GUEST EDITORIAL

Qualification of the Digital Services Tax Under Tax Treaties

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1 Equalization Levies and Tax Treaties

1.1 *Compliance with International Obligations as an Objective*

Relating to possible interim measures to address the tax challenges arising from digitalization, already the OECD in its 2018 Interim Report has accentuated the need for compliance of such measures with international law. 'Any new tax that a country introduces must be in compliance with its existing international obligations', i.e., tax treaties, EU and WTO law.[1] This compliance with international obligations is also an essential aim of the draft Directive on the digital services tax on revenues resulting from the provision of certain digital services ('DST'), as proposed by the European Commission and as currently worked on under the Austrian Presidency.[2] The DST proposal is the Commission's reaction to the invitation to adopt proposals responding to the challenges of taxing profits in the digital economy by the ECOFIN conclusions of 5 December 2017. At this time, many Member States had expressed an interest in devising temporary measures aimed at collecting more revenues resulting from digital activities in the Union, while ensuring these measures would remain outside the scope of tax treaties.[3] If, conversely, the DST would fall within the scope of tax treaties, a possible conflict between the levy of DST and the existing rules of tax treaties, especially with regard to provisions along the lines of Articles 5, 7 and 23 OECD MC, would arise.

The following discussion will address the relationship between the proposed DST and the substantive scope of tax treaties and it will confirm that the DST is not a tax on 'income' or 'elements of income' (but rather a tax on transactions and turnover) and therefore is not covered by Article 2 OECD MC.

1.2 *Existing Unilateral Equalization Levies under Tax Treaties*

Indeed, the OECD 2015 Final Report on BEPS Action 1 has already discussed 'an equalization levy' as a possible 'alternative way to address the broader direct tax challenges of the digital economy', i.e., to overcome the difficulties raised by the attribution of income under a new nexus approach for corporate taxation,[4] and implicitly assumed that such a charge would not be covered by existing tax treaties (and hence also not be creditable against corporate tax).[5] Unchallenged in that regard by the OECD,[6] unilateral 'equalization levies' have deliberately been structured to avoid being covered by tax treaties, e.g., the Indian equalization tax, Hungary's advertising tax or the

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1 OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2018) (OECD 2018 Interim Report), paras 413–431.

2 European Commission, *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services*, COM(2018) 148 (21 Mar. 2018) (DST Proposal).

3 Council of the European Union, *Responding to the Challenges of Taxation of Profits of the Digital Economy – Council Conclusions*, 15445/17, FISC 346 ECOFIN 1092 (5 Dec. 2017), para. 24.

4 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015) (OECD Action 1 Report), paras 276 and 302 et seq.

5 *Ibid.*, para. 307.

6 OECD 2018 Interim Report, *supra* n. 1, Box 4.3 on India's equalization levy (noting that India's equalization levy 'is not classified by the Indian legislation as a tax on income, but rather as a transaction-based tax that applies to the "amount of consideration" received', and further explaining that, '[a]s a result, it is unlikely to give rise to double tax relief in another jurisdiction under domestic law or a double tax treaty') and Box 4.4 on Italy's levy on digital transactions (noting that Italy's levy on digital transactions is '[d]esigned as a transaction-based tax' that 'should fall outside the scope of double tax treaties').

Italian 'web tax'.[7] Two legal consequences follow: first, the imposition of such taxes is not barred by tax treaties and, second, treaty relief from double taxation is not available in the taxpayer's residence state.[8] Moreover, Australia's discussion of a possible interim measure along the lines of the DST proposal also notes that, 'as an excise, an interim measure would not be expected to be covered by Australia's tax treaties',[9] and likewise the explanations for the introduction of a DST in the UK state that 'the DST will not be within the scope of the UK's double tax treaties'.[10] Nevertheless, commentators have raised doubts as to whether all unilateral measures would be outside the scope of tax treaties,[11] and some discussion has arisen as to whether the DST would fall under Article 2 OECD MC. With regard to the DST, however, nearly all commentators have – explicitly or implicitly – concluded that it would not.[12]

