Digital Services Taxes: Do They Comply with International Tax, Trade, and EU Law?

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Key Findings

- With respect to international tax law, companies can challenge the DST based on bilateral income tax treaties. The applicable tax treaty and available claims depend on the challenging company's country of residence.
- Although the DST is most likely not a "tax covered" by the most relevant tax treaties, it can still be challenged based on the non-discrimination clause of these treaties.
- With respect to international trade law, there are three legal instruments relevant to an analysis of the digital services taxes: (1) The WTO moratorium on customs duties on electronic transmissions; (2) The WTO General Agreement on Trade in Services; and (3) Individual bilateral or plurilateral free trade agreements.
- A digital services tax like the one implemented by France likely violates both the General Agreement on Trade in Services and a model U.S. free trade agreement. However, it is uncertain whether meaningful relief could be obtained under either regime.
- With respect to EU law, there are three potential areas for challenge: (1) Article 401 of the VAT Directive; (2) The freedom of establishment and the freedom to provide services provisions; and (3) The state aid rules laid down in the Treaty on the Functioning of the European Union.
- It is most likely that the DST is not subject to the prohibition laid down in Article 401 of the VAT Directive. On the other hand, it is possible that the DST violates both the fundamental freedoms and the state aid rules.

This analysis was prepared by a select group of J.D. and L.L.M. candidates at the Institute of International Economic Law (IIEL) at Georgetown University in conjunction with TradeLab. All research and analysis was supervised by Georgetown faculty, Tax Foundation experts, and outside tax professionals.

The Tax Foundation would like to thank the report authors for an exceptionally thorough, timely, and accessible analysis and the Georgetown Institute of International Economic Law and TradeLab for the opportunity to partner on the project. A longer version of this analysis is available for download here.

Introduction

The development and proliferation of digital technologies has led to a wave of digitalization in the global economy. While enriching our daily lives and enhancing the welfare of society, digitalization has also upended a host of longstanding legal and regulatory regimes. Among them is the international system for corporate income taxation. The lack of physical presence of digital companies within countries where they do business has rendered it almost impossible for tax authorities to collect taxes on profits made by foreign “tech giants” providing digital services within their territory. Bilateral tax treaties negotiated with brick-and-mortar trade in mind have failed to address this challenge associated with the taxation of digitalized economy.

Concerned about erosion of their tax base and pessimistic about the possibility of reaching a global consensus on the issue, several countries,[1] led by France, have proposed or implemented digital services taxes (“DSTs”) on the world’s largest technology companies to redeem the value of user-created data allegedly exploited by those digital service providers. By using the French Digital Services Tax (“the French DST” or “the DST” unless otherwise specified) as a case study, this article aims to assess the compliance of digital services taxes under the frameworks of international tax, international trade, and EU law.

Key Features of the DSTs

The French DST, along with other European DSTs, has the following features:

- First, it only targets companies that provide digital advertising and digital interface services whose revenues largely derive from user data generated within the territory of imposing countries.[2]
- Second, instead of following the permanent establishment rule,[3] it chooses to target digital companies at the group level and collect on their worldwide revenues as long as they are “generated” within the imposing countries’ territory.[4]
- Third, the French DST is levied at a flat rate on the gross revenues of targeted companies and no expenses are deductible for the purpose of calculating the tax base.[5]

1 For France, *see* LOI n° 2019-759 du 24 juillet 2019 portant création d’une taxe sur les services numériques et modification de la trajectoire de baisse de l’impôt sur les sociétés [LAW no. 2019-759 dated 24 July 2019 concerning creation of a tax on digital services and modification of the downward correction of the corporation tax] (“French DST”), Légifrance, July 24, 2019, https://www.legifrance.gouv.fr/eli/loi/2019/7/24/ECOE1902865L/jo/texte; for the UK, *see* Finance Bill 2019-21, HC Bill [114]; Italy: Digital Services Tax applicable from 1 January 2020, KPMG(Oct. 17, 2019) (“Italian DST”), https://kdocs.kpmg.it/Marketing_Studio/171019_Italy_Digital_Services_Tax_applicable_from_1_January_2020.pdf; for Spain, *see* 121/000001 Draft Law on Tax on Certain Digital Services (2020) (“Spanish DST”), http://www.congreso.es/public_oficiales/L14/CONG/BOCG/A/BOCG-14-A-1-1.PDF#page=1; Austria: Legislation Introducing Digital Services Tax, KPMG (Oct. 29. 2019) (“Austrian DST”), https://home.kpmg/us/en/home/insights/2019/10/tnf-austria-legislation-introducing-digital-services-tax.html; for Turkey, *see* DİJİTAL HİZMET VERGİSİ İLE BAZI KANUNLARDA VE 375 SAYILI KANUN HÜKMÜNDE KARARNAMEDE DEĞİŞİKLİK YAPILMASI HAKKINDA KANUN (“Turkish DST”), https://perma.cc/WZR5-C2F3.

