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The Compatibility of Digital Services Taxes with World Trade Organization (WTO) Law

I Introduction

The advancement of technology has led to the widespread digitalization in the global economy. This trend poses significant challenges to regulatory regimes, especially those which have an international element, one of the most important of which is corporate tax. The determination of the boundaries of a state's authority to impose tax on foreign enterprises has become an increasingly contentious battlefield between governments and multinationals.[1] Efforts to establish more fair taxation regimes on the providers of digital services through Digital Services Taxes (DSTs) raise a host of issues, one of which is their compatibility with international trade law – meaning the imposing country's obligations as a member of the World Trade Organization (WTO).

This chapter will consider the WTO implications of DSTs, assessing whether the imposition of a DST could constitute an illegitimate trade barrier by arbitrarily discriminating against a service supplier on the basis of its nationality, violating the Most Favoured Nation or national treatment provisions of WTO law.[2] The WTO instrument which is most relevant to a consideration of the DST is the General Agreement on Trade in Services (GATS), although there may also be a claim under the WTO's moratorium on customs duties on electronic transmissions. Other potentially unlawful elements of DSTs, including their compatibility with international tax principles will not be discussed, nor will claims of discrimination which might be brought under preferential trade agreements. The potential for DSTs to impact foreign investment will also not be examined. The chapter will begin by illustrating some of the common features of DSTs, highlighting their controversy in terms of their trade impacts.

II DSTs: Controversy and Main Features

[1] K Freida, *Cybertaxation: The Taxation of E-Commerce* (Arthur Andersen, 2000) at 263
[2] As found in GATS II and GATS XVII in the case of services

Normally a corporation pays tax in jurisdictions in which it has a physical presence. But for the large tech companies, a physical presence is not necessary to do business in a given jurisdiction. The lack of physical presence of companies which provide digital services within countries where they do business makes it nearly impossible for tax authorities to collect taxes on profits made by multinational technology firms serving customers in their jurisdiction. The growth of the digital economy has accordingly raised fundamental questions about how residence is determined as well as the jurisdiction in which value is creation occurs for tax purposes.[3] Added to this is the common perception that certain large companies, especially in the tech sector, do not pay their fair share of tax, a concern compounded by the global financial crisis of 2008-09 and ensuing fiscal austerity policies imposed by many countries which acted as catalyst for coordinated action against large multi-nationals seen as not paying their share.[4] The OECD has engaged in work on a framework for addressing Base Erosion and Profit Shifting (BEPS), which refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax, paying specific regard to issues arising from digitalization.[5] Yet a global approach to tax losses arising in the digital economy has yet to be actualized.

Concerned about erosion of their tax base and pessimistic about the possibility of reaching a global consensus on the issue via a multilateral treaty, approximately 30 countries have proposed or implemented DSTs on some of the world's largest technology companies. These taxes are designed to redeem the value of "user-created" data allegedly exploited by those digital service providers. Among the countries pursuing DSTs are France[6], the UK[7] and more recently, Canada.[8] Unilateral DSTs have been advocated for developing countries which rely heavily on corporate income tax and consequently suffer from tax evasion.[9] The US does not appear to be considering a DST, likely because it is home to many of the world's largest tech companies. The main targets of the DSTs are the technology behemoths like

[3] A de Jonge, "The Evolving Nature of the Transnational Corporation in the 21st Century" in A de Jonge and R Tomasic eds, Research Handbook on Transnational Corporations (Elgar, 2017) at 33

[4] M Geist, "The Law Bytes Podcast, Episode 115: Reuven Avi-Yonah on the Past, Present and Future of Digital Services Taxes" (31 Jan 2022) <https://www.michaelgeist.ca/2022/01/law-bytes-podcast-episode-115/> You could add another reference, in addition to the one you mentioned here.

[5] Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, OECD (31 May 2019)

[6] Bill n° 2019-759 of 24 July 2019 on the creation of a tax on digital services, NOR: ECOE1902865L

[7] Finance (Digital Services Tax) Bill 2020, HC Bill [114]

[8] Notice of Ways and Means Motion to introduce an Act to implement a Digital Services Tax (December 2021)

[9] M Magwape, "Unilateral Digital Services Tax in Africa: Legislative Challenges and Opportunities" Intertax 50:5 (May 2022)

Google, Amazon, and Facebook. It may come as no surprise that the US strongly objects to DSTs as it is the home jurisdiction of these companies.

In response to French, British, and other DSTs, the Trump administration proposed retaliatory tariffs under Section 301 of the US Trade Act of 1974. Under WTO law, retaliation can be pursued against other products and sectors from the one on which the alleged illegal measure is imposed.[10] The US imposed tariffs of up to 100 per cent on French luxury goods exports such as handbags and soaps,[11] notwithstanding the fact that the DSTs such as that of France are imposed only on digital services. In June 2020, the U.S. Trade Representative initiated an investigation of the UK DST under the US Trade Act.

More recently, the threat of a trade war over DSTs has been held in abeyance because of the negotiation of a global tax treaty, signed in October 2021 under the auspices of the Organization for Economic Cooperation and Development (OECD). The US agreed to conditionally withdraw the threatened Section 301 tariffs in exchange for a two-year moratorium, expiring in December 2023, on new DSTs. The OECD agreement calls for tax imposing countries to attribute, for tax purposes, a portion of earnings of their large corporations to foreign countries where goods or services are consumed rather than the traditional practice of attributing all earnings to the home country. With regards to DSTs themselves, the OECD agreement provides "[n]o newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the [Multilateral Convention which embodies the agreement]."[12]

DSTs, including that of France, the UK and Canada have similar features. DSTs only target companies that provide digital services whose revenues largely derive from user data generated within the territory of imposing countries.[13] The taxes depart from the permanent establishment rule which limits the source countries' tax jurisdiction, only allowing them to collect taxes on profits attributable to the physical presence/permanent establishment of companies within their own territory.[14] Instead, DSTs are imposed on digital companies at the group level and collected on their worldwide revenues as long as they are "generated"