2 Scope of Article 2 OECD MC

It should be mentioned at the outset that the categorization of a tax as 'indirect' under Article 113 TFEU or as non-indirect falling under the harmonization competence of Article 115 TFEU does not affect its classification under tax treaties. A tax that falls outside the scope of Article 113 TFEU would not automatically be a tax covered by Article 2 OECD MC. Conversely, a tax covered by Article 113 TFEU would not automatically be excluded from the scope of Article 2 OECD MC.[13] This is explicitly confirmed by the Council's legal service, noting that '[n]o automatic consequence may be derived from it […] as regards the question whether DST falls within the scope of existing international double tax treaties concluded by the Member States'.[14] Contrary to the TFEU, Article 2 OECD MC deliberately abstains from the imprecise distinction between indirect and direct taxation and instead focuses only on the taxes on income or elements thereof.[15] Nevertheless, it is understood that the line between a tax covered by Article 2 OECD MC and one outside a treaty's scope is blurred. This is due to the broad wording of the provision, which generally covers 'taxes on income' or on 'elements of income', i.e., taxes applying only to specific types of income,[16] 'irrespective of the manner in which they are levied', and that it will also apply to all new taxes that are identical or 'substantially similar' to the taxes listed.[17] In light of that the OECD 2018 Interim Report also spends considerable thought on the scope of Article 2 OECD MC. In doing so, the OECD points out that 'a tax that is covered by tax treaties is generally one that is focusing on the supplier, rather than on the supply'.[18] An income tax is usually explicitly imposed on the recipient of the income and looks at the characteristics and the economic situation of the recipient of a payment.[19]

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7 Also Spain and the United Kingdom are in the process of introducing levies on digital services that resemble the DST proposal. For details on the Spanish Draft Budget Plan for 2018, which was published on 23 Oct. 2018 and is currently open for public consultation, *see* Gobierno de Espana, Ministerio de Hacienda, *Punto de acceso para facilitar la participación pública en el procedimiento de elaboración de normas*, available at http://www.hacienda.gob.es/es-ES/Normativa%20y%20doctrina/NormasEnTramitacion/Paginas/normasentramitacion.aspx (accessed 29 Oct. 2018). For a description of HM Treasury's digital services tax *see* H. M. Treasury, *Budget 2018 Digital Services Tax*, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752172/DST_web.pdf (accessed 29 Oct. 2018). In total, twelve Member States have already adopted or are currently planning to adopt interim direct or indirect tax measures to target digitalized activities, *see* Commission Staff Working Document, *Impact Assessment Accompanying the Document 'Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence' and 'Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services'*, SWD(2018) 82 final 54–55 (21 Mar. 2018).

8 *See also* OECD Action 1 Report, *supra* n. 4, para. 307.

9 Australian Government, The Treasury, *The Digital Economy and Australia's Corporate Tax System*, Treasury Discussion Paper 28–29 (Oct. 2018), referring to the OECD 2018 Interim Report, *supra* n. 1, para. 422.

10 *See* Treasury, *supra* n. 7, point 10.

11 *See* for India's position and possible criticism, e.g. S. Wagh, *The Taxation of Digital Transactions in India: The New Equalization Levy*, 70(9) Bull. Int'l Tax'n 538, 543 et seq. (2016), and R. Ismer & C. Jescheck, *Taxes on Digital Services and the Substantive Scope of Application of Tax Treaties: Pushing the Boundaries of Article 2 of the OECD Model?* 46(6/7) Intertax 573, 575 (2018); *see also* W. Cui, *Article 2 – Taxes Covered*, in *Global Tax Treaty Commentaries* (R. Vann et al. eds, IBFD 31 Mar. 2018), Ch. 3.1.3.

12 *See* e.g. Ismer & Jescheck, *supra* n. 11, at 577; A. Turina, *Which 'Source Taxation' for the Digital Economy?* 46(6/7) Intertax 495, 518 (2018); CFE Fiscal Committee, *Opinion Statement FC 1/2018 on the European Commission Proposal of 21 March 2018 for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, 58(8) Eur. Tax'n 371, 373 (2018); Opinion of the European Economic and Social Committee ECO/459 on the Taxation of profits of multinationals in the digital economy (EESC 2018/01556 adopted on 12 July 2018, OJ C 367/73 (10 Oct. 2018), at ns 1.5 and 2.4 (referring to the DST as turnover tax or indirect tax); W. Cui, *The Digital Services Tax: A Conceptual Defense* (26 Oct. 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3273641 (accessed 29 Oct. 2018); *contra* M. Valta, *Verfassungs- und Abkommensrechtsfragen des Richtlinienentwurfs für eine Steuer auf digitale Dienstleistungen*, 27 IStR 765, 771–772 (2018).

13 *See* Valta, *supra* n. 12, at 771.

14 *See* Council of the European Union, Opinion of the Legal Service, *Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services*, Doc. 12922/18 (8 Oct. 2018), para. 6.

15 *See OECD Model: Commentary on Article 2,* para. 2 (2017), noting that 'the term "direct taxes" which is far too imprecise has […] been avoided'.