2 *See* French DST, *supra* note 1, art. 299-II.1; the UK DST, *supra* note 1 , cl. 42; Spanish DST, *supra* note 1, art. 4(5); Austrian DST *supra* note 1 (covering only online advertising services); Turkish DST, *supra* note 1, art. 1 (covering online advertising, online intermediary services and the provision of digital goods and contents).

3 The permanent establishment rule limits the source countries’ (the countries imposing DSTs) tax jurisdiction and only allows them to collect taxes on profits attributable to the physical presence/permanent establishment of multinational companies within their own territory. *See e.g.* OECD Model Tax Convention on Income and on Capital 2017 (“OECD Model”), art. 7, Nov. 21, 2017.

4 French DST, *supra* note 1, art. 299 III; Italian DST, *supra* note 1; the UK DST, *supra* note 1, cl. 45; Spanish DST, *supra* note 1, art. 8(3); Austrian DST, *supra* note 1; Turkish DST, *supra* note 1, art. 4(1).

5 French DST, *supra* note 1, art. 299 I.A; Italian DST, *supra* note 1; the UK DST, *supra* note 1, cl. 45; Spanish DST, *supra* note 1, art. 11; Austrian DST, *supra* note 1; Turkish DST, *supra* note 1, art. 5(3), (5).

The following analysis will be based on these common features and is equally applicable to similar DSTs imposed thus far.

International Tax Law

International tax law consists mostly of bilateral income tax treaties concluded between sovereign states. Therefore, in order to analyze the compliance of the DST with international tax law, the threshold question that must be answered is which tax treaty applies for purposes of the French DST.

The DST's implementing legislation provides that the tax should be assessed at the group level.[6] The group includes all companies that are owned or controlled, directly or indirectly, by the parent company.[7] This essentially means that the DST is imposed on every single company within the group that has generated revenues as defined by the DST. As a result, every company within the group that provides covered services in France can challenge the measure, and the treaties on which to base those challenges depend on the tax residence of the challenging companies. For example, if Google Ireland is liable for the DST, it can challenge the tax based on the bilateral tax treaty concluded between France and Ireland because it is a tax resident of Ireland as defined by Article 2 of the Ireland-France Bilateral Income Tax Treaty and is entitled to the protection provided by the Treaty.[8]

Considering the fact that all income tax treaties include substantively similar language and provisions and that most of the U.S. "tech giants" targeted by the French DST have their European headquarters in Ireland,[9] the following analysis will use the Ireland-France Treaty ("the Treaty") as an example to address the international tax issues raised by the DST.

This analysis addresses two issues: (1) whether the French DST is a tax covered in Article 1 of the Treaty; and (2) whether the French DST violates the non-discrimination clause of the Treaty by disproportionately targeting Irish companies while leaving most French companies exempted from the tax.

The DST Is Likely Not a Tax Covered by the Treaty

As to the first issue, in order to determine whether the DST is a tax covered by the Treaty, two inquiries must be made: (1) whether the DST is identical or substantially similar to the tax enumerated in Article 1(3)(a) of the Treaty, which includes French income tax on individuals, the French complementary tax, and the French company tax; and (2) whether the DST is a tax on income or elements of income.[10]

6 French DST, *supra* note 1, art. 299 III.

7 Code de commerce [C. COM] [Commercial Code] art. L 233- 16 (Fr.).

8 According to Article 2(7) of Ireland-France Bilateral Income Tax Treaty, Google Ireland constitutes a resident of Ireland within the meaning of the Treaty because it is a company managed and controlled in Ireland. By virtue of its status as a tax resident of Ireland, Google Ireland is entitled to the protection and benefits provided for by the Ireland-France Tax Treaty pursuant to Article 1(2).