[10] Dispute Settlement Understanding, Art 22.3
[11] A Williams, "US threatens $1.3bn worth of French goods with 25% tariff" The Financial Times (10 July 2020)
[12] GC Hufbauer and M Hogan, "Canada's digital services tax threatens global effort to curb tax havens" Pearson Institute for International Economics (15 December 2021)
[13] See e.g. French DST, above n 6, art. 299-II.1; the UK DST, above n 7, cl. 42
[14] See e.g. OECD Model Tax Convention on Income and on Capital 2017, art. 7 (21 November 2017)

within the imposing countries' territory.[15] As such they are "destination based taxes" – levied where services are consumed. DSTs are applied at a flat rate on the gross revenue of affected companies. The amount of the tax tends to be small: the UK, French and Canadian proposals are each at 3 per cent.[16]

DSTs apply to any kind of digital service such as advertising, streaming audio and movies. Controversially, DSTs apply only to the largest companies, typically those with over US $750 million revenue. For example, the UK DST applies to companies with £500 million in annual revenue. Approximately 30 companies are expected to be caught by the DSTs,[17] most of which, because of the size threshold, are US-based. Many of the large technology companies have stated that they will simply transfer the tax on to consumers,[18] precluding the element of fairness which tends to be associated with these, and other, taxes. This aspect of DSTs tends not to be disclosed by the politicians who have advocated for them. [19]

A DST could have an impact on a wide range of services delivered over the internet. Those that could be affected, either directly or indirectly, include online advertising, computer and related services, travel agencies, news and press agency services, betting exchanges, suppliers of video and audio streaming (where funded through advertising), non-regulated financial intermediaries, peer-to-peer marketplaces including crowdfunding, and distribution. Educational and professional services which are delivered over the internet could also be impacted due to the aspect of some DSTs that apply to intermediaries.[20] It is difficult to determine whether a business falls under the DSTs' scope as business models are rapidly evolving because of their use of dynamic technology. The lack of predictability with regards to tax exposure is itself a burden for digital services companies.[21]

III Tax as a Trade Barrier Under WTO Rules

[15] French DST, above n 6, art. 299 III; UK DST, above n 7, cl. 45
[16] French DST, above n 6, art. 299 I.A; UK DST, above n 7 cl. 45
[17] United States Trade Representative, "Section 301 Investigation Report on the United Kingdom's Digital Services Tax" (13 January 2021) at 12
[18] A Barker, "Google to pass cost of digital services taxes on to advertisers" Financial Times (1 September 2020)
[19] Geist, above n 4
[20] PWC, "A white paper analysing the EU's 2018 proposed digital services tax (interim measure) under WTO law" (undated) at 7 <https://thesuite.pwc.com/media/10060/dst-under-wto-law.pdf> (April 2022)
[21] USTR, above n 17 at 11

WTO law does not prohibit a tax, customs duty, or a tariff. The Appellate Body has specifically stated that tariffs are legitimate instruments to accomplish certain trade policy or other objectives such as to generate fiscal revenue and that they are not "inherently discriminatory."[22] Of the various taxes have been examined by WTO tribunals, most have been primarily concerned with those applied to goods rather than services, although some of the principles may be relevant for an assessment of the legality of DSTs. The question often arises before WTO panels and the Appellate Body whether foreign goods were subject to less favourable competitive conditions than domestic products, for example by facing a heavier tax burden or a more burdensome administrative method of tax collection. The tax disputed measures tend to be "origin neutral" but their application can violate WTO rules prohibiting *de facto* discrimination, causing adverse effects such as lost sales. [23]

In assessing the compatibility of a DST with WTO law it must be understood that the purpose of the WTO in relation to tax is to establish the limits of tax as it is applied to goods and services which are traded internationally. WTO law marks a sharp distinction between goods and services, arguably artificially so, particularly in an era of services bundled into goods and vice versa. WTO provisions also distinguish between customs duties, discriminatory taxes on imports, export subsidies (including tax reliefs on exports), and taxes on the supply of cross-border services.[24] Commentators urge that comparisons with existing kinds of tax are helpful in assessing the legality of new taxes like DSTs, but only under very specific circumstances. The use of analogy can help policymakers anticipate the incompatibility of a new tax with WTO law when the specific characteristics of the new tax resemble features of taxes that have been found compatible (or not) with WTO law by panels or the Appellate Body.[25] WTO members are less likely to challenge tax measures that are similar to taxes that are part of their domestic tax system. Therefore, new taxes that follow the design features of existing taxes benefit from what has been described as "political protection" under WTO law. If new destination-based taxes, like DSTs, simply replicated existing taxes, such as Value Added Taxes, there would probably be no reason to consider

[22] India—Additional Duties on Imports from the United States, Appellate Body Report, WT/ DS360/AB/R (17 November 2008) at [159]
[23] E.g. Japan – Taxes on Alcoholic Beverages, Appellate Body Report, WT/DS8/AB/R (1 November 1996)
[24] Part II.B.2
[25] A Pirlot, "Don't Blame it on WTO Law: An Analysis of the Alleged WTO Law Incompatibility of Destination-Based Taxes" 23:1 Florida Tax Review 432 (2019) at 442

them at risk of violating WTO law.[26] However, the fact that an existing tax has not been challenged in the past does not necessarily mean that it is fully WTO compliant.

There are two WTO legal instruments relevant to an analysis of DSTs. First, there is the WTO moratorium on customs duties on electronic transmissions. Secondly and more importantly, the GATS. Each will be explored in turn.

III) DST Compliance with the WTO Moratorium on Customs Duties on Electronic Transmissions

In 1998 as the Internet began to mature into a driving force behind global commerce, WTO members agreed not to impose customs duties on electronic transmissions as part of the Global Declaration on Electronic Commerce.[27] This moratorium has been renewed several times and remains in effect, having been renewed at the WTO's 12th Ministerial Conference in 2022.