16 *See* for the notion of 'elements of income', e.g. R. Ismer & A. Blank, *Article 2*, in *Klaus Vogel on Double Taxation Conventions* n. 32 (E. Reimer & A. Rust eds, 4th ed., Wolters Kluwer 2015), and *OECD Model: Commentary on Article 2* para. 3 (2017) referring to 'taxes on profits and gains derived from the alienation of movable or immovable property, as well as taxes on capital appreciation'.

17 For a detailed discussion of Art. 2 OECD MC in light of the features of 'equalization taxes', *see* Ismer & Jescheck, *supra* n. 11.

18 OECD 2018 Interim Report, *supra* n. 1, para. 421.

19 *Ibid.*, para. 417.

With a tax covered by Article 2 OECD MC, it makes no difference whether taxes are levied by way of withholding at source, or whether the tax is levied on a net or a gross amount.[20] The method of its assessment or the manner of collection under domestic law does not matter, either.[21] On these grounds 'Article 2 of the OECD Model Tax Convention could cover taxes that are badged as excise taxes but which are, in substance, income taxes'.[22] Moreover, '[a]n excise tax on a particular type of payment may not be very different from a tax on the gross payment of royalties or fees for services under the domestic law of some states'.[23] The more a tax is linked to income tax-features, the more it might be argued that it is covered by Article 2 OECD MC, e.g., because it 'is linked to the characteristics or economic situation of the recipient, for example, the profitability of the supplier'.[24] Conversely, 'an interim measure would more likely not be considered a covered tax where it is imposed on the supply itself, rather than the supplier, and where it focuses exclusively on the expenditure side of the payment – that is to say, the nature and value of the supply'.[25] According to the OECD, the mere fact that the tax may be collected from the supplier and that there is a threshold that must be met before a person is required to register and account for the tax will not generally be sufficient to bring the tax within the scope of the Convention.[26] Hence, the arguments for a tax falling outside the scope of Article 2 OECD MC would be stronger where it is:

> (i) levied on the supply of a certain defined category or categories of e-services and imposed on the parties to the supply without reference to the particular economic or tax position of the supplier; (ii) charged at a fixed rate, calculated by reference to the consideration paid for those services (without reference to the net income of the supplier or the income from the supply); and (iii) not creditable or eligible for any other type of relief against income tax imposed on the same payment.[27]

3 Characteristics of the DST

Against this background, the main features of the DST as proposed by the European Commission have to be recalled:

- It would be levied on revenue from digital services where user-created value is central, such as digital advertising and intermediation activities, and from the sale of data from users' engagement with digital interfaces. The DST would apply to gross revenues (net of Value Added Tax (VAT)) derived from the provision of taxable services at a rate of 3%, and apply only to businesses with total annual worldwide revenues exceeding EUR 750 million and EU taxable revenues exceeding EUR 50 million. Member States where users are deemed to be located would have taxing rights and revenues would be allocated according to set criteria – for example, for digital advertisements, the number of times an ad appears on users' devices in a set period would be considered when allocating revenues to that State. The taxable person is the person providing the services, with annual reporting and payment requirements.
- For the purpose of classifying the DST in the light of Article 2 OECD MC, the following characteristics of the DST are to be stressed:
  - the DST's tax base is turnover (revenues),
  - no deduction of expenses is permitted,
  - the overall profit or loss situation of the taxpayer is irrelevant,
  - it bears no relation to the actual profit margin of the taxpayer,
  - the DST would not be creditable against – domestic or foreign – corporate tax,[28] and
  - it applies without discrimination to domestic and cross-border services, on the one hand, and domestic and foreign taxpayers, whether from within or without the EU, on the other hand.

Indeed, no 'connection' to existing corporate taxes exists; neither does the corporate tax system of a Member State serve as a backstop,[29] nor is potential double taxation with regular corporate tax and the DST mitigated through a

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[20] *Ibid.*, para. 419.

[21] *Ibid.*

[22] *Ibid.*, para. 422.

[23] *Ibid.*

[24] *Ibid.*, para. 420.

[25] *Ibid.*

[26] *Ibid.*

[27] *Ibid.*, para. 421.

[28] *See also* European Commission, DST Proposal, *supra* n. 2, point 27 of the Preamble explicitly noting that '[i]n order to alleviate possible cases of double taxation where the same revenues are subject to the corporate income tax and DST, it is expected that Member States will allow businesses to deduct the DST paid as a cost from the corporate income tax base in their territory, irrespective of whether both taxes are paid in the same Member State or in different ones.'

[29] By contrast, in India, the non-resident advertiser is the taxpayer, but the Indian client has an obligation to withhold the tax; if it violates that obligation, no direct tax deduction is allowed for the advertising expense. *See* Wagh, *supra* n. 11, at 543 et seq.

credit[30] nor is the application of DST waived with regard to taxable revenues under DST that are also subject to domestic corporate income tax.

