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Testing for Consistency: Certain Digital Tax Measures and WTO Non-Discrimination

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Abstract

Few issues have challenged tax policymakers and commentators as much as digital taxation has in recent years. Ongoing efforts to reconstruct the rules of international tax to "properly" govern the taxation of the global digital economy have evoked some important tax and trade related considerations. As regards the latter, unilateral attempts by various states – partly spurred on by a lack of multilateral consensus – to tax nonresident digitalized businesses threaten to disrupt international trade relations, with threats of trade war exchanged between some World Trade Organization (WTO) member states over the propriety of the proposed tax measures. As the conversation on the underlying tax issues progresses, this article examines the consistency of some features of the various unilateral digital tax measures with the fundamental WTO principle of non-discrimination, as contained in the General Agreement on Trade in Services (GATS). Using the French Digital Service Tax (French DST) as a focal point, the article argues that there is a case to be made that some common features of the unilateral digital tax measures violate either the most favoured nation or national treatment rules of WTO non-discrimination.

Keywords: International Tax, International Trade, Digitalization, E-Commerce, WTO, Non-discrimination, Most Favoured Nation, National Treatment.

1. Introduction: Digital Trade and International Tax Concerns

> *The basic premise of free trade, advanced since the time of Adam Smith and David Ricardo, is that the welfare of residents of all countries is enhanced if they can purchase goods and services at their lowest prices on the world market*.[1]

Digitalization has steadily emerged as a catalyst for business process modernization, enhanced productivity, cost saving, wealth creation, consumers' choice expansion, expedited globalization, economic integration, and rapid international trade expansion.[2] Despite this array of positives, the

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[1] Paul R. McDaniel, *Trade and Taxation*, 26(4) Brooklyn J. Int'l L. 1621–25 (2001).

[2] See Christoph Ungerer, Marco Hernandez & Gallina A. Vincelette *How Economic Integration Can Increase Living Standards in the Western Balkans* (2018) https://www.brookings.edu/blog/future-development/2018/11/19/how-economic-integration-can-increase-living-standards-in-the-western-balkans/; Rachael Stelly, *Online Services Drive Exports, But Face Rising Trade Barriers, The Competition Disruption Project* (2019) http://www.project-disco.org/21st-century-trade/040319-online-services-drive-exports-face-rising-trade-barriers/; Peggy Abkemeier, *Cross-Border Trade: PayPal's $400B Business* (2017) https://www.paypal.com/stories/us/cross-border-trade-paypals-400b-business; Javier López González & Janos Ferencz, *Digital Trade and Market Openness* OECD Trade Policy Papers 217 (Paris: OECD 2018); OECD, *Trade In the Digital Era* (2019) https://www.oecd.org/going-

digitalization of international trade poses significant challenges, especially for governments, policymakers, and businesses. One issue is whether current trade rules adequately address trade in the digital age.[3] Existing multilateral trade rules were negotiated when digital trade was in its infancy and, even if conceived to be technologically neutral, questions arise over whether they might require clarifications to reflect new forms of, and issues raised by, digital trade.[4] A second fundamental issue borders on the interaction between digital trade and international taxation. There are different facets to this issue. For starters, cross border digital services undermine the ability of governments to maximize the local tax base. This is because digital services continue to supplant numerous physical products[5] and digital traders continue to replace local shops and physical establishments.[6] These transformations reduce a government's tax collection in at least three ways. First, the closure of countless factories, offices, shops and establishments erodes land-based revenues from property taxes and development charges.[7] Second, fewer physical goods could reduce the taxes levied on production or value addition to physical goods.[8] Third, taxes collected on the salaries and wages of local conventional workers disappear when those workers are rendered unemployed by the rise of the digital economy.[9] To aggravate matters, technical gaps in

digital/trade-in-the-digital-era.pdf. [OECD - Trade in the Digital Era]; John-ren Chen & Christian Smekal, *Should the WTO Deal with E-trade Taxation Issues?* 9(4) Progress in Dev. Stud. 339 (2009).

[3] OECD - Trade In the Digital Era *ibid*.

[4] *Ibid.* The United States, Mexico and Canada Agreement 2019 (USMCA) is a rare trade agreement with substantial provisions on digital trade. The Agreement prohibits a Party from imposing customs duties, fees, or other charges on or in connection with the importation or exportation of digital products (e-books, videos, music, software, games, etc.) transmitted electronically, between a person of one Party and a person of another Party. The Agreement, nevertheless, allows a Party to impose internal taxes, fees, or other charges on a digital product transmitted electronically, provided that those taxes, fees, or charges are imposed in a manner consistent with the Agreement. That seems to imply, in one sense, that the measure must not be discriminatory. See USMCA, Art. 19.3.

[5] Christopher Mims, *A Surprisingly Long List of Everything Smartphones Replaced* (2012) https://www.technologyreview.com/s/428579/a-surprisingly-long-list-of-everything-smartphones-replaced/.

[6] Nathaniel Meyersohn, *American retailers already announced 6,000 store closures this year. That's more than all of last year* (2019) https://www.cnn.com/2019/04/16/business/store-closures-retail-bankruptcies/index.html.

[7] See Vijay Govindarajan *et al*, *The Problem with France's Plan to Tax Digital Companies* (2019) https://hbr.org/2019/07/the-problem-with-frances-plan-to-tax-digital-companies

[8] *Ibid.*

[9] *Ibid.* See also Policy Horizons Canada, *The Next Digital Economy* (2019) https://horizons.gc.ca/en/2019/06/20/the-next-digital-economy/ Although digitalization has a diminishing effect on conventional jobs when digital services are

the current international tax regime result in a serious fiscal leakage with respect to cross-border digital trade income.[10] The incomes of digital businesses are often derived remotely by nonresident businesses or corporations (NRCs), rendering such incomes non-liable to tax in the source states and costing source states significant taxable revenue losses.[11] The current international tax rules, which allocate taxing powers among states, were designed as far back as the 1920s, a time when digitalized commerce did not exist.[12] Generally, under the current rules, a state can only tax the income of an NRC if the NRC has a permanent establishment (PE) in that state and derives income through the PE.[13] That means having some form of physical presence.[14] The evident negative impact of digital trade on domestic tax revenue, which remains unsolved, has aroused a sense of tax injustice and prompted states to fashion various measures to tax income arising from digital trade. Faulhaber identifies two underlying concepts that characterize the adoption of digital tax measures by states. First, such measures illustrate that countries believe that the current international tax system is outdated and needs to be reformed. Second, digital tax measures focus on three elements of the existing system that countries believe need to be reformed: the physical presence requirement, the low tax rates available in some countries, and the ability of multinationals in particular to earn income without having a physical presence or to shift income

delivered remotely, digitalization also has the effect of creating many new jobs. See Karim Sabbagh *et al*, World Economic Forum, *Digitization for Economic Growth and Job Creation: Regional and Industry Perspectives* (2013) http://www3.weforum.org/docs/GITR/2013/GITR_Chapter1.2_2013.pdf. The problem in the present case is that those new jobs are largely based overseas, which means that they are outside the tax net of the local authorities.

[10] Rifat Azam, *Global Taxation of Cross-Border E-Commerce Income*, 31(4) Va. Tax Rev. 639–52 (2012).

[11] See Reuven S. Avi-Yonah, *Three Steps Forward, One Step Back? Reflections on "Google Taxes" and the Destination-Based Corporate Tax* 2 Nordic Tax J. 69 (2016).

[12] See OECD, *Public Consultation Document Secretariat Proposal for a "Unified Approach" Under Pillar One 9 October-12 November 2019* (Paris: OECD 2019) [OECD Unified Approach].

[13] See Julie Bellemare, *Evolution of the Permanent Establishment Concept*, 65(3) Can Tax J. 725 (2017).

[14] OECD Unified Approach *supra* n. 12, at 7, para. 21.

to low-tax jurisdictions.[15] The ensuing sections of this article highlight some of the features often found in the digital tax measures and how these features interact with WTO non-discrimination.

2. Taxing Digital Trade

A recent KPMG survey reveals that a vast majority of countries have introduced some form of digital trade tax measure.[16] These measures are based on two main models: those that seek to adapt existing tax treaty principles to the peculiarities of digital trade[17] and those that seek to impose a digital service tax (DST).[18] These largely unilateral measures are being discussed by Members of the Organization for Economic Co-operation and Development's (OECD) Inclusive Framework on Base Erosion and Profit Shifting (BEPS) towards a consensus-based approach to digital taxation.[19] Action 1 of the OECD BEPS Project seeks to address specific challenges raised by digitalization.[20] Work on this action point has seen the development of digital tax proposals by the Inclusive Framework. The proposals are predicated on the concept of value creation, which, simply put, seeks to ensure that taxes are paid *where* economic value is created.[21] The proposals so far

[15] See Lilian V. Faulhaber, *Taxing Tech: The Future of Digital Taxation*, 39(2) Va. Tax Rev. 145 (2019).