Customs duties do not generally apply to services because they do not cross borders in the way that goods do. Still, it is not unreasonable that a DST could be characterized as a customs duty on electronic commerce.[28] But the WTO moratorium is limited specifically to formal "customs duties" whereas DSTs are internal taxes – a crucial difference. Customs duties are indirect taxes levied at the border and paid by the importer while DSTs are probably best viewed as direct taxes paid by the supplier of the service at the place of consumption, likely passed on to consumers in the form of higher prices (although not as a formal tax burden). Moreover, unlike most taxes, customs duties generally do not have a purpose of raising money, but are designed to regulate the flow of trade,[29] suggesting that the moratorium is most likely inapplicable to DSTs which are aimed at revenue generation. Commentators point out that the moratorium on customs duties on electronic transmissions therefore does not apply to direct taxes like the DST.[30] Others contend that a DST would

[26] I Grinberg, "A Destination-Based Cash Flow Tax Can Be Structured to Comply with World Trade Organization Rules" 70 National Tax Journal 803 (2017) at 811
[27] Declaration on Global Electronic Commerce, WTO Doc WT/MIN(98)/DEC/2 (25 May 1998, adopted on 20 May 1998).
[28] A Mitchell, T Voon and J Hepburn, "Taxing Tech: Risks of An Australian Digital Services Tax under International Economic Law" 20:1 Melbourne Journal of International Law (2019) at 95
[29] Frieda, above n 1 at 389. Tariffs play a more important role in revenue generation for developing countries.
[30] I Willemyns*, Digital Services in International Trade Law* (Cambridge University Press, 2021) at 280

constitute a tariff which would conflict with the moratorium on customs duties.[31] The characterization as a tariff seems somewhat strained since the DST will not be paid at the border, as is the case of a tariff. The applicability of the moratorium to the DST therefore appears to rest on how the tax is categorized.

Regardless of how the DST is characterized, the customs duty on electronic transmission moratorium is not subject to the WTO's dispute settlement system, so it cannot be used as the basis for a legal claim under WTO law. This suggests that the DST's alleged transgression of the moratorium could not be used to compel imposing countries to rescind its DST.[32] Until it solidifies into a binding treaty, the moratorium is best described as a political agreement which does not impose legal obligations on WTO members and as such should not affect the DST.[33]

Some have suggested that while the moratorium itself might not ground a claim against a DST, as a ministerial statement, the WTO's Declaration on Global Commerce might be relevant for interpreting GATS with regards to establishing the "object and purpose" of the latter agreement under Article 31(1) of the Vienna Convention on the Law of Treaties (VCLT) or even as "subsequent agreement" or "subsequent practice" under Article 31(3).[34] This could render an interpretation of the GATS more supportive of a challenge to a DST.

IV) DST Compatibility with the General Agreement on Trade in Services (GATS)

i) Taxation and Non-Discrimination based on National Origin

The most important agreement for the purposes of assessing the WTO law compatibility of a DST is the GATS. WTO caselaw has established that GATS is relevant to tax issues.[35] The GATT Secretariat noted the applicability of GATS to tax measures that affect services suppliers, particularly the National Treatment obligation (Art XVII) and the Most Favoured

[31] GC Hufbauer and Z Lu, "UK Money Grab: Proposed Digital Tax" Pearson Institute for International Economics (1 November 2018)

[32] C Forsgren, S Song, D Horváth, "Digital Services Taxes: Do They Comply with International Tax, Trade, and EU Law?" Tax Foundation (29 May 2020) <https://files.taxfoundation.org/20200522152239/Digital-Services-Taxes-Do-They-Comply-with-International-Tax-Trade-and-EU-Law.pdf> (April 2022)

[33] Willemyns, above n 30 at 279-280

[34] Mitchell, Voon and Hepburn above n 28 at 95

[35] See generally Argentina—Measures Relating to Trade in Goods and Services, Appellate Body Report, WT/DS/453/AB/R (9 May 2015)

Nation (MFN) obligation (Article II).[36] GATS does not prohibit any type of differential treatment between service suppliers but only those differentiations that affect the supply of services. A DST might have a discriminatory effect on cross-border services relative to those produced at home. Indeed, the US government criticised DSTs, including the UK DST in particular, for being discriminatory.[37]

GATS requires WTO members to adhere to the two aforementioned non-discrimination principles National Treatment and MFN. In that sense GATS limits the adoption of tax measures that impact trade in services with other WTO members. The National Treatment obligation of GATS explicitly requires members to "accord to services and service suppliers of any other member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers."[38] In contrast to the GATT, GATS National Treatment applies only to services that have been included by WTO members in their Schedule of Specific Commitments under the conditions that these commitments are not subject to additional limitations. WTO members can limit the scope of their commitments by means of horizontal limitations (meaning limitations that apply to all sectors listed in the schedule) or sectoral limitations (those specific to certain sectors).

ii) Assessing the Scope of a Members' National Treatment Commitments

For the DST to violate another members' GATS National Treatment commitments, it would first have to be shown that imposing country accepted a National Treatment commitment in respect of the services impacted by the DST and with regards to the mode of supply. A WTO member could adopt a horizontal limitation for National Treatment in order to exclude taxes from its GATS commitments. All tax measures, including DSTs, would thereafter fall outside of the scope of GATS obligations. This would remove the risk that any tax measures would be captured by GATS.[39]

[36] GATT Multilateral Trade Negotiations Uruguay Round, Group of Negotiations on Services, "The Applicability of GATS to Tax Measures" Note by the Secretariat, MTN. GNS/W/210 (1 December 1993)
[37] USTR, above n 17
[38] Art XVII
[39] J E Farrell, *The Interface of International Trade Law and Taxation* (IBRD Doctoral Series, 2013) at 189

WTO members often resist claims for breach of GATS National Treatment on the grounds that they never intended to bind itself in that sector or that mode.[40] Commitments made 20+ years ago may no longer correspond to services which exist today. Members may have listed a National Treatment obligation in their schedule of GATS commitments for a service or mode of supply mode that technology has transformed, resulting in a situation that the commitment is broader than that Member might have been anticipated during the original GATS negotiations. For example, China listed a National Treatment commitment for the distribution of sound recordings through electronic means. China's GATS schedule entry referred to "sound recording distribution services." However, China claimed that it only covered physical distribution. The Appellate Body disagreed, finding that this covered both physical and electronic distribution.[41] This ruling is also consistent with the generally agreed view that the GATS is a technological neutral agreement which does not distinguish between the various means through which a service can be supplied.[42] The result is, however, that a member may be held to a commitment which it did not intend to make. It is not only WTO law that has lagged behind technology – crucially tax law has also struggled to keep up to date with the transformation of the global economy. The telecommunications industry is perhaps the best example of one where domestic tax legislation has failed to adapt to technological advances.[43] Clearly, when assessing whether a member has made a GATS commitment which may be triggered by a DST, it must be ascertained precisely what services the DST is intended to cover. This will not be an easy task, again because digital trade is a rapidly evolving field where technological changes often outpace legal terminology.[44] A WTO panel would, following the Vienna Convention on the Law of Treaties, have to construe this concept by reference to the ordinary understanding of the term.[45]