4 Reasons the DST Does not Fall Under Article 2 OECD MC: General Aspects

4.1 *The DST Does Not Cause Double Taxation*

Tax treaties establish an independent mechanism to avoid double taxation by means of restricting tax claims in areas where overlapping tax claims are expected, or at least theoretically possible,[31] as a rule resulting from states taxing the income of resident taxpayers on a worldwide basis and taxing the income of non-resident taxpayers on a territorial basis. For this reason, actual tax treaties tend to uniformly cover income taxes, since income taxation certainly offers the best example of potential double taxation through the overlap of tax claims.[32] However, such an overlap of tax claims cannot occur in the case of the DST. As it is the case with VAT or other turnover/sales taxes, the DST is levied on a 'destination basis', so that only one state, the state where the consumption or use takes place, is entitled to tax the revenue. In other words, within a coherent DST system, international double taxation is theoretically impossible. From that perspective, the application of the distributive rules of tax treaties combined with the exemption or credit method along the lines of Article 23 OECD MC neither makes sense nor is required to avoid potential international double taxation.[33] In that respect, the DST is similar to the VAT or other sales taxes, which are, in no case, covered by Article 2 OECD MC.[34] On the other hand, the 'double burden' that might arise from the summation of income taxation and the DST is not the particular cross-border result of two or more states exercising their taxing powers in parallel, which is generally addressed by tax treaties, but may also arise in purely domestic situations without any cross-border element at all.

4.2 *The DST is Not Comparable to Taxes on Gross Income Covered by Article 2 OECD MC*

Presumably influenced by the OECD's position that (even) '[a]n excise tax on a particular type of payment may not be very different from a tax on the gross payment of royalties or fees for services under the domestic law of some states',[35] it has been argued that the DST bears similarity to other gross-basis taxes that are clearly covered by Article 2 OECD MC, e.g., the gross withholding taxes on dividends and interest under Articles 10 and 11 OECD MC. Arguments along those lines are, however, not decisive for the qualification of the DST in light of Article 2 OECD MC.

First and foremost, it should be remembered that in analysing the scope of Article 2 OECD MC, comprehensive or 'synthetic' taxes should not be broken down or fragmented into its component parts, but rather 'all that is required is the qualification of a tax as whole as a tax on income […]'; what is decisive is 'the main feature of the tax'.[36] To offer one example, the 1991 English case of *Yates v. GCA International* addressed a tax on gross revenue. In this case, the Special Commissioners found that the Venezuelan tax on 90% of gross revenue, i.e., presumptive income, 'corresponded' to a tax on net income, and the High Court upheld that conclusion based on the structure of the Venezuelan income tax law generally, as well as the specific provisions dealing with presumptive income, which eventually sought to charge net profits to income tax.[37] From this UK case, two major findings follow. Even though a tax levied on (almost fully) gross revenues may be considered an 'income' tax, in order to determine whether a tax is an income tax in such cases, the assessment must take into account the nature of the tax as a whole. This implies that the assessment should not focus on one particular technical component of a given tax. In other words, the fact that a tax is levied on gross revenues would not disqualify it as an income tax if as a whole it seeks ultimately to charge net profits to income tax. Based on the structure of the Venezuelan income tax law generally as well as the specific provisions dealing with presumptive income, the Court found that the

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30 As suggested by OECD Action 1 Report, *supra* n. 4, para. 308.

31 *See* K. Vogel & A. Rust, *Introduction* in *Klaus Vogel on Double Taxation Conventions*, *supra* n. 16, at n. 52.

32 *See* e.g. Cui, *supra* n. 11, Ch. 1.1.2.2.

33 With regard to the interplay between Art. 2 and the distributive articles *see* M. Helminen, *General Report*, in: *The Notion of Tax and the Elimination of International Double Taxation or Double Non-Taxation* 17, 24, IFA Cahiers vol. 101B (IFA 2016); P. Brandstetter, *Taxes Covered: A Study of Article 2 of the OECD Model Tax Convention* (IBFD 2011), Ch. 3.1.2.1.

34 *See* e.g. Cui, *supra* n. 11, Ch. 1.1.2.2; CFE Fiscal Committee, *supra* n. 12, at 373.

35 OECD 2018 Interim Report, *supra* n. 1, para. 422.

36 *See* Ismer & Blank, *supra* n. 16, at ns 32 and 38.