9 *See* Ciara O'Brien, *Google Ireland Takes the Reins for European Services*, IRISH TIMES (Dec.13, 2018), https://www.irishtimes.com/business/technology/google-ireland-takes-the-reins-for-european-services-1.3730721; *see also* Simon Roughneen, *Ireland Has Become A Mecca for U.S. Companies. Can Trump Lure Them Home?* L.A. TIMES (Feb. 10, 2017), https://www.latimes.com/world/europe/la-fg-ireland-economy-2017-story.html.

10 Convention between Ireland and France for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income ("Ireland-France Treaty"), art. 1, Mar. 21, 1968.

It is most likely that the DST is not identical or substantially similar to the enumerated taxes because—although the tax is borne by companies—it is imposed on the supply of digital services without regard to the economic situation of the supplier. It is different from the French company tax or the other enumerated taxes that vary depending on the profitability of the target company or individual. By the same token, as a tax on total revenue of companies regardless of their profit margin, the DST is also not a tax on income or elements of income and thus fails to qualify as a tax covered by Article 1 of the Treaty.[11]

A Claim Based on the Non-discrimination Clause of the Treaty Might Be Successful

Although the DST falls outside the scope of Article 1, the non-discrimination clause (Article 22) of the Treaty, due to its broad scope that incorporates "taxes of every type and description," still allows challenges against the DST for its violation of the duty of non-discrimination. Under Article 22 of the Treaty, companies seeking to challenge the DST can make three kinds of claims depending on their status.

Using Google as an example, Google Ireland can claim "nationality discrimination"[12] under Article 22 (1)[13] of the Treaty. For the branch offices or any other permanent establishments created by Google Ireland in France, it could claim "permanent establishment discrimination" under Article 22 (4)[14] of the Treaty. Moreover, Article 22 (5)[15] allows Google France, as a subsidiary of Google Ireland, to claim "foreign ownership discrimination" for any disparity in treatment by the DST.

Ultimately, Google Ireland and other similar Irish technology companies might be able to succeed in their "nationality discrimination" claim because the DST discriminates against it using the global revenue threshold. The global revenue threshold seeks to exclude companies whose groups are unable to generate a designated amount of global revenues, most of them French companies. Though it could be argued that the global revenue threshold is introduced to realize the DST's objective of targeting only large companies, it is in fact unnecessary because the French revenue threshold could have achieved this objective on its own. Therefore, the global revenue threshold is essentially an irrelevant factor included solely for the purpose of distinguishing between French and Irish companies without explicitly mentioning their nationalities. As a result, by excluding French companies that are the same as Irish companies except for their groups' global revenues, the DST discriminates against Google Ireland and other similar Irish technology companies.

11 This conclusion is equally applicable to any other treaty that includes a similar provision prescribing the scope of the tax covered by the Treaty. For example, this conclusion is equally applicable to a U.S.-France Treaty if it is used by a U.S. company subject to the DST to challenge the measure. Moreover, this conclusion is also applicable to other European DSTs imposed by the UK, Italy, Spain, Austria, and Turkey.

12 It should be noted that not all non-discrimination clauses in Treaties concluded by France allow companies to make a "nationality discrimination" claim. Article 25 (1) of the U.S.-France Treaty only allows individuals, not companies, to claim discrimination based on nationality. Therefore, for targeted companies that are incorporated in the U.S., it is likely that they will not be able to claim the protection of the non-discrimination clause in a U.S.-France Treaty. *See* S. Comm. on Foreign Relations, Rep. on Income Tax Convention with the French Republic 13 (Comm. Print 1995).

13 Ireland-France Treaty, *supra* note 10, art. 22 (1) ("The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.")

14 Ireland-France Treaty, *supra* note 10, art. 22 (4) ("The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances.")

15 *Id.*, art. 22 (5) ("Enterprises of a Contracting State, *the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State,* shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of that first-mentioned State are or may be subjected.")

By the same token, Google France and similar French subsidiaries of Irish companies, if subject to the DST, are also discriminated against as compared with their French-owned counterparts and they are likely to prevail on a claim of "foreign ownership discrimination." However, permanent establishments created by Irish companies in France are likely not able to claim a "permanent establishment discrimination" because as a tax on total revenue, the DST is not a tax on permanent establishment as defined by Article 4 and covered by Article 22 (4) of the Treaty,[16] and is therefore not prohibited from discriminating against permanent establishments.