Taking the UK's DST as an example, the tax only applies to "online services," although this phrase is not defined in the legislation. The UK tax authority, Her Majesty's Revenue and Customs (HMRC)'s revised guidance contains some commentary on whether activities are sufficiently separate to be considered a "service" in their own right, or if they are ancillary to a wider business function. There are three sub-categories of online services

[40] E.g. United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services, WT/DS285/AB (5 April 2005)
[41] China – Publications and Audiovisual Products, Appellate Body Report, WT/DS363/AB/R (19 January 2010)
[42] D Curiak, "The Challenge of Updating Institutions for Digital Trade", CIGI (16 July 2021)
[43] Frieda, above n 1 at 402
[44] Willemyns, above n 30 at 95
[45] Article 31.1

specified in the UK DST, the first of which is social media service. The definition of "social media service" requires a main purpose of promoting user interactions and sharing of user-generated content, which must be "a significant feature of the service." This condition means that businesses will not be covered by the DST simply because users share content on their platform even if, for example, that content is not significant because it merely relates to a comment on content provided by the business.[46] For the second category, online games, the HMRC's guidance notes that a case-by-case approach will be needed to determine whether user-generated content is a significant part of the game. Any in-game messaging and user-generated items would be considered user-generated content, although playing the game itself will not.[47]

The UK DST also covers "internet search engines" which is similarly undefined. The legislation excludes search engines which search a single (or closely related) website. The search engines that are covered by the DST are those whose core business involves the operation of a search engine. HMRC guidance notes that these engines will in principle search the whole of the Internet. Further, where a website has a "search box" that uses third party technology to display results from external websites, the third-party technology provider typically would be considered performing an in-scope activity, rather than the website owner. The other kind of online service which falls under the UK's DST is "online marketplaces" but only where the marketplace has a main purpose to facilitate the sale or hire of goods or services offered by users, and the marketplace enables users to sell or advertise. The use of the "main purpose" test here may be controversial, given the difficulty that there has been historically in the application of this test in WTO law.[48] HMRC's guidance on the definition of "online marketplace" sets out a list of factors that it considers to be relevant in determining whether there is an online marketplace. These include competition between sellers, the existence of a recognisable place or portal, and features that allow customers to search for products or services.[49]

As noted earlier, sectors that could be impacted (either directly or indirectly) by the DST therefore include advertising services, computer and services, travel agencies, news services, betting exchanges, suppliers of video and audio streaming services (where funded

[46] HMRC, "Internal Services Tax Manual" (19 March 2020, updated 14 June 2021) <https://www.gov.uk/hmrc-internal-manuals/digital-services-tax> (April 2022)
[47] Ibid
[48] Ibid
[49] Ibid

through advertising), non-regulated financial intermediaries, peer-to-peer marketplaces including crowdfunding, and distribution services. Educational and professional services could also be affected because of the feature of the DST that applies to intermediaries.

Returning to the scope of National Treatment commitments in these sectors, the appropriate mode of supply (cross border, consumption abroad, commercial presence and movement of natural persons) must also be identified to ascertain whether commitments have been made by members imposing the DST with regards to the relevant digital service. Evaluating the applicability of different modes is further relevant where a member has scheduled "unbound"[50] or a limitation in respect of Mode 1 supply of a service but accepted full commitments respect of Mode 2 of that same service ("none" in the schedule, meaning full commitment undertaken). A DST could conceivably have an impact on all four modes of supply, although the effect on certain modes may be more direct than others.[51] DST may impinge many different types of trade in services spread across modes as enabled through connections established by multiple interfaces and subsequently supplied through a variety of modes. To appreciate the application of a DST to services commitments it is necessary to understand the intangible supply chain or the "footprint" of the supply,[52] which could be much broader than is appreciated. It would seem that basic commitments in relation to various traditional kinds of services could be construed to engage GATS disciplines in those areas.

iii) National Treatment and "Likeness"

National Treatment requires that the imposing country not discriminate against foreign services or service suppliers in favour of "like" domestic services or services suppliers.[53] The WTO Appellate Body has indicated that the concept of likeness under the GATS with respect to non-discrimination is primarily "concerned with the competitive relationship of services and service suppliers."[54] This involves a "holistic analysis," considering both services and service suppliers together.[55] Consequently, a key consideration in evaluating the likeness of

[50] No commitments, therefore free to impose restrictions
[51] PWC, above n 20 at 9
[52] PWC, ibid at 8-9
[53] General Agreement on Trade in Services, art. XVII (15 April 1994), Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, (1994)
[54] Argentina – Financial Services, above n 35 at [6.25]
[55] Ibid

digital services such as advertising is the extent to which the advertising services and service suppliers actually compete for customers. The more competition to be found to exist between digital and non-digital advertising services, the more probably that these types of services would be regarded as "like."[56]

The likeness of digital advertising and conventional advertising is reasonably clear as both tend to compete for the same customers. The likeness of digital interfaces is less straightforward. For example, while a small retail business that sells its products on Amazon's platform would be covered by a DST, Amazon selling its own products through the platform would not be. But these services are obviously in a competitive relationship and could therefore be considered "like." Similarly, while Uber would fall under the coverage of a DST, a taxi company that operates an app would not because the latter company is selling its own service, which excludes it from the scope of a DST.[57] A close consideration of each situation will therefore be required to assess the application of the non-discrimination rule.

Factors such as the technological equipment, size and scale of a business such as number of employees and types of assets could be relevant in determining supplier likeness. GATS does provide for supplier likeness to be taken into account; however this is not for the purpose of distinguishing suppliers on the basis of size but rather a recognition that the quality of a service and nature of a supplier are inextricably linked. Whether such characteristics of services suppliers could inform an assessment of likeness has not been clarified by the Appellate Body. In particular, it is not clear how criteria such as size would be relevant if the services compete in the same given market. Distinctions based on size are problematic because this could make it practically impossible to find "like" suppliers, undermining the effectiveness of National Treatment in preventing discrimination.