37 UK: High Court 13 Feb. 1991, *Yates v. GCA International Ltd*, BTC 107.

presumptive income tax in Venezuela sought ultimately to charge net profits to income tax. If one applies a similar reasoning to the DST, it is clear that it cannot be considered an income tax. The main feature of the DST is clearly to tax turnover (without taking into account any expenses) with regard to certain, narrowly defined services, without regard to the personal circumstances of the service providers and without any connection to the corporate income tax systems of the Member States.[38]

Second, it should not be overlooked that the gross-basis of taxation was the outcome of a historic compromise and not the inevitable conclusion derived from a clearly defined notion of 'income', which is commonly understood to be a net (flow) amount after the deduction of current expenses.[39] Quite to the contrary, to this date the OECD MC Commentary notes, for example, that the taxation by the state of source of the gross amount interest payments 'ignores the real amount of income derived from the transaction for which the interest is paid'[40] and acknowledges that, '[s]ince the State of source, in determining the amount of tax payable on the interest, will usually ignore the cost of funds for the bank, the amount of tax may prevent the transaction from occurring unless the amount of that tax is borne by the debtor'.[41] The inclusion of such taxes in the concept of taxation of 'income' is therefore justified only because of the historical compromise of balancing taxing rights of source and residence states[42] and the specific set-up of the OECD MC.[43] Moreover, Articles 10(2) and 11(2) OECD MC do not prevent the source state from calculating the tax base and/or tax rate in a different way than applying a fixed tax rate on gross revenues from capital provided. By referring to a specific maximum tax rate on the gross amount of the dividend or interest paid these provisions merely define the maximum amount of source taxation allowed.[44] Also, where domestic gross-basis taxes on those payments exist, those are generally imposed on a simplified measure of income (at a lower rate) in substitution for a net income tax, especially for administrative and enforcement reasons.

Third, the notion of 'income' in Article 2 OECD MC must not be overstretched. For example, the *Schanz/Haig/Simons* definition of income would include inheritances,[45] which are clearly not covered by Article 2 OECD MC. Likewise, net wealth taxes can be viewed as taxes on potential income from capital ('Sollertragsteuern'), but they are only covered by tax treaties that explicitly refer to taxes on capital (which is, e.g., not the case for the US Model Income Tax Convention), and even if they are covered by a tax treaty (e.g., based on the OECD MC), it is clear that capital taxes are only creditable against other capital taxes but not against income taxes.[46] Deeming the DST a tax on income would equate 'income' to gross revenues from payments on a limited number of carefully defined e-service transactions – a stretch indeed.

Fourth, the economic incidence of a tax cannot be determinative of the notion of 'income' under Article 2 OECD MC.[47] The economic incidence depends on market forces and elasticities; in any case, the DST proposal is silent on the economic incidence of the DST. Indeed, as the OECD 2018 Interim Report notes, 'the incidence of taxation could be fully or partially passed on to local consumers in the form of higher prices for goods or services' '[d]epending on the price sensitivities of the seller and customers, and the structure of the market'.[48] Also, there are a number of supposedly 'direct' business taxes that are clearly not 'income' taxes within the meaning of Article 2 OECD MC (e.g., the UK bank levy which is a tax on bank's balance sheet liabilities).

Fifth, as mentioned above, the DST is similar to a VAT with regard to the potential for double taxation. Just as a VAT, the DST is destination-based tax, so it is

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38 *See also* the Opinion of the European Economic and Social Committee ECO/459, *supra* n. 12, at ns 1.5 and 2.4.

39 *See* e.g. Ismer & Blank, *supra* n. 16, at n. 39.

40 *OECD Model: Commentary on Art. 11*, para. 7.7 (2017).

41 *Ibid.*; *see also* the discussion in *OECD Model: Commentary on Art. 11*, para. 7.1 (2017).

42 The tax sharing mechanism in Arts 10 and 11 of the OECD MC is a typical compromise to settle the clash between source states and residence states in cases in which both states believe that they have justified claims to exercise their taxing jurisdiction that they do not want to forgo completely. This is especially true with respect to dividends, interest and/or royalties. On the one hand, the state of residence may put forward as a justification that the invested capital or the assets allowed to be used emanate from its national wealth. On the other hand, the state of source may emphasize that the income is produced by means of its infrastructure, labour force etc. *See* E. C. C. M. Kemmeren, *Preface to Articles 10 to 12*, in *Klaus Vogel on Double Taxation Conventions* (E. Reimer & A. Rust eds, 2015), at n. 4.

43 *See* Ismer & Blank, *supra* n. 16, at n. 36.

44 *See* W. Haslehner, *Article 10* in *Klaus Vogel on Double Taxation Conventions, supra* n. 16, at ns 49 and 52.

45 *See* e.g. G. Schanz, *Der Einkommensbegriff und die Einkommensteuergesetze*, 13 Finanzarchiv 1, 24 (1896), and H. C. Simons, *Personal Income Taxation* 49 et seq. (University of Chicago Press 1938).