In sum, although the French DST is not a tax covered by the Treaty, the Irish headquarters of the targeted "tech giants" and their French subsidiaries might still be able to successfully challenge the DST based on the non-discrimination clause of the Ireland-France Bilateral Income Tax Treaty.[17] The same could also be achieved by companies managed or controlled in other states that have similar provisions in their Bilateral Income Tax Treaties with France.

Targeted Companies Can Resort to Domestic Litigation, Mutual Agreement Procedure, and Arbitration to Challenge the DST

As provided by French law, the challenging companies could bring a claim before the French Administrative Court after the claim is presented and rejected or ignored by the French tax authority.[18] After obtaining the decision of the lower court, the challenging companies can also bring an appeal to the Administration Court of Appeals and the Conseil d'Etat.[19] It can take eight to ten years for this kind of claim to reach final resolution in French courts.

Apart from litigation in French domestic courts, most French tax treaties provide that companies can present their claim of nationality discrimination before their national tax authority[20] and initiate the Mutual Agreement Procedure ("MAP") to attempt to find a solution that is mutually agreed upon by both their national authority and the French authority.[21] In the event that the two authorities are unable to reach an agreement—assuming the applicable treaty allows for it—the challenging company can submit the unresolved issues to arbitration via written request and obtain a decision by an independent arbitration panel.[22] The resolution reached via either MAP[23] or arbitration[24] will be binding on both national authorities unless it is rejected by the challenging company.

In conclusion, it is preferable for challenging companies to utilize MAP and arbitration to enlist the help of their domestic authorities to try and obtain a more favorable result—while being mindful of the interaction between domestic litigation and the procedures provided in tax treaties.

16 *Id.* art. 4.

17 This conclusion is equally applicable to other DSTs imposed by the UK, Italy, Spain, Austria, and Turkey as long as the bilateral income tax treaties concluded by the imposing country include a non-discrimination clause that allows companies to claim discrimination based on nationality and their subsidiaries to claim discrimination based on foreign ownership.

18 Livre des procédures fiscales [Tax Procedures Book] art. R* 199-1, ¶ 2 (Fr.).

19 Code de Justice Administrative [Code of Administrative Justice] art. R 811-2 (Fr.).

20 Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ("MLI"), art. 16 (1), *opened for signature* Dec. 31, 2016.

21 *Id.*, art. 16.

22 *Id.*, art. 19.

23 Ireland Office of the Revenue Commissioners, Guidelines For Requesting Mutual Agreement Procedure ("MAP") Assistance in Ireland 5 (2019) ("Ireland MAP Guideline"), https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-35/35-02-08.pdf.

24 MLI, *supra* note 20, art. 19 (4)(b).

International Trade Law

With respect to international trade law, there are three legal instruments relevant to an analysis of the French DST: (1) The WTO moratorium on customs duties on electronic transmissions (hereinafter "the Moratorium"); (2) The WTO General Agreement on Trade in Services (hereinafter "the GATS"); and (3) Individual bilateral or plurilateral free trade agreements.

It is important to note that, under all of these instruments, a claim challenging a DST must come from a member state—in contrast to the international tax context, where an aggrieved company itself would bring the claim. The U.S. is the country most likely to bring such a state-to-state challenge because most of the companies affected by the French DST are U.S- headquartered companies.

The Moratorium on Customs Duties on Electronic Transmissions Is Likely Not Applicable to the French DST

In 1998, amid deadlock over how electronic commerce should be treated under WTO rules, members had agreed "not impos[e] customs duties on electronic transmissions."[25] The WTO moratorium on electronic transmissions likely would not cover the French DST, as it is limited specifically to formal "customs duties" and the French DST is an internal tax.[26] Moreover, the moratorium is not subject to the WTO's binding dispute settlement,[27] so it cannot be used as the basis for a legal claim that could compel France to rescind its DST if successful. Both because the French DST is likely consistent with the moratorium and because it cannot be enforced through the WTO dispute settlement system, it is an ineffective avenue for the U.S. to challenge the French DST.

The French DST Could Be Successfully Challenged under the WTO General Agreement on Trade in Services

The GATS is the primary vehicle through which the U.S. can challenge the French DST under international trade law. The U.S. could potentially bring two types of claims against the French DST under the GATS: national treatment (under Article XVII) and most-favored nation (hereinafter "MFN") (under Article II).

