferable solution on an international level, which prescribes the temporary nature of such levies. The OECD has recommended that equalization levies only apply to a limited circle of business models – that is, those constituting the highest risk for the national CIT – due to the potentially significant adverse consequences these levies have, such as overtaxation. Further, the tax rate applicable to gross revenues as well as the creation of revenue thresholds intended to exclude SMEs to promote innovation and growth need to be determined carefully, taking into account the significant economic impact such levies may have. EU law prescribes equal treatment of domestic and cross-border situations. Further, administrative cost and complexity of application should be kept to a minimum in order to ensure effective tax collection.

The 2018 DST Directive Proposal, if adopted, would create a 3% turnover tax imposed on gross revenues arising from certain digital services. It aims at levelling the playing field for businesses active in Europe but raises a number of concerns regarding its compatibility with international and EU, a number of policy questions and a myriad of technical issues, some of which were addressed in this chapter. Moreover, unilateral or EU 'equalization taxes' might prompt reactions by major trading partners, as they deviate from the historic consensus that taxation of multinationals should be based on profits rather than on turnover.

Since the time of writing this chapter, the initially strong will of certain Member States to adopt a DST at the European level seems to decrease. During the ECOFIN meeting of 4 December 2018, Member States' finance ministers could not agree on the compromise text proposed by the Austrian presidency,[292] and currently a more limited tax addressing only advertising services is under discussion.[293] The tendency of certain Member States seems to prefer waiting for agreement on a global approach at the level of the OECD/G20.[294] Despite its inherent risks, however, some Member States such as

292. Council of the European Union, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services – General approach, Doc. No. 14886/18 FISC 511 ECOFIN 1149 DIGIT 239 (29 November 2018).

293. Council of the European Union, Economic and Financial Affairs Council, 04/12/2018, *available at* https://www.consilium.europa.eu/en/meetings/ecofin/2018/12/04/ (accessed 22 February 2019). The proposed compromise (*see supra* note 292) notably suggested a more nuanced definition of the terminology employed in the directive; modified the services covered, so as to exclude, e.g., the sale of certain data from its scope; to limit the location of users to the use of their devices' IP addresses, excluding thereby 'any other method of geolocation'; and certain modifications to the procedural rules, such as an extended deadline for the DST return submission. Further, the compromise proposed to delay the application of the DST to 1 January 2022. Moreover, in the meantime, the European Parliament has been consulted and proposed a number of amendments to the Commission proposal, see European Parliament, European Parliament legislative solution of 13 December 2018 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)) (13 December 2018).

294. Council of the European Union, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services – General approach, Doc. 14885/18 FISC 510 ECOFIN 1148 DIGIT 238 (29 November 2018), para. 8.

the Austria, France, Italy, Spain, and the UK are in the process of moving forward with the enactment of unilateral equalization levies due to the failure to adopt a (modified) DST proposal at Union level by the end of 2018.[295]

295. *See, e.g.*, for Austria: *EU: Digitalsteuer für Internetriesen soll spätestens 2020 kommen*, Die Presse, *available at* https://diepresse.com/home/wirtschaft/economist/5431409/EU_Digitalsteuer-fuer-Internetriesen-soll-spaetestens-2020-kommen (accessed 22 February 2019); for France: David Keohane, *France Accelerates Plans for Its Own Digital Tax*, Financial Times, 17 December 2018, *available at* https://www.ft.com/content/a4881362-0216-11e9-9d01-cd4d49afbbe3 (accessed 22 February 2019); for Italy: EY, *Italy Introduces New Digital Services Tax*, *available at* https://taxinsights.ey.com/archive/archive-news/italy-introduces-new-digital-services-tax.aspx (accessed 22 February 2019); for Spain: EY, *Spain Sends Bill on Digital Services Tax to Parliament for Approval*, 29 January 2019, *available at* https://www.ey.com/gl/en/services/tax/international-tax/alert--spain-sends-bill-on-digital-services-tax-to-parliament-for-approval (accessed 22 February 2019).