[16] See KPMG, *Taxation of the Digitalized Economy: Direct Taxes* (2020) https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf

[17] This consists of Action 1 of the OECD BEPS Project as well as the European Union's digital PE proposal.

[18] This consists of some radical changes to existing tax rules proposed or introduced by the European Union, as well as some individual states within and outside the EU.

[19] OECD, *Public Discussion Draft BEPS Action 1: Address the Tax Challenges of the Digital Economy 24 March 2014-14 April 2014* (Paris: OECD 2014); OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1—2015 Final Report* (Paris: OECD 2015) [OECD BEPS 2015 final report]; OECD, *Tax Challenges Arising from Digitalization—Interim Report 2018: Inclusive Framework on BEPS* (Paris: OECD 2018); OECD, *Addressing the Tax Challenges of the Digitalization of the Economy—Policy Note: As Approved by the Inclusive Framework on BEPS on 23 January 2019* (2019) https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf; OECD, *Tax and Digitalization*, OECD Going Digital Policy Note (2019) (www.oecd.org/going-digital/tax-and-digitalisation.pdf); OECD, *Public Consultation Document Addressing the Tax Challenges of the Digitalization of the Economy 13 February-6 March 2019* (Paris: OECD 2019); OECD, *Programme of Work To Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy: Inclusive Framework on BEPS* (Paris: OECD 2019); OECD Unified Approach *supra* n. 12; OECD, *OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors* (Riyadh: OECD 2020).

[20] See OECD BEPS 2015 final report *ibid*; Joachim Englisch, *BEPS Action 1: Digital Economy – EU Law Implications* 2015(3) British Tax Rev. 280 (2015).

[21] For analysis of "value creation" see Johannes Becker & Joachim Englisch, *Taxing Where Value Is Created: What's 'User Involvement' Got to Do with It?* 47(2) Intertax 161 (2019); Itai Grinberg, *User Participation in Value Creation* 2018(4) Brit. Tax Rev. 407 (2018).

considered by the OECD include the significant digital presence, the withholding tax model, the equalization levy, the user participation proposal, the marketing intangibles proposal and more recently the "Unified Approach".[22] Despite years of work, attaining a consensus on these proposals has proven challenging.[23] The impasse can be attributed to diverging interests among states and the inherent difficulty in constructing a system that represents a radical departure from existing international tax norms. There are significant considerations bordering on the reallocation of taxing rights between jurisdictions; fundamental features of international taxation, such as the traditional notions of PE and the applicability of the arm's length principle; the future of multilateral tax co-operation; the prevention of aggressive unilateral measures; and the intense political pressure to tax highly digitalized multinational enterprises.[24] Perhaps, only a political solution that is built on compromise, rather than "right", can be break the impasse.

Paralleling OECD discussions, the European Commission (EC) and several European Union (EU) countries have advanced proposals for taxing the digital economy.[25] The EC's two proposals are the significant digital presence proposal and the digital services tax proposal. Each proposal outlines certain criteria that a business must meet to be eligible for digital taxation.[26] While the EU

[22] OECD BEPS 2015 final report *supra* n. 19; OECD Unified Approach *supra* n. 12. For discussion of these proposals see Chukwuemeka Stanley Ndibe, *A Review of the Proposals for Taxation of Profits of Businesses in the Digitalized Economy*, University of Western Ontario Master of Laws Research Repository (2019) https://ir.lib.uwo.ca/llmp/5/; Daniel Bunn, *Tax Foundation Response to OECD Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One* (2019) https://taxfoundation.org/response-to-oecd-public-consultation-document-secretariat-proposal-for-a-unified-approach-under-pillar-one/; Pasquale Pistone, João Nogueira & Betty Andrade, *The 2019 OECD Proposals for Addressing the Tax Challenges of the Digitalization of the Economy: An Assessment*, 2(2) Int'l Tax Stud. 1 (2019).

[23] Mark Scott, *Push for Global Digital Tax Agreement Stalls Amid Tensions* (2020) https://www.politico.eu/article/digital-tax-taxation-oecd-france-united-states-bruno-le-maire-facebook-amazon-apple-google/; Chris Giles & Jim Pickard, *UK to push on with digital tax in face of US anger* (2020) https://www.ft.com/content/c80079ca-3c61-11ea-a01a-bae547046735.

[24] OECD Unified Approach *supra* n. 12 at 4, para. 7.

[25] See European Commission, *Proposal for a Council Directive Laying down Rules relating to the Corporate Taxation of a Significant Digital Presence*, COM (2018) 147 final (2018) [EC Council Directive]; United Kingdom Finance Act 2015, c. 11.

[26] *Ibid*, Art. 4.1. See also Wei Cui, *The Superiority of the Digital Services Tax Over Significant Digital Presence Proposals*, 72(4) National Tax J. 839–842 (2019).

states failed to reach a consensus on any of the above proposals, individual EU states have initiated digital tax measures of their own. Simultaneously, a flurry of Asian countries, emboldened by their EU counterparts, have followed suit.[27] Many of the unilateral measures draw similarities with some of the OECD (pre-Unified Approach) and EC proposals. Examples are India's equalization levy and significant economic presence measures.[28]

Of the measures in play, the French DST has attracted the most attention and appears likeliest to trigger a trade conflict. For context, France's 2019 DST legislation is a modified version of the EC's DST proposal.[29] The law imposes a 3% tax that applies to about 30 companies generating more than €750,000,000 in global digital sales and more than €25,000,000 in France.[30] The tax applies to turnover from online advertising, the sale of data for advertising purposes, and fees derived from linking users to online sales platforms.[31] The revenue attributable to France is the proportion of the worldwide revenue from the corporation's taxable services that are derived from French users, determined by a percentage that is based on the location of users in France and number of accounts opened in France.[32] The French DST is designed as a temporary measure pending an international (e.g. OECD-wide) consensus on digital trade taxation. In the meantime, unilateral digital tax measures continue to be met with stiff opposition from the U.S. The U.S. argues that it should be the only country taxing U.S. companies involved in digital trade,[33] that the

[27] See Govindarajan et al *supra* n. 7. See KPMG *supra* n. 16.
[28] See Finance Act 2019, No. 13, section 4. See, generally, KPMG *ibid.*
[29] This is also the case with DST measures adopted by EU states like Austria and Spain.
[30] Terry Sprackland & Stephanie Soong Johnston, *French Senate Passes DST Despite U.S. Tariff Threats*, Tax Notes Intl 243 (2019 https://s3.amazonaws.com/pdfs.taxnotes.com/2019/2019tni28-20.pdf
[31] *Ibid.*
[32] EY, *French Government Submits Draft Bill on Digital Services Tax to Council of Ministers* (2018) https://www.ey.com/gl/en/services/tax/international-tax/alert--french-government-submits-draft-bill-on-digital-services-tax-to-council-of-ministers.
[33] Colin Wilhelm, *U.S. Retaliation Still Looms in French Digital Tax Talks (1)* (2019) https://news.bloombergtax.com/daily-tax-report/u-s-retaliation-still-looms-in-french-digital-tax-talks

measures discriminatorily target its companies,[34] and has repeatedly threatened to retaliate against any country that tries to impose such measures.[35]

Although there are differences between the measures that states have initiated to tax digital trade, some common threads can be identified. First, the measures aim at highly digitalized business models. Second, they seek to deviate from traditional taxing rules by targeting businesses that lack a physical presence in the taxing jurisdiction, but, nevertheless, 'operate' there remotely. Third, the measures are marketing jurisdiction or destination-based, to the extent that they seek to tax where the customers and clients are located irrespective of where the business is located. Fourth, the measures contemplate the use of some taxability threshold, which may be users, income, or transactions. Fifth, there is a preference for direct taxation that is based on turnover rather than profits. While each of these features raises tax policy concerns, there is also an international trade law concern that such measures may contravene WTO disciplines.[36] It is trite that WTO principles, generally, prohibit discriminatory trade treatment among members.[37] Since the countries seeking to implement (unilateral) digital tax measures also subscribe to the WTO and its rules, would they be in contravention of those rules by implementing measures with some discriminatory features?