There is a danger that size or other such factors become a proxy that could target digital companies in order to distinguish them from non-digital ones.[58] Assessing likeness based on business model appears to jeopardize the principle of technological neutrality – meaning that regulations should not favour one technology for delivering a service over another one. The concept of technological neutrality has reasonably strong support across WTO membership, although it remains under active discussion.[59] A determination by WTO

[56] Mitchell, Voon and Hepburn, above n 28 at 100
[57] Willemyns, above n 30 at 278
[58] PWC, above n 20
[59] Curiak, above n 21

panel or Appellate Body that suppliers of services supplied digitally are not "like" suppliers of like services that are supplied through more "traditional" means, such as in-person, would have significant implications, even more so because almost all types of commercial activity are becoming digitized. Digital delivery of services can complement traditional ones, with education being a good example. Indeed, the same supplier could offer services digitally that compete with "like" services that it supplies on an in-person basis.[60]

Monetary thresholds below which service suppliers are exempt from DSTs enhances the risk of a breach of an imposing countries' National Treatment obligation. This especially so because the "likeness" comparison would therefore be between digital service suppliers below the threshold and digital service suppliers above the threshold (rather than between digital and non-digital services). The WTO member imposing the DST could conceivably argue that the service suppliers below the chosen threshold are not like the service suppliers above the threshold,[61] which effectively would be a distinction based on size.

Under National Treatment, a complainant country must show that the only meaningful difference between its digital service suppliers, who must pay the DST, and suppliers of the country imposing the DST such as the UK of the same covered digital services, who are not subject to the DST, is national origin. The complainant country must then demonstrate that the DST's facially neutral revenue thresholds which capture that country's suppliers but not UK suppliers, are merely a proxy for national origin. The complainant's argument would be that the DST is designed to capture companies with a business model typical of U.S. digital service suppliers but not UK service suppliers – *de facto* discrimination.

Taking the U.S. as the most likely example of a complainant given that it is home to most of the big tech companies; it must also prove that U.S. digital service suppliers subject to the DST and their excluded UK competitors cannot be distinguished from one another on the grounds that covered companies benefit from so-called "user value creation." The U.S. could achieve this by showing that either U.S. digital service providers do not, in fact, derive meaningful value from UK users or it could show that UK service providers not captured by the DST also benefit from user value creation. The USTR has argued that the theory of "user created value" is unfounded, in part because it is unclear why firms of a certain size benefit from this value when smaller firms do not.[62] Theories of network effects suggest otherwise –

[60] PWC, above n 20
[61] Mitchell, Voon and Hepburn, above n 28 at 101
[62] USTR, above n 17 at 18

networks of users interacting with each other, such as Twitter or dating sites like Tinder only possess value when there is a critical mass of users. In the words, "the more users a communication network has, the more value it offers to every user."[63] On the other hand, some hold that the value of "peer production networks" are often over-estimated and that such services are unlikely to compete with commercial, professionally-produced sources.[64] That the intangible value of data may not easily be reflected in profits nor recorded on a balance sheet, rendering its applicability to various kinds of legislation, such as taxation, highly complicated.[65] The greater the relevance of user-created value, the more likely that "likeness" will not be found, precluding a successful claim of National Treatment.

iv) DST Affecting Trade in Services

In order to demonstrate that DST is discriminatory, the complainant must also demonstrate that the tax "affects" trade in services. The concept of "affect" is broadly understood in WTO law. A measure "affects" trade in services where it changes the conditions of competition in the supply of a service – a concept wider in scope than merely regulating the service. Having "an effect on" trade in services is sufficient. Indirect effect is enough - even a measure designed to regulate goods can be found to have an indirect effect on services.[66] The DST must be found to modify the conditions of competition of the foreign company on which the tax is imposed with regards to a "like" domestic service or service supplier of the imposing country.

Regarding the adverse impact of DST, firms to which the tax applies will not only pay higher taxes and thereby suffer a weakening of their competitive position, but will also need to fulfil additional compliance requirements for tax collection. These firms will face administrative difficulties in obtaining information on revenue generated from taxable activities. The fact that the burden of the DST will be passed on to consumers, as some companies such as Google have conceded, will not offset these costs. The USTR argued that DSTs have the effect of shifting advertising spending away from larger U.S. companies with revenues that exceed the thresholds, to domestic companies with digital advertising revenues

[63] J Montero and M Finger, *The Rise of the New Network Industries Regulating Digital Platforms* (Routledge, 2021) at 65
[64] A Guadamuz, *Networks, Complexity and Internet Regulation* (Elgar, 2011) at 143
[65] Magwape, above n 9 at 452
[66] China – Publications and Audiovisual Products, above n 41

that do not meet the thresholds. In that way, DSTs unfairly advantage smaller domestic companies against leading US companies.[67]

WTO jurisprudence has found less favourable treatment when the design leads disproportionately capturing foreign products under higher tax rates.[68] Some DST proposals, such as that of France, may have been designed in this way.[69] Unlike the GATT National Treatment provision which mentions the use of measures "so as to afford protection", the GATS National Treatment provision does not make any such reference. Regulatory intent to afford protection to domestic suppliers is not required (nor is it relevant for the purpose of determining 'likeness').[70] The intent behind the measure could, however, be relevant for fitting the DST under one of the GATS' exceptions.

v) The DST as a Breach of Most Favoured Nation (MFN)

There may be potential to bring an MFN claim against a DST. Recall that MFN requires that the country imposing the tax not to discriminate between the services and service suppliers of one foreign country in favour of "like" services and service suppliers of another foreign country.[71] For example, the U.S. could claim that a Canadian digital services company receives more favourable treatment under the UK DST than "like" US digital services companies. The strength of such a claim will depend on which other foreign service supplier it uses for its comparison. As with National Treatment, the main difficulty here will be proving that the U.S. service supplier and the services it provides are "like" the other foreign service supplier and its services.[72]

Since, based on their construction, the burden of DSTs appears to fall particularly on services or service suppliers from the U.S., this constitutes less favourable treatment of U.S. services and service suppliers in comparison with the treatment of services and service suppliers of other WTO members, evidently breaching MFN. As discussed above, the inclusion of a threshold exempting smaller suppliers from the DST would increase this risk if suppliers of WTO members other than the U.S. are more likely to be exempt.[73] It is

[67] USTR, above n 17 at 17
[68] See e.g. Japan – Alcoholic Beverages, above n 23 (which concerned goods rather than services)
[69] PWC, above n 20 (referring to Article 12 of the French DST)
[70] Argentina – Financial Services, above n 35
[71] GATS, art. II.
[72] Pirlot, above n 25
[73] Mitchell, Voon and Hepburn, above n 28 at 102-103

noteworthy that in France the DST is referred to as the "taxe GAFA" which refers to Google, Apple, Facebook and Amazon.[74] Therefore, as the taxes appear to disproportionately target U.S. companies it is quite likely that an MFN violation could be found.