The French DST Is Likely Inconsistent with France's GATS National Treatment Obligation

National treatment requires that France not discriminate against foreign services or service providers in favor of "like" domestic services or service suppliers.[28] For example, the U.S. might claim that a U.S. digital ad supplier like Facebook is treated less favorably than a French firm that also supplies digital ads. In order to bring a national treatment claim to WTO dispute settlement, the U.S. must demonstrate that the French DST is not covered by a double taxation treaty between the U.S. and France. Otherwise, a national treatment claim against the French DST will be barred under GATS

25 *See* Declaration on Global Electronic Commerce, WT/MIN(98)/DEC/2, adopted 20 May 1998.

26 See Council for Trade in Services, *The Work Programme on Electronic Commerce: Note by the Secretariat*, WTO Doc. S/C/W/68, Nov. 16, 1998, ¶ 34, 35.

27 Art. 1 of the WTO's Dispute Settlement Understanding limits use of the dispute settlement mechanism to claims under the "covered agreements," which does not include a General Council decision like the moratorium. Understanding on Rules and Procedures Governing the Settlement of Disputes art. 1, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, U.N.T.S. 401.

28 General Agreement on Trade in Services, art. XVII, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, (1994). (hereinafter GATS).

Article XXII.[29] This aspect of the claim raises some challenging and novel issues. However, it seems likely that the U.S. can establish that the French DST is not covered by the U.S.-France Bilateral Income Tax Treaty because (1) the DST is not within the scope set out in the treaty's scope provision, and (2) the non-discrimination provision—which covers all taxes—cannot be invoked by companies for protection against nationality-based discrimination.[30]

Assuming the U.S. can bring a national treatment claim to dispute settlement, the key issue for establishing that the French DST violates national treatment will be the question of whether U.S. digital services and service suppliers covered by the French DST are "like"—i.e., sufficiently similar to—the French digital services and service suppliers that are not covered by the DST. To prevail on this claim, the U.S. will need to persuasively demonstrate two things.

First, the U.S. must show that the only meaningful difference between U.S. digital service suppliers (who must pay the DST) and French suppliers of the same covered digital services (who are not subject to the DST) is national origin. To do so, the U.S. will need to persuasively argue that the DST's facially neutral revenue thresholds—which capture U.S. suppliers but not French suppliers—are simply a proxy for national origin because they are designed to capture companies with a business model typical of American digital service suppliers but not present among competing French digital service suppliers.

Second, the U.S. must demonstrate that American digital service suppliers subject to the DST and their excluded French competitors cannot be distinguished on the grounds that covered companies benefit from "user value creation." The U.S. could accomplish this by showing that either (1) U.S. digital service providers do not, in fact, derive meaningful value from French users, or (2) that French service providers not captured by the DST also benefit from user value creation. Ultimately, it is likely that the U.S. can succeed in establishing that the French DST violates national treatment.

Whether the French DST Violates France's MFN Obligation Depends on the Comparison the U.S. Makes in Its Claim

MFN requires that France not discriminate between the services and service suppliers of one foreign country in favor of "like" services and service suppliers of another foreign country.[31] For example, the U.S. could claim that a Japanese digital services company receives more favorable treatment under the DST than competing U.S. digital services companies. Whether the U.S. can establish an MFN violation is highly dependent on which other foreign service supplier(s) the U.S. uses for its comparison. Again, the key issue will be demonstrating that the U.S. service supplier and the services it provides are "like" the other foreign service supplier and its services. Assuming it can do so, establishing that U.S. suppliers were treated less favorably would only require showing that the American supplier is subject to the DST, while the other foreign supplier is not.

29 *See id*. art. XXII.

30 *See* Convention for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, arts. 2, 25, Fr.-U.S., Sep. 9, 1994.