[34] U.S. corporations like Google, Amazon, Facebook, and Apple are reputed to be the biggest players in the digital space. See Naomi Jagoda & Emily Birnbaum, *Trump Escalates Fight over Tax on Tech Giants*, (2019) https://thehill.com/policy/technology/472915-trump-escalates-fight-over-tax-on-tech-giants

[35] Pierre Briançon, *Why the U.K. and France play against type in digital tax row with the U.S.*, (2020) https://www.marketwatch.com/story/why-the-uk-and-france-play-against-type-in-digital-tax-row-with-the-us-2020-01-23

[36] See Hosuk Lee-Makiyama, *The Cost of Fiscal Unilateralism: Potential Retaliation against the EU Digital Services Tax (DST)*, ECIPE Occasional Paper 5 (2018); Gary Clyde Hufbauer & Zhiyao (Lucy) Lu, *The European Union's Proposed Digital Services Tax: A De Facto Tariff* (2018) https://www.piie.com/system/files/documents/pb18-15.pdf; PWC, *A white paper analyzing the EU's 2018 proposed digital services tax (interim measure) under WTO law* (2018) https://www.pwc.com/us/en/services/tax/assets/dst-under-wto-law.pdf; Anna Dias & Olivier Prost, *French Digital Services Tax and Proposed US Retaliation Measures: Preliminary Legal Analysis* (2019) https://www.gide.com/en/news/french-digital-services-tax-and-proposed-us-retaliation-measures-preliminary-legal-analysis

[37] William J Davey, *Non-discrimination in the World Trade Organization the Rules and Exceptions* (Hague Academy of International Law 2012); Kyle Bagwell & Robert W. Staiger, *Reciprocity, Non-discrimination and Preferential Agreements in the Multilateral Trading System* 17 European J of Political Economy 281–282 (2001).

This issue is taken up in the following sections. If the measures are based on international consensus between affected states, the above concerns are not likely to arise since WTO rules generally allow states to negotiate their tax relationships, especially as regards direct taxes.[38] As one commentator fairly observes:

> When considering the three different proposals for new tax measures discussed in this chapter, it is fairly obvious that neither (a) an extension of the PE concept to an SDP or other form of VPE nor (b) a treaty-based extension of WHT to returns on digitally provided services create serious issues with respect to WTO law. Since either extension would have to be based on DTCs and would fall under the rules concerning direct taxes, such measures would benefit from the carve-outs found in GATS Article XIV(d) for measures intended to ensure the 'equitable and effective imposition or collection of direct taxes in respect of services or service suppliers of other Members' and in GATS Article XIV(e) for measures intended to apply DTC provisions.[39]

The focus here is, therefore, on unilateral tax measures that fall outside the contemplation of subsisting double taxation conventions (DTC), e.g. measures with features such as those found in the EC/French DSTs.

3. Digital Trade Taxation and WTO Non-discrimination

The WTO is a multilateral trade body established pursuant to the Marrakesh Agreement of 1994 (WTO Agreement). The WTO Agreement is an umbrella treaty setting out a series of agreements, among which are the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS) and the Agreement on Trade-related aspects of Intellectual Property Rights (TRIPs).[40] Two key pillars of the WTO are market access and non-discrimination, serving as major drivers of trade liberalization.[41] The latter principle, non-discrimination, demands that

[38] See Jinyan Li, *Relationship Between International Trade Law and National Tax Policy: Case Study of China*, (2005) 59:2 Bulletin for Intl Taxation 77.
[39] See Werner Haslehner, *EU and WTO Law Limits on Digital Business Taxation* in W. Haslehner *et al*, eds., *Tax and the Digital Economy Challenges and Proposals for Reform* 25 at 45 (Kluwer Law International BV 2019).
[40] See Li *supra* n. 38 at 78.
[41] Marta Carmo, *International Trade Law, Double Taxation Agreements and the Principle of Non-Discrimination*, 3(3) RJLB at 928–929 (2017).

contracting parties to an international economic treaty shall not treat domestic market actors more favorably than foreign market actors (national treatment principle) or differentiate between foreign market actors from different origins (most favoured nation principle).[42] What these antidiscrimination clauses require is equal treatment of members that are "similarly situated" on the basis of their prevailing conditions.[43] A domestic tax or regulatory measure may be discriminatory in one of two ways: where there is an *intent* to discriminate (also referred to as purpose or motive or aim) and where the *effect* of the measure is discriminatory (also referred to as disparate impact).[44] Intent to discriminate may be found in the expressed views of the legislators or regulators to put in place the measure or in the overall motive of the government in putting in place the measure, as gleaned from the wordings of the measure itself.[45] The effect theory of discrimination looks at whether the measure has a discriminatory effect or impact against imports.[46] It is also well established that non-discrimination obligations not only apply to measures that differentiate directly – or de jure – on the basis of origin, but also to indirect – or de facto – discriminatory measures.[47] De jure discrimination is apparent on the face of the measure while de facto discriminatory measures do not explicitly differentiate between imported and domestic goods or services but distinguish between them on the basis of their characteristics.[48] The prohibition of discrimination is enshrined in both GATT and GATS via their respective MFN[49] and national treatment obligations.[50] Non-discrimination applies to all types of governmental trade obstacles,

[42] Nicolas F. Diebold, *Standards of Non-Discrimination in International Economic Law*, 60 Intl Comp LQ 831 (2011).
[43] Julia Ya Qin, *Defining Nondiscrimination Under the Law of the World Trade Organization*, 23 Boston Uni Intl LJ 215 at 218 (2005).
[44] See Simon Lester, Bryan Mercurio & Arwel Davies, *World Trade Law, Text, Materials and Commentary* (3rd ed, Hart Publishing 2018) at 259–260.
[45] *Ibid* at 260.
[46] *Ibid.*
[47] Diebold *supra* n. 42 at 832.
[48] Lester, Mercurio & Davies *supra* n. 44 at 263.
[49] GATT Art. I and GATS Art. II.
[50] GATT Art. III and GATS Art. XVII:1.

such as border measures (e.g. tariffs and quantitative restrictions) and internal regulations (e.g. taxes and product standards).[51]

Some of the arguments against unilateral digital tax measures hinge on both aspects of non-discrimination. Such arguments can be found, for instance, in the U.S. complaint against France and the EC's DSTs respectively – the USTR Report on France's Digital Services Tax published in December 2019.[52] The U.S. contends that the French DST, by its structure and operation, is intended to discriminate against U.S. Companies.[53] The U.S. concludes that the selection of the digital services covered by the tax, including carve-outs in the definition of such services, targets U.S. companies,[54] while the DST's revenue thresholds likewise target U.S. companies as opposed to French ones.[55] The USTR Report points to statements made by responsible French officials showing that the French law and the EU proposal, its model, deliberately targeted U.S. digital companies.[56] French officials, including Finance Minister Bruno Le Maire, repeatedly referred to the French DST and the EU proposal as the "GAFA tax," a term that stands for Google, Apple, Facebook, and Amazon, or the "GAFAM tax," which also includes Microsoft.[57] Again, the contentions of the U.S., if taken literally, lead to the conclusion that the French DST and other similar measures violate both the MFN and national treatment principles.

[51] Diebold *supra* n. 42 at 832.
[52] United States Trade Representative, *Report on France's Digital Services Tax Prepared in the Investigation under Section 301 of the Trade Act of 1974* (Washington DC: Office of the United States Trade Representative 2019) [USTR Report].
[53] *Ibid.*, at 30–48.
[54] *Ibid.*, at 31.
[55] *Ibid.*
[56] *Ibid.*
[57] *Ibid.*

5.1 MFN

In simple terms, the MFN treatment obligation prohibits a country from discriminating *between* countries.[58] Although the expression 'most favoured nation' suggest that some sort of special treatment or privilege is accorded to the country entitled to MFN treatment, the idea underlying the principle is the opposite, that is the main objective of the principle is to prevent discrimination, by generalizing concessions made to a specific trading partner.[59] Article II of GATS provides that each member shall accord immediately and unconditionally to services and service suppliers of any other member treatment *no less favourable* than that it accords to like services and service suppliers *of any other country*.[60] Unlike the national treatment obligations, the MFN obligation in the GATS constitutes a general obligation which is in principle applicable across the board by all members to all services sectors.[61] The principal purpose of the MFN provision in GATS is to ensure equality of opportunity for services and service suppliers from all WTO Members.[62] The MFN provision sets out a three-tier test of consistency: (a) whether the measure at issue is a 'measure covered' by GATS; (b) whether the services or service suppliers concerned are alike; and (c) whether the member accords 'less favourable treatment' to the services or services of another member. This article assumes that the first test is covered and, thus, analyzes only the second and third tests.