The DST and GATS Exceptions

i)Securing Compliance with Domestic Laws and Direct Taxes

Commentators have argued that it is unlikely that the discriminatory nature of DSTs would be saved by GATS general exceptions.[75] In particular, it is improbable that a DST would be considered necessary to protect public morals or to maintain public order, despite the broad scope of these concepts. There is arguably a moral dimension to compliance with an obligation to pay taxes that are owed,[76] but it is hard to see how the crafting of tax policy could possibly be considered an element of "public morals" or vital to the preservation of order in the sense of preventing civic unrest. A footnote to Article XIV a) on public moral states that this exception may only be invoked where there is a genuine and sufficiently serious threat posed to one of the fundamental interests of society, which does not appear to be engaged with regards to taxation of digital services.

GATS Article XIV(c) entitled "Securing Compliance with WTO-Consistent Regulations" could conceivably apply to a DST. In *Argentina — Measures Relating to Trade in Goods and Services*, the panel found that, by taxing the profits earned from certain financial services supplied from service suppliers of non-cooperative countries at a higher rate than like services from service suppliers of cooperative countries, the measure contributed to protecting the tax base. This was because it discouraged the undeclared outflow of capital and the false payment of interest.[77] For a digital services tax to be justified under GATS art XIV(c), the country imposing the DST would have to show that the tax was '"necessary" to secure compliance with other domestic laws or regulations that were themselves consistent with WTO law – a high threshold. However, since DSTs appear to address tax avoidance only in a general sense, rather than targeting conduct that is unlawful

[74] Willemyns, above n 30 at 278
[75] Mitchell, Voon and Hepburn, above n 28 at 88
[76] See e.g. D Gonzalez, "Morality, Consciousness and Tax Discipline: Their Role in Tax Compliance" Inter-American Centre of Tax Administrators (13 July 2020) <https://www.ciat.org/morality-conscience-and-tax-discipline-their-role-in-tax-compliance/?lang=en> (April 2022)
[77] Argentina — Financial Services, Report of the Panel, above n 35. This decision was ultimately rejected by the Appellate Body.

in the imposing countries, a defence under art XIV(c) is unlikely to succeed.[78] Most consequently agree that it would be difficult to argue that a DST is necessary to secure compliance with certain laws or regulations given that these taxes were adopted to address tax avoidance in general.[79]

Unlike the GATT, GATS contains specific tax exceptions: GATS Art XIV (d) refers to direct taxes as a the carve-out from the National Treatment principle "provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members." This exception could conceivably justify the features of destination-based taxes like DSTs that are potentially problematic under the National Treatment principle. It is not available for breaches of MFN. GATS' tax carve-out enables members to differentiate between resident and non-resident service suppliers as well as between "service suppliers subject to tax on worldwide taxable items" and "other service suppliers." When considering the scope of the direct tax exception, the Appellate Body recognized the importance of a WTO member's ability to protect its tax system, combat harmful tax practices and have effective tax collection.[80] It could be argued that the DST seeks to secure compliance with domestic tax law, although the relevant tax law would be the DST itself (since no equivalent exists under most domestic tax regimes), rendering the measure problematically self-justifying. The exemption of certain resident service suppliers from DSTs could be saved by GATS article XIV(d) under the condition that they are subject to a broader personal income tax than non-residents (so as to meet the condition of the chapeau that they are not arbitrary, of which more below). For example, some large UK technology companies would be subject to the UK DST while smaller foreign ones are not. It is noteworthy that GATS Article IV (d) only justifies inconsistencies with the National Treatment obligation – it would not operate as a defence to a breach of MFN.

In assessing the validity of the "direct tax" exception GATS Article XXVII(o) usefully defines "direct taxes" to comprise all taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation. In one sense this definition

[78] Michell, Voon and Hepburn, above n 28 at 105
[79] Willemyns, above n 30 at 279
[80] Argentina-Financial Services, Appellate Body Report, above n 35 at [6.191]

captures DSTs because these are taxes on income generated by the provision of digital services. On the other hand, the practical consequence of DSTs is that the service supplier will pass the tax on to consumers, effectively acting as an intermediary, although only in a *de facto* sense as there is no requirement for consumers to pay this tax. A DST applicable to each digital service transaction, similar to an excise tax, would likely be characterised as an indirect rather than direct tax. In contrast, a digital services tax imposed on a proportion of a service supplier's income (that portion attributable to the supply of digital services in the imposing country) would be more likely to qualify as a tax on "elements of income" and consequently be viewed as "aimed at ensuring the equitable or effective imposition or collection of direct taxes" within the meaning of the exception in GATS art XIV(d) (as elaborated in GATS footnote (6).[81] Of course, the fact that a tax (or a tax regime) is described as such is not determinative. In other words, both indirect and direct taxes can violate the GATT if they are implemented in a discriminatory manner with respect to imported products.[82]

ii) The Chapeau

While DSTs could conceivably fit under at least one of the enumerated exceptions to the GATS, it would be difficult for the DST-imposing country to satisfy GATS Article XIV's gatekeeping provision, known as "the chapeau," which is necessary to successfully invoke any of the exceptions: "measures [must] not [be] applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade…" Many believe that there is a good chance that a claimant could succeed in a WTO case challenging a DST on the basis of the chapeau.[83]