46 *See OECD Model: Commentary on Article 23*, paras 70–71 (2017), noting in para. 70 that, '[a]s para. 1 is drafted, credit is to be allowed for income tax only against income tax and for capital tax only against capital tax. Consequently, credit for or against capital tax will be given only if there is a capital tax in both Contracting States.'

47 *Contra* Valta, *supra* n. 12, at 771–772.

48 *See* OECD 2018 Interim Report, *supra* n. 1, para. 407, further explaining: 'The lower the customers' price sensitivity and the more competitive the market the more likely it is that the burden of tax will be passed to the customer. This implies that, the less prepared customers are to stop buying a specific service or to shift to another, less taxed service, the higher the incidence of the tax on them. If services provided in a B2B context are subject to the same price sensitivities, the tax will result in a higher cost of inputs for other, non-taxable producers. This may also affect small businesses as users of such services even if the digital services they provide are excluded from the tax.'

unlikely that double taxation resulting from overlapping DST claims by more than one state can occur.[49]

Also, a close examination of the individual features of the DST proposal clearly qualifies the tax as one that falls outside the scope of Article 2 OECD MC, as the arguments in the following section demonstrate.

5 Reasons the DST Does not Fall Under Article 2 OECD MC: Specific Aspects

5.1 *Tax Base and Tax Rate*

The flat tax rate, the impossibility to deduct expenses in any situation and the equal applicability to residents and non-residents certainly qualifies the DST as a special turnover tax,[50] which is excluded from the scope of DTCs.[51] By way of example, a similarly structured French solidarity tax on the total annual turnover of businesses was recently viewed as a 'tax on goods' within the meaning of Article 110 TFEU by the European Court of Justice, as that tax, though collected annually, 'directly influence[s] the cost price of the goods concerned, since each sale or transfer to another Member State of one of those goods necessarily leads to the increase of the basis of assessment for those contributions which are levied on the turnover thus generated, when that turnover is at least EUR 760,000 per year'.[52] The same logic applies to the DST, clearly qualifying it as a tax on specific, narrowly defined services (and not income from those services). Admittedly, the fact that DST is levied on gross receipts does not automatically make it a turnover tax and exclude it from income taxes covered by Article 2 OECD MC.[53] One could be even tempted to argue that, while the DST is levied on a gross basis, the low tax rate of 3% takes into account lump-sum expenses, making it a 'disguised' net tax.[54] However, this argument seems to be ill founded. It is true that tax treaties also apply to taxation on the gross amount of dividends and interest (Articles 10 and 11 OECD MC) and that many national income tax systems contain presumptive income or lump-sum tax bases (e.g., for tonnage taxation, for taxation of farming income etc.). However, as discussed above, it is the whole tax that needs to be considered, and not its fragmented parts or structural elements. Such lump-sum taxes are, as a rule, integrated in the national income tax or corporate income tax systems. As they are generally structured so that taxpayers can opt for 'normal' net income taxation (i.e., giving the taxpayer the right to choose either lump-sum taxation or net income taxation) or as preliminary taxation that can be complemented and completed by an income tax assessment at the end of the tax period (with the amount of taxes already paid being creditable against the annual tax due), they are clearly part of the income tax system. In contrast, the DST is neither designed nor intended to be part of national income tax systems. First, the DST cannot be avoided by exercising an option for 'normal' income taxation and, second, it cannot be integrated in income taxation as a form of preliminary taxation or prepayment of income tax that is later taken into account during an income tax assessment. Finally, the application of the DST to only specific digital services renders the DST less likely to fall within the definition of covered taxes by tax treaties.[55]

5.2 *Thresholds*

As the OECD 2018 Interim Report notes, '[t]he mere fact that the tax may be collected from the supplier and that there is a threshold that must be met before a person is required to register and account for the tax will not generally be sufficient to bring the tax within the scope of the Convention'.[56] Moreover, the thresholds in the DST proposal closely follow the design features identified in the OECD 2018 Interim Report.[57] While it is true that the twofold revenue threshold regarding taxable persons might be viewed as referring to the economic or tax position of the supplier, this is not the determinative factor in assessing whether the DST is covered by tax treaties.

First, the objectives of the DST – namely to level the playing field, to simplify the administration and

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49 *See also* with regard to VAT Cui, *supra* n. 11, Ch. 1.1.2.2; Brandstetter, *supra* n. 33, Ch. 3.1.1.2.