WTO jurisprudence has expounded the meaning and scope of the phrase 'treatment no less favourable' in Article II(1) of GATS. In *EC-Banana III* the Appellate Body (AB) opined that the

[58] Peter Van den Bossche, *The Law and Policy of the World Trade Organization: Text, Cases and Materials*, at 308 (Cambridge University Press 2005).
[59] Robert Howse & Michael J Trebilcock, *Regulation of International Trade* at 54 (3rd ed Taylor & Francis Group 2005).
[60] GATS, Art. II.
[61] See Federico Ortino, *The Principle of Non-discrimination and Its Exceptions in GATS: Selected Legal Issues* at 20 (2006) http://ssrn.com/abstract=979481.
[62] Van den Bossche *supra* n. 58 at 319.

phrase should be taken to include both de jure and de facto discrimination.[63] Drawing further insights from GATT jurisprudence, the phrase 'no less favourable' has been described as an expression of the underlying principle of *effective* equality of treatment between imported products, under the most favoured national standard.[64] Accordingly, a measure affords less favourable treatment if it *adversely* modifies the conditions of competition between imports from different states. In order to establish whether the 'no less favourable standard' has been met, panels need to determine whether the particular measure at issue has the *potential* to lead to the application to imported products of treatment less favourable, and not whether it had actually done so.[65] In the case of the French DST, there appears to be some underlying intention on the part of the French authorities to accord less favorable tax treatment to the digitalized businesses of a specific country (the U.S.) vis-à-vis like businesses of EU countries. This can be gleaned from statements attributed to the French officials that imply an intention to protect like EU businesses from the tax. An example is a March 2019 statement by then French Secretary of State for Digital Affairs, Mounir Mahjoubi, that the forthcoming DST proposal "should not sanction European actors."[66] However, even absent such expressed intentions, if the digital tax measures only appear to impact the digitalized businesses of a certain country – as has been the complaint of the U.S. all along – despite the potential of competition elsewhere – such as from other EU countries – there is an MFN violation case to be made (if not necessarily won).

[63] ABR, *EC – Bananas* WT/DS27/AB/R, paras 231–234.
[64] See Ortino *supra* n. 61 at 24–25.
[65] *Ibid.*
[66] USTR Report *supra* n. 52 at 34; Elea Pommiers, *Taxation des GAFA: la France peut-elle faire cavalier seul?* (2019) https://lexpansion.lexpress.fr/actualite-economique/taxation-des-gafa-la-france-peut-elle-faire-cavalierseul_2055669.html.

There is an exception to the application of MFN as regards obligations arising from DTCs. A differential treatment may not be deemed a violation of MFN if it is the result of a binding DTC.[67] Thus, hypothetically, a member state (Country A) may justify a differential treatment between service suppliers from Country B and Country C on the basis that it has a binding DTC with one of those countries. It has been asserted that the exception prevents "free riders" from enjoying the benefits and concessions enshrined in tax treaties.[68] It is arguable, however, that the exception can only apply where the measure is meant to avoid double taxation.[69] Following that supposition, a state that receives less favourable digital tax treatment may attempt to enforce the MFN rule by arguing that it would be unreasonable to expect the article XIV(e) exceptions to extend to tax treaty measures that are not geared towards avoiding double taxation.[70] By using income thresholds to distinguish between like (digital) service providers from different WTO members, a DST measure violates the MFN principle, unless the difference is based on a relevant DTC or, more fundamentally, unless the taxing state is able to show that the services in question are not alike.

Ortino notes that GATS does not contain a definition of the term 'like' service providers.[71] The issue of likeness under Article II GATS has, however, been variously addressed in GATS/WTO jurisprudence. In *Argentina – Financial Services* the AB stated that "in the context of both trade in goods and trade in services, "likeness" refers to something that is similar."[72] In the cases of *EC*

[67] See GATS, Art. XIV(e). This flows from Paragraph 2 of Art. II which allows a member to maintain a measure inconsistent with paragraph 1 (of Article II) provided that such measure is listed in, and meets the conditions of, the Annex on Article II Exemptions. See Catherine A Brown, *Non-discrimination and Trade in Services: the Role of Tax Treaties*, at 20 (Springer 2017) (asserting that "while the GATS provides general non-discrimination obligations, Member States may not challenge an alleged violation in respect of "matters that are the result of, or fall within, the scope of an agreement on the avoidance of double taxation ('tax treaty')").
[68] See Nellie Munin, *Legal Guide to GATS* at 371 (Kluwer Law International 2010), cited in Jennifer E. Farrell, *The Interface of International Trade Law and Taxation*, at 186 (IBFD 2011).
[69] See Jennifer E. Farrell, *The Interface of International Trade Law and Taxation*, at 186 (IBFD, 2011).
[70] *Ibid* at 187 (citing tax sparring as a common example of DTC provisions with a different objective than the avoidance of double taxation).
[71] Ortino *supra* n. 61 at 23.
[72] *Argentina – Financial Services* WT/DS400/AB/R and WT/DS401/AB/R, para. 6.21.

– *Bananas III* and *Canada – Autos*, perhaps, the relevant statement by both Panels was that "to the extent that entities provide like services, they are like service suppliers."[73] In other words, "likeness" is constituted when the compared products or services stand in a competitive relation to each other.[74]

One of the main challenges with digital taxation is how to define those businesses that qualify as digital businesses. This is so because most businesses nowadays leverage digital technology.[75] If a tax legislation defines taxable digital services in a way that singles out the businesses of a specific country or singles out aspects of digital business where a specific country's companies are dominant while leaving out other forms of digital business where entities from other countries are dominant, that measure becomes liable to an MFN violation challenge. This is one of the arguments against the French and EU DST measures. The U.S. asserts that:

> The French DST, like the EU DST proposal, targets two categories of services where U.S. companies are dominant—Internet advertising and "digital interfaces," covering online marketplaces for goods and services and some subscription services like dating websites. It does not cover other sectors where French companies are more successful, including sectors similar to the covered services. Additionally, within "digital interface" services, the DST excludes particular types of services where French and European companies are particularly successful.[76]

The question is whether the services provided by EU suppliers are any less 'digital' than those provided by U.S. suppliers? Fleming observes that one of the biggest challenges with designing a digital tax system is simply that this is new territory for tax authorities. "There isn't (one) single business model and the problem is that the traditional solutions (are) not applicable because there

[73] *Ibid.*
[74] Rolf H Weber, *Digital Trade in WTO-Law - Taking Stock and Looking Ahead* 5(1) Asian J of WTO & Int'l Health L & Policy 1 at 12 (2010). See *Argentina – Financial Services*, para. 6.25.
[75] See Lee-Makiyama, *supra* n. 36.
[76] USTR Report *supra* n. 52 at 35.

are no other companies like Facebook, there are no other companies like Google or Amazon. They stand on their own."[77] Pointing to the character of the big "digital companies" aligns with the view that analysis of "likeness" should embody both the services and the service suppliers.[78] However, the argument that these big companies are unique is not wholly convincing especially if it is largely based on the size (market share) – rather than service model – of the mentioned companies vis-à-vis their European counterparts/competitors. As Farrell observes, "a small service supplier is – regardless of economic weight or political affiliation – entitled to no less favourable treatment than a large multinational."[79] In any case, although determination of likeness will always depend on the specific circumstances, likeness does not mean identical or same.[80] It should be enough that there is a number of shared identical or similar characteristics.[81] Kofler, Mayr & Schlager give the example of Amazon to question the arguments that are often made about the uniqueness of digitalized businesses. They highlight that even though Amazon markets products and concludes contracts via its online platform, recent company sales data reveals that the sale of physical goods to consumers (i.e. the mail order business) constitutes the most important segment.[82] In other words, the mail order business – which is neither a new nor unique form of business, albeit refined by digitalization – remains the core activity of Amazon, and the physical goods continue to be