In assessing the applicability of the chapeau, it must be recognized that the tax base of a digital services company will be some measure of global revenue attributed to website users in the imposing country. But since users do not pay anything to tech firms, the attribution of advertising and other revenues, perhaps paid by firms located in the U.S. or France, to the UK tax authority in the case of the UK DST will be arbitrary.[84] Thus, DSTs arguably constitute

[81] Mitchell, Voon and Hepburn, above n 28 at 106
[82] Pirlot, above n 25
[83] Forsgren, Song and Horváth, above n 32
[84] Hufbauer and Lu, above n 31

"arbitrary or unjustifiable discrimination between countries where the same conditions prevail." Indeed, the USTR claimed that the UK DST was designed as "a narrowly-targeted tax" on revenues from specific digital platform business models to ensure it is established tech giants – rather than UK tech start-ups – that shoulder the burden. The USTR argued that references to "established tech giants" by the UK government clearly refer to U.S. companies and disclose the intention to hit U.S. companies while excluding similarly situated UK digital service companies. The USTR further asserted that the UK DST only pertains to three specific categories in which U.S. firms are marketplace leaders—namely, certain search engines, social medial platforms and online marketplace. It therefore unfairly targets U.S. companies. [85] DSTs have been viewed by others as discriminatory precisely because they apply almost exclusively to U.S. companies.[86]

In assessing the discriminatory effect of a measure for the purposes of satisfying the chapeau of Article XIV, the DST's design, structure and intended operation must be examined along with its implications for the marketplace - not necessarily its actual effects. The USTR stated that the design of the UK's DST was such that leading digital services firms in the UK and Europe would not be affected. It cited Spotify and Monzo as two companies which would not be caught by the DST because they do not operate search engines, social media services and online marketplaces.[87] Neither Spotify nor Monzo are British, however the fact that the services provided by these firms are excluded calls into question why the UK DST was crafted in the way that it was, suggesting arbitrariness. The USTR further argued, in the case of the UK DST, that it appears as though the UK government intends to interpret its DST purposefully in a manner that would exclude UK companies. Notably "marketplace delivery fees" may be excluded, precluding the application of the DST to two British companies that might have otherwise been subject to the DST: Just Eat and Deliveroo.[88]

The USTR also criticized the UK DST on the basis that it was crafted so that the thresholds will apply on a group-wide basis, not on a per business activity or per company basis. This means that revenues will be counted towards DST thresholds even if they are recognised in entities which do not have a UK taxable presence for corporation tax purposes. The USTR claimed that the purpose of this application of the tax is precisely to ensure that

[85] USTR, above 14 at 16
[86] Geist, above n 4
[87] USTR, above 17 at 15
[88] Ibid at 16

leading US firms' revenues are captured, which it views as indicative of unfair discrimination against U.S. companies.[89]

A measure that applied particularly to foreign service suppliers, such as those from the U.S., as the consequence of a lower threshold, may be seen to constitute trade discrimination or restriction, contrary to the chapeau. The country imposing the DST would need to demonstrate that this distinction had a legitimate rationale linked to the overarching purpose of the measure,[90] namely ensuring the fair collection of tax. But it seems that the DSTs' exemption for smaller suppliers undermines the purpose of ensuring tax coverage of digital services.[91] A measure's absence of consistency is thought to indicate arbitrary discrimination or a disguised restriction on international trade.[92]

Establishing the policy purpose behind the DST would assist in determining whether it satisfies the Article XIV chapeau. Ideally there should be some proportionality between the objective and the measure chosen. The greater the contribution to the stated objective, the easier it would be to establish that the DST is "necessary."[93] It is useful to consider the stated objective of the UK DST, as explained by the HMRC:

> The application of the current corporate tax rules to businesses operating in the digital economy has led to a misalignment between the place where profits are taxed and the place where value is created. Many of these digital businesses derive value from their interaction and engagement with a user base.
>
> Under the current international tax framework, the value businesses derive from user participation is not taken into account when allocating the profits of business between different countries. This measure will ensure the large multinational businesses in-scope make a fair contribution to supporting vital public services.

The objective of the DST therefore seems to be, rather vaguely, one of "fairness." But commentators have noticed that the DST does not seem to support the objective of establishing a tax system which is "fair." The scope of the DST seems counterproductive to a

[89] Ibid at 18
[90] EC — Seal Products, Appellate Body Report, WT/DS400/AB/R and WT/DS401/AB/R at [5.306] (adopted 18 June 2014)
[91] Mitchell, Voon and Hepburn, above n 28 at 106
[92] US – Gambling, Report of the Panel, WT/DS285/R (20 April 2005)
[93] A Mitchell, "Proportionality and Remedies in WTO Disputes" 17:5 European Journal of International Law 985 (2006)

fair tax regime, particularly because of thresholds and the services covered by the tax.[94] In the context of DSTs imposed by EU members, notably France, the EU position appears to be that profit margins of the big tech companies are so high that the 3 per cent DST imposed by France, for example, will have no practical bearing on the firm,[95] detracting from the claim that the tax is somehow fair in terms of a company's ability to pay.

Furthermore, the rationale underlying taxing user value creation, identified by HMRC as one of the justifications for the UK DST, does not seem credible. This is because the use of digital interfaces creates value for all companies that use them including excluded businesses, for example those that supply certain investment services. The application of the measure indicates that, rather than taxing user value creation, which would capture a broader range of services/suppliers, the DST seeks to tax companies where the degree of value created by users is at a particular level, which happens primarily to be U.S. companies. With regards to preventing the distortion of competition, it is not clear that the tax profile of suppliers targeted by the DST will beneficially impact competition in that sector. Competition may be more the result of technological advances and consumer habits which has led consumers to use digitally supplied services.[96]

Arbitrariness is identified in WTO law by reference to reasonably available less trade restrictive alternative measures. The trade restrictiveness of a measure is typically a question of degree. The Appellate Body ruled recently that the mere modification of the conditions of competition in a market does not suffice to indicate the level of restrictiveness – evidence regarding the actual trade effects may also be needed.[97] Less trade-restrictive measures, instead of a DST, are conceivable, suggesting that the DST is not "necessary" within the meaning of Art XIV. Commentators have suggested that "a less blunt and discriminatory alternative DST might cover an expanded scope of services supplied digitally and capture more services that are in a competitive relationship by using different revenue thresholds."[98] The revenue thresholds, which lack a clear rationale, might also pose challenges under the chapeau. If the objective of the UK's DST is truly to provide a regulatory environment in which smaller start-ups can grow and thrive, to the ultimate betterment of consumers, then surely competition law is a more suitable mechanism to address the dominance of the large