50 Such as, e.g. the Italian 'web tax'; *see* Ismer & Jescheck, *supra* n. 11, at 575.

51 *See* OECD 2018 Interim Report, *supra* n. 1, para. 421: The arguments for a tax being outside the scope of Art. 2 OECD Model would 'be stronger where it is: […] (ii) charged at a fixed rate, calculated by reference to the consideration paid for those services (without reference to the net income of the supplier or the income from the supply) […]'.

52 FR: ECJ, 14 June 2018, Case C-39/17, *Lubrizol France SAS*, ECLI:EU:C:2018:438, paras 33–34.

53 Ismer & Jescheck, *supra* n. 11, at 575.

54 *See* F. van Horzen & A. van Esdonk, *Proposed 3% Digital Services Tax*, 25(4) Int'l TP J. 267, 270 (2018). That argument might be supported by European Commission, DST proposal, *supra* n. 2, point 35 of the Preamble, where the Commission explicitly relates the tax rate to 'different profit margins'.

55 OECD 2018 Interim Report, *supra* n. 1, para. 421 (point (i)).

56 *Ibid.*, para. 420.

57 *Ibid.,* paras 450 et seq.

application of the tax, and to respect proportionality, together with the premise to minimize the impact on start-ups, business creation, and small businesses more generally[58] – render the revenue thresholds necessary.

Second, it is a common feature of other non-income taxes to utilize taxpayer-related thresholds, yet this feature has not subjected these taxes to scrutiny under Article 2 OECD MC. Indeed, a number of indirect taxes harmonized by the European Union provide for certain thresholds. In the area of the VAT Directive,[59] for example, there is a threshold for small and medium enterprises (Articles 281 et seq.; e.g., GBP 85,000 in the UK, EUR 85,000 in France), a threshold for the application of the special scheme for acquisitions by taxable persons not entitled to deduct input tax and by non-taxable legal persons (Article 3(2)(a); not less than EUR 10,000), and a threshold for distance sales (Article 34; EUR 100,000). Moreover, various examples of thresholds can be found in the area of excise duties, e.g., the simplifications for small wine producers,[60] reduced rates for small breweries,[61] reduced rates for small distilleries,[62] and tax reductions in favour of energy-intensive businesses.[63]

Third, the thresholds in the DST proposal are revenue-related. They are neither related to the personal circumstances of the taxpayers nor to their ability to pay.

Fourth, and finally, the mere legislative technique on how a necessary design feature is implemented (e.g., the design feature advocated in the OECD 2018 Interim Report to minimize the impact on start-ups, business creation, and small businesses more generally as either an allowance or as a revenue-based threshold etc.[64]) should and cannot impact on the assessment of the tax under Article 2 OECD MC, unless such technical design feature fundamentally alters the character of the tax as a tax on turnover, which is certainly not the case with respect to the DST.

5.3 *Relation to Corporate Income Tax*

An equalization tax that is structured as 'creditable against the corporate income tax'[65] would likely create a 'risk' that such tax might be considered to fall under Article 2 OECD MC.[66] Conversely, the fact that DST is 'not creditable or eligible for any other type of relief against income tax imposed on the same payment'[67] further strengthens the conclusions that the DST is not a tax on 'income' and hence is excluded from the scope of tax treaties.[68] Moreover, when the DST proposal notes that Member States are 'expected to […] allow businesses to deduct the DST paid as a cost from the corporate income tax base in their territory, irrespective of whether both taxes are paid in the same Member State or in different ones',[69] this clearly indicates that the DST is outside the corporate income tax system. Indeed, it is a common feature of domestic (federal) corporate tax systems that an (federal) income-based tax is not deductible from its own tax base, but that, conversely, other taxes are generally deductible as costs of doing business.

5.4 *(Ir)Relevance of Legislative and Political Intent*

Finally, in determining whether the DST falls within the scope of Article 2 OECD MC, a debate can arise

Notes

58 *Ibid.*

59 Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, OJ L 347/1 (11 Dec. 2006), as amended.

60 Council Directive 2008/118/EC of 16 Dec. 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, OJ L 9/12 (14 Jan. 2009), as amended, Art. 40. Art. 40 provides for administrative simplifications; Member States may exempt small wine producers (producing on average less than 1,000 hl of wine per year) from requirements relating to storage under duty suspension, movement and monitoring.

61 Council Directive 92/83/EEC of 19 Oct. 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages, OJ L 316/21 (31 Oct. 1992), as amended, Art. 4. Member States may apply reduced rates of excise duty, which may be differentiated in accordance with the annual production of the breweries concerned, to beer brewed by legally and economically independent small breweries, producing not more than 200,000 hl of beer per year. The reduced rates shall not be set more than 50% below the standard national rate.