[77] Fleming *supra* n. 69.
[78] *Argentina – Financial Services*, para. 6.29.
[79] Farrell *supra* n. 69 at 184. The author bases her view on the inference – drawn from the reasoning in *Canada – Autos* – that "likeness" pertains to the form of service, i.e. whether the services are of the same form, rather than the form of the service provider.
[80] PWC *supra* n. 36 at 11.
[81] A non-exhaustive list of factors can be analyzed to determine whether services are alike. These include the services' CPC classification, consumers' preferences, and the nature and characteristics of the services (e.g. their nature and quality). *Ibid*. It has been suggested that the likeness test in the GATS should be based, inter alia, on the following factors: (a) service's end-uses in a given market; (b) consumer habits and preferences regarding the service or the service supplier; (c) characteristics of the service or the service supplier; and (d) classification and description of the service in the UN CPC system. See Aaditya Mattoo, *National Treatment in the GATS – Corner Stone or Pandora's Box* 31 JWT 107 at 128 (1997), cited in Ortino *supra* n. 61 at 24.
[82] Georg Kofler, Gunter Mayr & Christoph Schlager, *Taxation of the Digital Economy: "Quick Fixes" or Long-Term Solution?* European Taxation 523 at 526 (2017).

delivered in the traditional way (by parcel post).[83] While Amazon's model does not apply to all the companies sought to be ringfenced by current digital tax measures, the question must yet be asked whether Amazon's business model washes off the "likeness" with traditional European goods sellers, for instance. One might even argue that the "less favourable treatment" is tantamount to punishing innovation. Such misgivings, perhaps, explain why some pro-U.S. scholars argue vigorously that such distinctions are wholly unjustifiable; that corporations of other countries, predominantly in the EU, have significant extra-territorial operations in the U.S. (and China) that also leverage digital technology; and that the US would be justified to impose reciprocal taxes on those European businesses following the EU's DST.[84] In any case, one of the ways in which WTO jurisprudence has determined likeness is by looking at whether the affected businesses are in competition with one another. It has been held, severally, that a determination of likeness is, fundamentally a determination about the nature and extent of a competitive relationship between and among products.[85] Thus, if there is competition between service suppliers from different countries operating in the digital trade space – for instance over online advertising– it may be asserted that likeness exists between them.[86]

In the light of the foregoing considerations, it seems that, absent a consensual selection of businesses that qualify for digital taxation, it is likely that unilateral measures run into problems with the MFN test. A safer alternative may be to design the tax rules in a way that captures digitalized businesses broadly. This may be achieved by expanding the scope of digitalized

[83] *Ibid.*
[84] See Lee-Makiyama, *supra* n. 36.
[85] See WTO AB Report, *EC – Asbestos* WT/DS135/AB/R, para. 99; See Diebold *supra* n. 42 at 837; *China – Electronic Payment Services* WT/DS413/10, para. 7.700; *Argentina – Financial Services*, para. 6.25.
[86] One of the aims of the EC DST, as stated by EU, was to rectify problems in the competitive relationship between services/suppliers caught by the DST and those not caught, which suggests that there is already some degree of competition. See PWC *supra* n. 36 at 11.

businesses covered by the tax legislation and by lowering the taxability threshold. The problem with that approach, however, lies in its administrability.[87]

5.2 National Treatment

The national treatment rule requires that nonresident services or service providers not be treated less favorably than their domestic counterparts.[88] The rule mandates that each member accords 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.[89] The national treatment obligations do not apply automatically, but only to a member that has made specific market access and national treatment commitments.[90] Once a member has made these commitments they become bound in that member's Schedule of Specific Commitments.[91] When establishing if a discriminatory tax measure falls under the national treatment obligation, one must establish (i) if the service sector or subsectors are subject to national treatment; (ii) that the particular mode of supply of the service in question is subject to market access and national treatment commitments; and (iii) that there are no specific or horizontal limitations excluding tax treatment.[92] The analysis below focuses on the third factor.[93]

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[87] Administrability is a tax policy issue and lies outside the scope of this article. For some perspective on the administrability of digital taxes see Itai Grinberg, *International Taxation in an Era of Digital Disruption: Analyzing the Current Debate*, Taxes 73 (2019).
[88] See GATS, Art. XVII.
[89] *Ibid.*, Art. XVII.
[90] See GATS, Art. XVI.
[91] The extension of national treatment to any sector could be made subject to conditions and qualifications. The implication is that each country's commitments tend to reflect national policy objectives and constraints. See Brown *supra* n. 67 at 24.
[92] See Farrell *supra* n. 69 at 189.
[93] "[t]he EU Member States (including the UK after Brexit) are fully committed to market access and national treatment in data processing and advertising services, the two categories of classification under which intermediary services must fall" and that "[t]he commitment under CPC843 and CPC 871 applies to both sides of online intermediary services where the EU have made no relevant exceptions." Lee-Makiyama *supra* n. 36. See also Dias & Prost *supra* n. 36 (stating that advertising is included in the EU's schedule of commitments on services). This article proceeds on the supposition that the first two elements are met.

The national treatment principle affords flexibility to members in terms of how they treat foreign services/suppliers vis-à-vis their local counterparts. By virtue of Article XVII(2) of GATS, a member may satisfy the national treatment requirement by according NRCs either formally identical treatment or formally different treatment to that which it accords its own like services and service suppliers. Clearly, the respective treatments of resident and nonresident services/service suppliers need not be identical. Formally identical or different treatment shall, however, be considered less favourable if it modifies the *conditions of competition* to the detriment of NRCs.[94] It has been asserted that the wordings of paragraphs (1) and (2) of Article XVII draw heavily on the reasoning of two well-known GATT panel reports: *US – Section 337* and *Italian Agricultural Machinery*, respectively.[95] In the former case, the GATT Panel noted that:

> The words 'treatment no less favourable' in paragraph 4 [of GATT Article III] call for *effective equality of opportunities* for imported products in respect of the application of laws, regulations and requirements affecting internal sale… of products. This clearly sets a minimum permissible standard as a basis. On the other hand, contracting parties may apply to imported products *different formal legal requirements* if doing so would accord imported products more favourable treatment. On the other hand, it also has to be recognised that there may be cases where application of *formally identical legal provisions* would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded to them is in fact no less favourable. For these reasons, the mere fact that imported products are subject under Section 337 to legal provisions that are different from those applying to products of national origin is in itself not conclusive in establishing inconsistency with Article III:4. In such cases, it has to be assessed whether or not such differences in the legal provisions applicable do or do not accord to imported products less favourable treatment. Given that the underlying objective is to guarantee equality of treatment, it is incumbent on the contracting party applying differential treatment to show that, in spite of such differences, the no less favourable treatment standard of Article III is met.[96]

[94] GATS, Art. XVII:3. See *China — Electronic Payment Services*.
[95] Ortino *supra* n. 61 at 3.
[96] See Panel Report, *US – Section 337 of the Tariff Act of 1930*, para. 5.11.

In explaining the scope of application of Article III:4 GATT (that is the meaning of the term 'affecting'), the GATT panel in *Italian Agricultural Machinery* indirectly also set out the underlying rationale of the 'no less favourable treatment' standard.[97] The panel remarked that:

> The selection of the word 'affecting' would imply, in the opinion of the Panel, that the drafters of that Article intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or purchase but also any laws or regulations which *might adversely modify the conditions of competition* between the domestic and imported products on the internal markets.[98]

It is arguable that taxes that do not explicitly target non-resident businesses, but end up only burdening them, for example, because few if any domestic service providers exist that surpass the size thresholds for the tax's application.[99] This suggests that the EC Proposal and the French DST may be vulnerable to a WTO violation challenge.[100] Also, while the EU's position appears to be that margins are allegedly so high in the digital services sector that the DST will have no bearing except that the targeted suppliers will be paying a "fair" amount of tax, it is arguable that a tax of 3% on a service supplier's turnover must have some consequence for the conditions of competition.[101] Both could amount to *de facto* discrimination.

The foregoing notwithstanding, the application of national treatment in the context of domestic tax policy appears significantly limited.[102] While any misconceptions that the WTO plays a marginal

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[97] See Ortino *supra* n. 61 at 3.
[98] See also Panel Report, *Italy – Discrimination Against Imported Agricultural Machinery* (L/833 - 7S/60), para. 12.
[99] See Haslehner *supra* n. 39 at 46.
[100] *Ibid.*
[101] See PWC *supra* n. 36 at 9.
[102] Farrell chronicles that during the latter stages of the Uruguay Round negotiations (1994) the U.S. expressed concern about the influence of the GATS over tax policy. In particular, the U.S. wanted greater flexibility under Article XIV (the General Exceptions clause) to ensure that companies were taxed "on a fair and equitable basis". U.S. officials argued that the issue of tax discrimination was better addressed in the tax treaty framework and sought a "total direct tax carve-out" from the GATS. Other countries opposed this request believing it could potentially subject foreign companies to higher taxes compared to domestic counterparts. In response, the U.S. threatened to place horizontal limitations on its national treatment commitments. Ultimately, the Secretariat adopted a "common ground approach" to tax measures, which entailed that tax measures affecting services require no justification unless they violate an

role in regulating members' tax policies were dismissed when the EU successfully challenged the U.S. Foreign Sales and Extraterritorial Income Exclusion tax breaks offered to U.S. exporters,[103] WTO rules are still limited in that they do not explicitly apply to tax policies outside the area of tax subsidies.[104] The international tax arrangements that underpin the international tax regime are generally carved out of the WTO's jurisdiction over international trade.[105] Article XIV(d) of GATS stipulates that:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of *arbitrary or unjustifiable discrimination* between countries where like conditions prevail, or *a disguised restriction on trade in services*, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures: (d) inconsistent with Article XVII, *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*. [emphasis added].