31 GATS, art. II.

The French DST Cannot Be Justified under the GATS Exceptions Provision

If the U.S. could establish that the DST violates national treatment or MFN, France would not be able to justify these violations under the exceptions in GATS Article XIV because the French DST cannot satisfy the Article XIV gatekeeping provision (the so-called chapeau), which is necessary to successfully invoke any of the exceptions. This is because the French DST constitutes "arbitrary or unjustifiable discrimination between countries where the same conditions prevail."[32]

Ultimately, there is a good chance that the U.S. could prevail in a WTO case challenging the French DST. However, given that the WTO dispute settlement system is not currently functional, even a successful claim may not be able to deliver meaningful relief at this time.[33]

Whether the French DST Can Be Challenged under Free Trade Agreements Depends on the Nature of the Obligations in the Agreement

While there is currently no free trade agreement in place between the U.S. and France, as DSTs proliferate to more countries, free trade agreements will likely come into play as another legal regime applicable to these measures. As such, it is important to assess the compliance of a measure like the French DST against now standard provisions in U.S. and European trade agreements.

Under the relevant U.S.-Japan Digital Trade Agreement—lauded as the "gold standard" for rules on digital trade[34]—the U.S. may prevail on a challenge against a measure like the French DST. This is because a French-style DST likely violates the Agreement's non-discrimination obligation for internal taxes.[35] Moreover, a French-style DST does not qualify for any of the exceptions in the agreement—which mirror GATS Article XIV.[36]

On the other hand, if the agreement mirrored the EU-Canada Comprehensive and Economic Trade Agreement ("the CETA") then a challenge to a French DST-like measure would probably fail. A French-style DST would be consistent with the CETA's prohibition on customs duties on electronic deliveries because these provisions explicitly exclude internal taxes like a DST.[37] Even assuming the DST violates the national treatment and MFN provisions in the CETA's trade in services chapter,[38] it would almost certainly be justified under the agreement's exceptions provisions[39]—which are significantly more generous than GATS Article XIV.

Finally, it is worth noting that the efficacy of challenging a DST under a free trade agreement hinges on whether the agreement in question has a binding enforcement mechanism. Without such a mechanism, the challenging country would be powerless to compel the party imposing the DST to rescind or alter the measure.

32 GATS, art. XIV.

33 Brandon J. Murrill, Congressional Research Service, The WTO's Appellate Body Loses Its Quorum: Is This the Beginning of the End for the "Rules-Based Trading System"? (2019).

34 Press Release, White House, President Donald J. Trump Has Secured a Tremendous Victory for American Farmers and Businesses with New Japan Trade Agreements, (Oct. 7, 2019) https://www.whitehouse.gov/briefings-statements/president-donald-j-trump-secured-tremendous-victory-american-farmers-businesses-new-japan-trade-agreements.

35 Agreement between the United States of America and Japan Concerning Digital Trade art. 6.3., Oct. 7, 2019. (hereinafter "U.S.-Japan Agreement").

36 *Id.*

37 Comprehensive Economic and Trade Agreement between Canada, of the One Part, and the European Union and its Member States of the Other Part art. 16.3.2, Oct. 30, 2016. (hereinafter "CETA")

38 *Id.* arts. 9.3, 9.5.

39 *Id.* art. 28.7.4(d).

EU Law

European Union law is a body of law that is specific to EU Member States and citizens—or in the case of legal persons, EU nationals. U.S. parent companies targeted by the DST usually operate in Europe through registered subsidiaries and, as such, those subsidiaries—being EU nationals—have the right to challenge the DST under EU law either before their domestic court or through specific procedures before EU institutions.

Claims could be brought against the DST under three areas of EU law: (1) the EU's VAT directive[40]; (2) the fundamental freedoms; and (3) the state aid rules laid down in the Treaty on the Functioning of the European Union (hereinafter "TFEU").[41]

The French DST Is Likely Consistent with the VAT Directive

The key issue under the VAT Directive is whether the French DST can be characterized as a "turnover tax" and, as such, is prohibited by the VAT Directive. The CJEU seems to conflate a turnover tax and a VAT for purposes of the Directive, holding that "article 401 does not preclude the maintenance or introduction of a tax which does not display one of the essential characteristics of VAT."[42] The French DST does not appear to display all the essential characteristics of VAT as defined by case law.[43] Specifically, the French DST (1) is not a general tax as it only applies to the supply of certain digital services; (2) is not charged at each stage of the production process; and (3) taxes paid at earlier stages of production cannot be deducted from the DST. Therefore, it is not subject to the prohibition laid down in Article 401 of the VAT Directive.