[94] PWC, above n 20
[95] Ibid at 10-11
[96] Ibid at 15
[97] Australia – Tobacco Plain Packaging, WT/DS435/AB/R (9 June 2020)
[98] Ibid at 13-14

tech companies that have crowded out the market. The EU's new Digital Markets Act, designed to control abuse of market dominance of the large tech companies, is a good example of this approach.[99] Getting rid of cumbersome data privacy requirements, like the EU's General Data Protection Regulation (GDPR), which disadvantages smaller firms, would be another sensible move.[100] Moreover, evidence indicates that suppliers caught by the DST currently pay about the same percentage of direct taxes as multinational enterprises which fall outside its scope. This in turn suggests that the DST may constitute arbitrary or unjustifiable discrimination against foreign/U.S. services and suppliers and a disguised restriction on trade in digital services.[101]

In addition to GATS direct tax exception, there is also room to challenge the application of a DST on the basis that the DST is covered by an existing double taxation treaty between the countries under Article XIV (e). This defence reflects the WTO dispute settlement body's cognizance of international treaties between the parties.[102] In order defend its DST against a National Treatment claim, the imposing country would have to respond successfully to the claimant's demonstration that the foreign country's DST is covered by a double taxation treaty between the two countries. If such a treaty exists, a National Treatment claim against a foreign country's DST will be barred by GATS Article XXII. Commentators have suggested, in the case of a U.S. claim against the French DST for example, the U.S. would be able to establish that the French DST is not covered by the non-discrimination provision of the US-France Bilateral Income Tax Treaty.[103]

V Conclusion

The DSTs proposed by a number of countries poses significant challenges in terms of compliance with WTO law. The clear target of DSTs, being U.S. big tech companies, may prompt the U.Ss to bring WTO discrimination claims under the GATS against countries imposing DSTs. While the success of these claims will ultimately depend on how DSTs are

[99] Proposal for a Regulation of the European Parliament and of the Council on Contestable and Fair Markets in the Digital Sector (Digital Markets Act) COM(2020) 842, 2020/0374(COD)
[100] C B Frey, G Presidente, "The GDPR Effect: How Data Privacy Regulation Shaped Firm Performance Globally" Vox EU CEPR (10 March 2022) <https://voxeu.org/article/how-data-privacy-regulation-shaped-firm-performance-globally> (April 2022)
[101] PWC, above n 20 at 15
[102] P van den Bossche and W Zdouc, *The Law and Policy of the World Trade Organization* (Cambridge University Press, 2022) at 68-70
[103] Forsgren, Song and Horváth, above n 32

applied in practice, there is good reason to believe that they will be viewed as discriminatory and potentially arbitrary, primarily because of their apparently purposeful design to hit U.S. companies as well as the debateable value of user-generated content. The U.S.'s threat of trade retaliation against every country imposing a DST is not credible. It is conceivable that the U.S. could impose retaliatory tariffs against France and a few other large economies, but not likely against thirty plus countries. Ultimately retaliatory tariffs are also harmful to consumers, undermining many of the gains from free trade. This is particularly so since the tax burden of DSTs is fairly small and, again, it will for the most part, be passed on to consumers.[104]

The fair contribution of large tech companies has exposed the inadequacy of traditional tax laws in capturing profit generating activity which occurs in a digital environment. Some argue that WTO law should not be used as an excuse to disregard a move towards destination-based taxation as a relevant policy option to reform outdated tax systems.[105] In contrast, some contend that national DSTs undermine global efforts through the OECD to establish a multilateral destination-based tax,[106] although the proposed OECD convention will probably never be implemented because it will require changes to every tax treaty in existence.[107] This may explain why countries like Canada are preparing to go ahead with DSTs on their own. Others hold that multilateral conventions regarding taxation of digital presence are inferior to unilateral DSTs which can be structured to address the particular needs of each country.[108]

The possibility of the U.S. retaliating against DSTs by imposing tariffs on the countries which have imposed it highlights the larger issue in the use of DSTs. Until a global treaty on digital tax is established, DSTs constitute a unilateral response to some of the tax problems posed by the digital economy. Unilateral measures of this kind can have unintended and unnecessary consequences, furthering the growing trend towards economic nationalism, which runs counter to the universal understanding that globalization, in particular freer trade, has contributed to economic and social prosperity.[109]

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[104] Geist, above n 4
[105] Pirlot, above n 25
[106] USTR, above n 17 at 2
[107] Geist, above n 4
[108] W Cui, "The Superiority of the Digital Services Tax over Significant Digital Presence Proposals" 72:4 National Tax Journal 839 (Dec 2019)
[109] Mitchell, Voon and Hepburn, above n 28 at 124

Apart from imposing taxes on a unilateral or even multilateral basis, a better way to ensure that the big digital services providers like Google and Amazon "pay their way" is to ensure that they are making a fair contribution to society, for which payment of tax tends to be a proxy, is to mandate that these companies genuinely make such contributions. But as one commentator puts it, digital services providers "do not have the economic incentive nor the legal obligation to ensure public values such as reliability, diversity or pluralism in the public debate that they increasingly manage and shape."[110] If consumer-led demands for more socially-minded digital services providers are unheeded, additional regulation may be needed to ensure that digital services providers fulfil these "duties." Regulation of this kind will raise even more controversies than the debates surrounding DSTs. On the other hand, the mere enabling of online interactions amongst communities of people, detached from particular social objectives, has itself facilitated participatory democracy and the cultivation of civic identity. So-called "voice" is often viewed as an essential component of citizenship and digital media has unquestionably facilitated this.[111] If this can be believed, then it is at least plausible that the large tech companies should not bear the brunt of additional taxes that appear to run counter to established principles of international trade.

[110] Montero and Finger, above n 63 at 118

[111] B Bimber, "The Impact of Digital Media on Citizenship from a Global Perspective" in E Andvizen, M Jensen, L Jorba eds. *Digital Media and Political Engagement Worldwide* (Cambridge University Press, 2012) at 30