A state is thus, generally, entitled to deploy tax measures that differentiate between resident and nonresident digital services/service suppliers, provided that such differential treatment aims to ensure the equitable or effective imposition or collection of direct taxes. On the one hand, this implies that the tax measure exception is not absolute.[106] On the other hand, it implies that the mere existence of differential tax treatment cannot sustain a discrimination complaint. As Diebold asserts, it is logically consistent that differential treatment is only relevant to international

obligation or commitment of the Agreement. See Farrell *supra* n. 69 at 190–191 and the various sources referenced therein. It seems a tad ironic that the U.S. is the today the chief complainant against tax discrimination.

[103] Farrell, *ibid.* at 3.

[104] See Li *supra* n. 38 at 86. See Ortino *supra* n. 61 at 3. In further support of this view, but in the context of digital taxation, Haslehner opines that although WTO case law (particularly the *US FSC* dispute) shows that the national treatment provision also covers differences in taxation of foreign 'producers' when compared to domestic ones, its importance for digital services taxation is limited since the specific issue related to taxation of 'digital businesses' is not related to either the production or sale of goods. See Haslehner *supra* n. 39 at 44. See *US – Tax FSC*, WT/DS108/26, 25 April 2003.

[105] Yariv Brauner, *International Trade and Tax Agreements May Be Coordinated, but Not Reconciled*, 25(1) Va. Tax Rev. 251 at 256 (2005).

[106] Brown *supra* n. 67 at 27.

economic law to the extent that it modifies the conditions of competition to the detriment of certain foreign market actors.[107]

As hinted earlier, one of the complaints of discrimination raised by the U.S. is that France's DST applies to U.S. companies and not French companies[108] – an argument that could be made against the digital tax measures of many countries.[109] It has to be said, however, that going by the language of the GATS exceptions, if digital tax rules are designed *sui generis* to apply specifically to NRCs in order to ensure the equitable or effective imposition or collection of tax, then they may be accommodated by the GATS exceptions. The footnote to GATS Article XIV(d) lists various yardsticks to determine whether measures are aimed at ensuring the equitable or effective imposition or collection of direct taxes. They include measures that apply to: (i) non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; (ii) non-residents in order to ensure the imposition or collection of taxes in the Member's territory; (iii) non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; (iv) consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or (vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident

[107] Diebold *supra* n. 42 at 842.
[108] At least one French company – online advertising firm, Criteo – does fall within the parameters of the law. Chinese, German, Spanish and British firms are also affected. See BBC, *France passes tax on tech giants despite US threats* (2019) https://www.bbc.com/news/world-europe-48947922.
[109] See KPMG *supra* n. 16.

persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.[110]

It is arguable that – apart from (iv) which applies to border adjustable or indirect taxes – each of the above conditions potentially justifies the adoption of the digital tax measures discussed in this article. However unorthodox some of those measures may seem, they may be necessary to ensure the effective imposition and collection of direct taxes on income derived remotely by digitalized businesses and to deal with the fiscal challenges posed by the equally unorthodox *modus operandi* of nonresident digitalized businesses.[111] Thus, the mere fact that those measures do not apply to resident businesses or apply differently between residents and NRC does not necessarily render them discriminatory. This is especially so since resident businesses would, presumably, also be taxed – usually on their worldwide income – under the state's ordinary tax rules.[112]

Although the GATS does not define the terms "arbitrary or unjustifiable" or disguised restriction on trade in services" – contained in the *chapeau* of Article XIV – it seems that those terms relate to measures that go beyond the purpose of ensuring the effective collection of taxes.[113] Recourse may also be had to case law relating to the similar *chapeau* under Article XX of GATT. In *US* –

[110] To buttress the wide powers reserved to resident states in respect to design their tax policies, footnote 6 further states that tax terms or concepts in paragraph (d) of Article XIV and in the footnote are determined according to tax definitions and concepts under the domestic law of the Member taking the measure.
[111] Adding to this point, it is not in dispute that one of the ideas – if not the core idea – behind Pillar 2 of the BEPS Project is that digitalized businesses divert or erode profits from source jurisdictions – by avoiding the application of subsisting tax nexus rules (such as the traditional permanent establishment) – to low tax jurisdictions. This situation that has sparked significant public outrage and, perhaps, justifies the design of specialized rules to ensure tax compliance in source states. See Wei Peng, *Multinational Tax Base Erosion Problem of the Digital Economy*, (2016) 7 Modern Econ J 345 (2016); David Pegg, *Google Shifted $23bn to Tax Haven Bermuda in 2017, Filing Shows* (2019) https://www.theguardian.com/technology/2019/jan/03/google-tax-haven-bermuda-netherlands. Further, the fact that U.S. companies are most impacted by digital tax measures may also be because U.S. companies appear to be at the center of the BEPS problem. See Avi-Yonah *supra* n. 11 at 69.
[112] For instance, Nigeria's significant economic presence rule only applies to NRC. However, Nigerian companies are taxed under separate provisions, on their worldwide income and irrespective of the digital status of their business.
[113] See Farrell *supra* n. 69 at 196.

Gasoline, the AB noted that the *chapeau* is intended to prevent abuse of the exception.[114] The AB also observed that "the chapeau by its express terms addresses, not so much the questioned measures… but rather the manner in which that measure is applied."[115] Thus, while there is a legal right to invoke exceptions, "they should not be so applied as to frustrate or defeat the legal obligations of the holder of the right under the substantive rules of the General Agreement."[116] This national treatment restriction on a member's tax policy is, nevertheless, limited.[117] This article's view is that in the light of the wide leverage afforded taxing jurisdictions under paragraph (d), the *chapeau* ought to be applied narrowly, such that only a tax measure that is excessive or "unreasonable"[118] can be faulted. A narrow approach is preferable if one is to avoid undue encroachment on the tax sovereignty reserved by the national treatment provisions. Suffice it to say that taxation is traditionally viewed as an exercise of sovereign powers which every state has over persons and economic activities within its territory.[119] Sovereignty, like the judicial concept of jurisdiction is guarded jealously. Sovereignty is a concept that has been harped on by states to assert their entitlement to initiate unilateral digital tax measures.[120] For instance, responding to U.S. threats regarding the French DST, French Finance Minister Bruno Le Maire asserted:

> Let me be very clear: France is a sovereign nation. We take our decisions related to taxation issues as a national and sovereign nation. And we will continue to take our decisions related to taxation issues as a national and sovereign nation.[121]

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[114] *United States–Standards for Reformulated and Conventional Gasoline* WT/DS2/AB/R, para. 22.
[115] *Ibid.*
[116] *Ibid.*
[117] See Brown *supra* n. 67 at 27.
[118] Farrell *supra* n. 69 at 197.
[119] See Tsilly Dagan, *Tax Sovereignty in an Era of Tax Multilateralism*, in Dennis Weber, ed, *EU Law and the Building of Global Supranational Tax Law: EU BEPS and State Aid* 37 (IBFD 2017).
[120] Several authors have recognized that countries retain a bilateral tax system and resist an international tax organization in order to retain their tax sovereignty. See Farrell *supra* n. 69 at 9, citing Thomas Rixen, *The Political Economy of International Tax Governance* (Palgrave, 2008) at 26. See Kofler, Mayr & Schlager *supra* n. 82.
[121] Sprackland & Johnson *supra* n. 30.