62 Council Directive 92/83/EEC of 19 Oct. 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages, *supra* n. 60, Art. 22. Member States may apply reduced rates of excise duty to ethyl alcohol produced by legally and economically independent small distilleries. The reduced rates shall not be applied to undertakings producing more than 10 hl of pure alcohol per year and shall not be set more than 50% below the standard national rate.

63 Council Directive 2003/96/EC of 27 Oct. 2003 restructuring the Community framework for the taxation of energy products and electricity, OJ L 283/51 (31 Oct. 2003), as amended, Art. 17. Art. 17 allows Member States to apply tax reductions on the consumption of energy products used for heating purposes or for specific industrial and commercial purposes, and on electricity, in favour of energy-intensive business. An 'energy-intensive business' shall mean a business entity where either the purchases of energy products and electricity amount to at least 3.0% of the production value or the national energy tax payable amounts to at least 0.5% of the added value.

64 OECD 2018 Interim Report, *supra* n. 1, paras 450 et seq.

65 *See* e.g. Communication from the Commission to the European Parliament and the Council, *A Fair and Efficient Tax System in the European Union for the Digital Single Market*, COM(2017)547 final (21 Sept. 2017), at 10.

66 OECD 2018 Interim Report, *supra* n. 1, para. 421 (point (iii)): The arguments for a tax being outside the scope of Art. 2 OECD Model would 'be stronger where it is: […] (iii) not creditable or eligible for any other type of relief against income tax imposed on the same payment'; *see also* e.g. G. Kofler, G. Mayr & C. Schlager, *Taxation of the Digital Economy: 'Quick Fixes' or Long-Term Solution?* 57(12) Eur. Tax'n 523, 531–532 (2017).

67 OECD 2018 Interim Report, *supra* n. 1, para. 421 (point (iii)).

68 *See also* Turina, *supra* n. 12, at 495, 518.

69 European Commission, DST proposal, *supra* n. 2, point 27 of the Preamble: 'In order to alleviate possible cases of double taxation where the same revenues are subject to the corporate income tax and DST, it is expected that Member States will allow businesses to deduct the DST paid as a cost from the corporate income tax base in their territory, irrespective of whether both taxes are paid in the same Member State or in different ones.'

regarding the role that the legislative and political intent underlying the DST proposal should play in the analysis. Indeed, the genesis of the DST proposal has a corporate tax background. When a number of European finance ministers called upon the Commission to work on 'a so-called "equalization tax" on the turnover generated in Europe by the digital companies', those ministers also noted that '[t]he amounts raised would aim to reflect some of what these companies should be paying in terms of corporate tax'.[70] Moreover, the DST proposal itself frequently conceptualizes the scope of the DST with the notion that '[s]uch business models, which depend on user value creation for obtaining revenues and are only viable if carried out by companies with a certain size, are the ones responsible for the higher difference between where their profits are taxed and where value is created'.[71] Nevertheless, it has to be borne in mind that the DST is designed as an alternative to classical corporate profit taxation in order to sidestep the complex nexus and attribution issues raised by a potential long-term solution along the lines of a 'significant digital presence'. Moreover, even expressed legislative intent as to the revenue goal of a specific tax is by no means determinative of the qualification of a tax under Article 2 OECD MC,[72] which solely depends on its design features. Hence, turnover-based taxes such as the DST remain excluded from Article 2 OECD MC, regardless of any intention or political goal underlying the tax.[73]

6 Conclusion

'Income' and 'elements of income' are core concepts of the substantive scope of tax treaties, and new taxes frequently raise questions whether they are covered by Article 2 OECD MC. The proposed DST is no exception. However, having carefully considered the criteria for a tax to fall under the scope of Article 2 OECD MC and analysed the design features of the DST, the characteristics of the DST that resemble a tax on 'turnover' or 'transactions' greatly outweigh any potential characteristics of a tax on 'income'. Accordingly, the DST is not covered by Article 2 OECD MC.

Notes

70 Initially, France, Germany, Italy and Spain have signed a 'political statement' calling for the introduction of an equalization levy based on turnover generated in Europe by digital companies as a 'quick fix' in Sept. 2017, and six more Member States agreed to this approach at the informal ECOFIN meeting in Tallinn on 16 Sept. 2017. *See Political Statement – Joint Initiative on the Taxation of Companies Operating in the Digital Economy* (9 Sept. 2017), https://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Europa/ECOFIN_und_Eurogruppe/2017-09-18-eurogruppe-informeller-ecofin-nachbericht-september-anl3.pdf?__blob=publicationFile&v=1 (accessed 5 Nov. 2018).

71 *See* e.g. European Commission, DST proposal, *supra* n. 2, point 26 of the Preamble.

72 Ismer & Jescheck, *supra* n. 11, at 575.

73 *Ibid.*