It Is Unclear Whether the French DST Violates the Fundamental Freedoms

The fundamental freedoms prohibit Member States from placing restrictions on the freedoms enjoyed by nationals established in other Member States. The critical issue here is whether the DST constitutes an obstacle to the exercise of the freedom of establishment[44] and the freedom to provide services[45] by nationals from other Member States.

A measure capable of affecting cross-border trade must be applied in a nondiscriminatory manner. Under prior CJEU case law, the French DST's discriminatory features—such as its global revenue thresholds—which cause the tax to be imposed mostly on foreign companies might have been sufficient to establish that the DST violates these fundamental freedoms. However, recent CJEU decisions appear to take a more lenient approach to these kinds of discriminatory features, such that it is unclear whether the French DST would be found to violate the fundamental freedoms today.

40 Council Directive of 28 November 2006 on the common system of value added tax (OJ 2006 L 347), https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32006L0112.

41 Consolidated Version of the Treaty on the Functioning of the European Union art. 49, May 9, 2008, 2008 O.J. (C 115) 47 ("TFEU").

42 Vodafone Magyarország, C75/18, EU:C:2019:492, ¶ 61; *see also* Viking Motors and Others, C-475/17, EU:C:2018:636, ¶ 38; Solisnor-Estaleiros *Navais* [1997] Case C-130/9 ECR I-5053, ¶¶ 19, 20; Banca Popolare di Cremona, C-475/03, EU:C:2006:629, ¶ 27; GIL Insurance and Others, ¶ 34.

43 Vodafone Magyarország, *supra* note 42, ¶ 62; Banca popolare di Cremona, *supra* note 42, ¶ 28.

44 TFEU, *supra* note 41, art. 56 ("Within the framework of the provisions set out below, restrictions on freedom to provide services within the Union shall be prohibited in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended.")

45 TFEU, *supra* note 41, art. 49 ("Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.")

If discrimination is established, France could justify the measure under a legitimate public policy interest, "provided that it is appropriate for ensuring the attainment of the objective pursued and does not go beyond what is necessary to attain that objective."[46] This is a high standard because—assuming discrimination is established—France would not only have to come up with (1) a convincing public policy interest, but it would also have to demonstrate that the DST is a (2) suitable and (3) proportional measure to achieve that objective. In light of relevant case law, it seems more likely than not that the French DST could not be justified by a legitimate public policy interest. Ultimately, given the ambiguous state of relevant case law, it is unclear whether a challenge to the French DST under the fundamental freedoms would prevail.

The French DST Likely Violates the TFEU's State Aid Provisions

Article 107 of the TFEU prohibits Member States from providing any form of aid that favors certain undertakings or production of certain goods in a way that distorts competition and affects trade between Member States.[47] The key question is whether the DST's revenue threshold criteria selectively favors certain undertakings in violation of this prohibition. The DST was specifically designed—for example, through the revenue thresholds—to favor domestic companies by de facto exempting them from the DST and thus reducing their tax burden relative to foreign-owned firms. The DST is unlikely to be justified by any legitimate public policy objective or qualify for the applicable exceptions. Moreover, the DST has the potential to affect intra-union trade as the companies affected by it tend to operate in multiple markets. The DST also threatens to distort competition by providing a competitive advantage to French-owned companies in the form of a reduced tax burden. Therefore, the DST likely violates the TFEU's prohibition on state aid.

Conclusion

Despite the multilateral efforts at the OECD level to reach a consensus on how to solve the tax challenges presented by the digital economy, it is likely that DSTs will occupy the stage for the time being. Therefore, it is vital for all stakeholders to obtain a comprehensive understanding of the status of the DSTs under current international law in order to make an informed judgment about whether it is the right approach to tackling the challenges going forward.

While this analysis does not purport to be authoritative in determining the legality of the French DST under international law, it is clear that serious challenges can be mounted against such a measure across all three legal regimes. Therefore, countries considering enacting DSTs of their own may be well-advised to consider carefully if and how they go about doing so. Otherwise, those states may find themselves before courts and international tribunals grappling with many of the same issues raised here.

46 Hervis Sport- és Divatkereskedelmi, C 385/12, EU:C:2014:47, ¶ 42; *Commission* v *Spain*, C400/08, EU:C:2011:172, ¶ 73; CaixaBank France, C442/02, EU:C:2004:586, ¶ 17.

47 TFEU, *supra* note 41, art. 107(1).