While states may be willing to place limitations on their tax sovereignty for the purposes of a directly reciprocal and beneficial bilateral tax arrangement, they may be less willing to see their tax sovereignty restrained or constrained by the multilateral reciprocal arrangement which obliges them to commit to various tax regulations irrespective of the direct trade benefits that are acquired from other countries.[122] It seems apposite that if one is to imply any constraint on a state's taxing power on the basis of its trade obligations, rather than a DTC, the text of the trade obligations should be construed strictly in favour of the taxing state, such that only in cases where it is evident that the purpose of the tax measure is excessive or unreasonable can it be said that the measure violates the national treatment rule. The mere inclusion of taxability thresholds, for instance, should not be conclusive, even though it is arguable that the exemption for smaller suppliers contradicts the purpose of ensuring tax coverage of digital services.[123] It seems fairly settled after all that the purpose of taxability thresholds in digital tax measures is simplicity of administration. As the OECD observes:

> The simplest way of operating the new rule would be to define a revenue threshold in the market (the amount of which could be adapted to the size of the market) as the primary indicator of a sustained and significant involvement in that jurisdiction.[124]

National treatment discrimination would, however, exist if it is demonstrable that the threshold or other measure is arbitrary or unjustifiable. It is after all the absence of a justifiable reason for "discrimination" that could render a measure arbitrary and, thus, impeachable.[125] It seems that

[122] Farrell *supra* n. 69 at 10. See GATS, Art. XIV(e).
[123] See Andrew D Mitchell, Tania Voon & Jarrod Hepburn, *Taxing Tech: Risks of an Australian Digital Services Tax under International Economic Law*, 20(1) Melbourne J Intl L 88 at 103 (2019).
[124] OECD Unified Approach, *supra* n. 12 at 8, para. 22. There is an argument to be made that the inclusion of taxability thresholds also benefits other states since it limits the scope of NRCs that are exposed to digital tax. For example, U.S. digitalized firms or startups that earn foreign-sourced income below the threshold would entirely escape tax abroad even when the aggregate income of such businesses is significant. Such safe harbours also ameliorate the compliance obligations of affected businesses since those businesses do not have to pay taxes in the (potentially numerous) jurisdictions where they have less significant business cashflows.
[125] See *United States — Gambling and Betting Services* WT/DS285/AB/R.

paragraph (d), in principle, provides ample legal justifications for a state to apply specialized tax rules to NRCs, provided that those measures are implemented for effective imposition or collection of taxes and that resident digitalized businesses are also taxed, albeit in a differential way.[126] Be that as it may, there are hard-to-ignore pointers to intended arbitrary discrimination towards U.S. companies in the French DST. As the USTR Report asserts, "French officials have also expressed that the DST should cover the U.S. "digital giants" *and not* French and European companies, including in order to make the latter group more competitive against the former." Evidence of this anti-competitive intention is also expressed in the report, to wit:

> On March 2, 2019, a member of the National Assembly stated: "We must also highlight the fact that the new tax will be selective. It will only affect the large digital enterprises. In this sector, which benefits from considerable economies of scale, this will give a comparative advantage to French start-ups and young fledgling entrepreneurs that could compete with these large, often foreign, platforms. Discussions and hearings we have had showed that a significant large part of the French enterprises in this sector will be largely spared from the future tax."[127]

If, as is evident in the above statement, the French DST measures were designed to apply in a way that confers competitive advantages to French and EU digital businesses over their U.S. counterparts, then their adoption indicates arbitrariness. The situation throws into question whether the motive for selection of covered services and taxability thresholds are arbitrary and unjustifiable. It is interesting that one French company is affected by the DST. If more local businesses could be covered by a broader definition of taxable services, questions would abound as to the justifiability of a narrow definition.

[126] For a contrasting view, see Lee-Makiyama *supra* n. 36.
[127] USTR Report *ibid;* National Assembly, *Committee on Finance, General Economy, and Budgetary Control*, Report No. 64, (Paris: National Assembly 2019) http://www.assemblee-nationale.fr/15/cr-cfiab/18-19/c1819064.asp (statement of M. Jean-Noel Barrot).

The approach taken by the French DST can also be evaluated from the perspective of the "necessity" exception, the test sometimes adopted in the evaluation of domestic measures that deviate from WTO law. This evaluation becomes relevant if the justification for the impugned digital tax measure is that it is deployed for the purpose of securing compliance with some law or regulation.[128] Delimatsis observes that:

> The principle of necessity… constitutes the WTO heuristic device *par excellence* for limiting to very specific cases deviations from WTO law. This is particularly done through the identification and comparison of alternatives, which has become the conceptual tool for ascertaining the 'necessity' of a given measure.[129]

The necessity test is contained in various provisions of the General Exceptions.[130] Among them, Article XIV(c) allows a state to adopt or enforce any measure that it considers "necessary to secure compliance with laws or regulations which are *not inconsistent* with the provisions of this Agreement." It is an established principle, first under GATT, that a respondent seeking to justify the adoption of a measure under the above exception must establish two elements: (1) that the measure is designed to secure compliance with laws or regulations that are not themselves inconsistent with provision of GATS; and (2) that the measure is "necessary" to secure the compliance.[131] The first element requires an initial examination of the relationship between the inconsistent measure and the relevant laws or regulations to ascertain whether a measure secures compliance with them.[132] According to the AB in *Argentina – Financial Services,* a measure can

[128] See, for instance, Nigeria's Companies Income Tax (Significant Economic Presence) Order 2020, No. 21, which defines the term "significant economic presence" contained in and for the enforcement of section 4 of the Finance Act 2019, No. 6. The Finance Act amends section 13(2) of the Companies Income Tax Act 1961, Cap C21 LFN 2004 (CITA) to introduce the taxation of nonresident digital companies.
[129] Panos Delimatsis, *The Principle of Necessity in the WTO – Lessons for the GATS Negotiations On Domestic Regulation* Tilburg Law School Research Paper 04/2014 at 7 (2013) https://dx.doi.org/10.2139/ssrn.2375596.
[130] See GATS, Art. XIV(a), (b) and (c).
[131] See ABR *Korea – Beef* WT/DS161/AB/R; WTDS169/AB/R.
[132] ABR *Mexico – Taxes on Soft Drinks* WT/DS308/AB/R, para. 72.

be said “to secure compliance" with laws or regulations when its design reveals that it secures or aims to secure compliance with *specific* rules, obligations, or requirements under such laws or regulations.[133] In context, what is required at this stage is a preliminary assessment of whether the impugned elements of a digital tax measure are designed to secure compliance with specific provisions of any law of the country applying the measure.[134] Any law here could simply mean a law that imposes tax on business income. In *Argentina – Financial Services*, both the Panel and the AB found that the impugned measures were designed to secure compliance with the overall objective of Argentina’s 1973 Gains Tax Law, as embodied in its provisions; that the objective pursued was the protection of the tax collection system against the risks posed by harmful tax practices of non-cooperative countries for tax transparency purposes. A similar conclusion could be reached with regard to the digital tax measures discussed here, if it can be demonstrated, for instance, that they aim to ensure that digitalized NRCs do not unduly exploit their offshore status to bypass taxes (paid by local service suppliers).

The second element entails a more in-depth, holistic analysis of the relationship between the inconsistent measure and the relevant laws or regulations. It entails an assessment of whether, in the light of all relevant factors in the "necessity" analysis, this relationship is sufficiently proximate, such that the measure can be deemed to be "necessary" to secure compliance.[135] The relevant factors to consider are: (1) the importance of the objective pursued by the measure; (2) the contribution made by the measure towards fulfilling that objective; (3) the trade-restrictiveness of the measure; and (4) whether any reasonably available alternative measure was identified by

[133] ABR *Argentina – Financial Services*, para. 6.203.
[134] *Ibid*, para. 6.210.
[135] *Ibid.*, para. 6.204. The AB observes in this case that the analyses of the two elements should not be viewed as distinct. They may overlap in the sense that some considerations may be relevant to both elements of the Article XIV(c) defence. *Ibid.*, para. 6.205.

the complainant. It is the duty of the panel to conduct a "weighing and balancing" exercise on these factors.[136]

In analyzing "necessity", a panel's duty is to assess, in a qualitative or quantitative manner, the extent to which the measure is *capable of making a contribution* to the end pursued, rather than ascertaining whether the measure makes an actual contribution.[137] Such a contribution exists when there is *a genuine relationship of ends and means* between the objective pursued and the measure.[138] The greater the contribution, the more likely that a measure is found to be "necessary."[139] If after thorough examination, a digital tax measure is found to contribute substantially to the prevention of base erosion the contribution is likely to place the measure in good stead as regards the necessity test. In that case, the measure may not be faulted even if it has a "limited restrictive effect" on international trade in services.[140] The impact on free trade is outweighed by the importance of the measure to its purpose. In *Argentina – Financial Services*, measures that restricted access to Panama-based financial service providers (including by placing a higher tax burden on them) were held to be valid exceptions because they served the purposes of discouraging harmful tax practices and base erosion. From the language of that case, it seems that the measure may have fallen on the wrong side of the scale if it imposed "a very high level of trade restriction".[141] This approach accords a wide latitude of regulation to the taxing state.[142] In that sense, it can be asserted that WTO jurisprudence accords wide latitude to states adopting measures

[136] *Ibid.*, para. 6.221.
[137] ABR *Brazil – Retreated Tyres*, para. 146–147.
[138] *Ibid.*, para. 145.
[139] ABR *Argentina – Financial Services*, para. 6.234.
[140] *Ibid.*
[141] *Ibid*, para. 6.239.
[142] The broad latitude afforded by recent WTO decisions contrasts with the past where the necessity test was more readily applied to undermine the domestic regulatory policies of states. See Ming Du, *The Necessity Test in World Trade Law: What Now?* 15 Chinese J Int'l L. 817–847 (2016).

to ensure that digital NRCs comply with local laws on taxation of business profits. Even if those measures appear to restrict market access to perceived defaulters, they will, generally, not be faulted, *ceteris paribus.* Laws that may fall into this category include Australia's MAAL and the UK's DPT, discussed in the ensuing paragraphs.

The last factor to be considered is whether there is a reasonable alternative to the measure that is adopted.[143] The requirement that a measure be "necessary" — that is, that there be no "reasonably available", WTO-consistent alternative—reflects the shared understanding of members that substantive GATS obligations should not be deviated from lightly.[144] Thus, a measure with a reasonably available alternative is not considered necessary to achieve a regulatory goal.[145] A "reasonably available" alternative must meet four conditions. It must be less trade restrictive than the impugned measure. It must preserve for the responding member its right to achieve its desired appropriate levels of protection. It is not merely theoretical in nature and will not impose an undue burden on the member, such as prohibitive costs or substantial technical difficulties; and the alternative measure must be consistent or less inconsistent with the WTO.[146]

It is no secret that various tax measures have been considered or deployed to capture derived from remote digital operations. Given the novelty of digital taxation, it is not clear whether any alternative(s) would be more WTO-compliant than, say, the French/EU DST. One example, Kenya's DST – a tax of 1.5% applicable to the gross value of digital marketplace transactions –

[143] *Korea – Beef.*
[144] See *US – Gambling*, para. 308. The overall onus to show that a measure is "necessary" rests on the respondent. As such, the respondent has a *prima facie* burden to show that there is no reasonably available alternative to the measure. See *US – Gambling*, paras 309–311
[145] Benn McGrady, *Necessity Exceptions in WTO Law: Retreaded Tyres, Regulatory Purpose and Cumulative Measures* 12(1) J. Int'l Eco L. 153 at 154 (2008).
[146] *Du* supra n. 142 at 832. See ABR, *Brazil – Retreated Tyres*, para.156; ABR, *EC – Seal Products*, para. 5.261; ABR *US – Gambling*, para. 308; ABR, *Korea – Beef*, para.166.

does suggest the possibility of an alternative nondiscriminatory measure since it applies to both resident and nonresident digitalized businesses.[147] The initiative raises questions as to whether the adoption by other states of a seemingly more restrictive and discriminatory measure (e.g. the French DST) is necessary to achieve the purpose of digital taxation. However, as the AB affirmed in *European Cummunities – Seal Products,*[148] an alternative measure may be found not to be "reasonably available" where it is merely theoretical in nature. Suffice it to state that the so-called Kenyan alternative, thus far, exists only in theory. To this end, it is impossible to draw practical conclusions on its viability to meet the purposes of the French law.

In 2015, the UK introduced the "Diverted Profits Tax" (DPT) to encourage large companies that try to minimise their tax liabilities through the use of "contrived arrangements" to change their behaviour and pay their due corporation tax, or face paying tax at a higher rate of 25%. Unlike the DSTs, the DPT (although commonly called the "Google Tax") does not target specific sectors or companies, but rather at particular behaviors and arrangements.[149] Likewise, in 2015, Australia introduced the Tax Integrity Multinational Anti-Tax Avoidance Law (MAAL), to "prevent foreign corporations from using complex, contrived and artificial schemes that enable them to have substantial sales activities in Australia, but pay little or no tax anywhere."[150] Unlike the DPT, MAAL is not a new tax, but an amendment to Australia's GAAR (part IVA of the Income Tax Assessment Act 1936). The features of these alternative laws appear to be less discriminatory and,

[147] See Finance Act 2019, No. 23, section 3; EY, *Kenya proposes Finance Bill, 2020* (2020) https://www.ey.com/en_gl/tax-alerts/kenya-proposes-finance-bill--2020. Kenya now proposes to use a withholding tax system to administer compliance with the tax. For residents and NRCs with a PE in Kenya, the tax will be offset against the tax payable for a year of income. See Daniel Ngumy & Kenneth Njuguna, *Finance Bill 2020: Legal Alert* (2020) https://www.africalegalnetwork.com/kenya/wp-content/uploads/sites/22/2020/05/Anjarwalla-Khanna-Legal-Alert-The-Finance-Bill-2020.pdf.
[148] *EC – Seal Products* WT/DS400/AB/R; WT/DS401/AB/R, para. 5.261.
[149] See Finance Act 2015, sections 80, 81 and 86.
[150] See Avi-Yonah *supra* n. 11 at 72.

perhaps, less likely to stifle competition. Yet it is not clear whether any of these regimes can meet the purpose of the proliferating DSTs. If the goal of these digital tax measures is to curb harmful tax practices by digitalized NRCs, there are indications that the DPT and MAAL can serve as alternatives. Australia realised billions in additional taxes, largely from ecommerce, in the first year of MAAL implementation alone[151] while HMRC statistics suggest a sharply declining default rate resulting from the DPT.[152] Yet, like France, the UK remains a major protagonist of the digital tax drive.[153] This suggests that the UK purpose – like the French – is outside the scope of Article XIV(c). Justification is more likely to be sought within the broader confines of Article XIV(d). In any case, both laws (DPT and MAAL) are not immune from some criticisms of the French DST, such as the inclusion of taxability thresholds that may advantage companies other than the US giants.[154] Although, in their further defence, they do not (overtly, at least) target specific sectors, unlike some DSTs that are said to target "categories of services where U.S. companies are dominant."[155]

4. Conclusion

The question of whether (unilateral) digital tax measures contravene the WTO principle of non-discrimination is a complex one. The question appears easier to resolve when digital taxes offer differential treatment to like businesses resident in other states based on their respective origin.

[151] ATO, *ATO clarifies impact of the MAAL* (2017) https://www.ato.gov.au/Media-centre/Media-releases/ATO-clarifies-impact-of-the-MAAL/#:~:text=The%20MAAL%20bolsters%20the%20capabilities,Australian%20sourced%20sales%20to%20Australia.

[152] See Sarah Bond & Helen Buchanan, *Has the UK's Diverted Profits Tax Done its Job?* (2020) https://riskandcompliance.freshfields.com/post/102fxtr/has-the-uks-diverted-profits-tax-done-its-job

[153] Natalie Sherman, *US Attacks UK Plan for Digital Services Tax on Tech Giants* (2018) https://www.bbc.com/news/business-46050724.

[154] The UK law specifies a £250 million threshold, while the Australian law specifies a threshold of AUD1billion.

[155] USTR Report *supra* n. 52 at 35. Underscoring its relatively less controversial status, MAAL, in particular, has been endorsed as compliant with Australia's DTT obligations. See Avi-Yonah *supra* n. 11 at 72.

Such treatment can be more readily characterized as a violation of the MFN principle. However, as regards national treatment, the numerous exemptions allowed by GATS warrant deeper scrutiny. This article has attempted such a reflection, zeroing in mainly on the controversial French DST. The analysis suggests that there exist discriminatory elements to the DST. Although discrimination may not be manifest on the face of the law, it may be deduced from various external sources, including statements attributable to the very drivers of such a law. This conclusion does not, however, imply that unilateral digital tax measures are innately discriminatory. Each measure must be evaluated on its own distinct features. In the difficulty of designing a workable digital services tax system, there are important lessons to be learned from the French/EC measures, especially as the need for further experimentation may inevitably resurface if the quest to design a consensus-based digital trade tax system does not produce the hoped-for consensus.[156]

[156] A no-deal became more probable in June 2020 when the U.S. quit the OECD-led negotiations and re-threatened retaliatory tariffs against countries that proceed with the DST policy. Julie Martin, *OECD to Stick to Digital Tax Negotiation Timetable Despite US Opposition* (2020) https://mnetax.com/oecd-to-stick-to-digital-tax-negotiation-timetable-despite-us-opposition-39092