A white paper analyzing the EU's 2018 proposed digital services tax (interim measure) under WTO law

Executive Summary

The World Trade Organization (WTO), and WTO law, has a number of key aims and principles, including: free trade/regulation of trade distortions (market opening and sustainable market access); predictability and security for traders; and ensuring equality of competitive opportunities for foreign services and service suppliers (core non-discrimination obligations reappear throughout the WTO rulebook). Violations of WTO obligations can be justified under WTO law however, e.g. where the measures are taken for legitimate policy purposes that are specified in the WTO agreements.

The WTO dispute settlement system is a state-to-state system of dispute settlement that has a positive track record in terms of WTO Members' compliance with its rulings. There is no possibility of damages and compensation is rarely employed. WTO dispute settlement is forward looking; the system (and its rulings) is aimed at inducing compliance.

A significant number of WTO disputes have concerned tax measures that have been found to be WTO-inconsistent, as a result of their **de facto** discriminatory effect for example.

The WTO rules on services – contained in the General Agreement on Trade in Services (GATS) – is most relevant when assessing the WTO-consistency of (i) the EU's 2018 proposed digital services tax (DST) and (ii) DST-type measures of countries such as the UK, Spain, etc. The proposed DST may violate the EU's non-discrimination obligations under the GATS, namely the EU's national treatment (NT) and most-favored nation (MFN) treatment obligations.

The DST may violate the EU's NT because its exclusions, exemptions and thresholds capture US companies (primarily but other foreign companies too), while on balance EU companies are not caught by the tax. Thus, the DST impacts the conditions of competition so as to result in less favorable treatment of non-EU services and service suppliers when compared with "like" domestic services and service suppliers. Somewhat similarly, the DST may also violate the EU's MFN treatment because it favors certain foreign services and service suppliers over other foreign services and service suppliers, again by virtue of its design.

In order to find that there is no breach of the NT and MFN obligations, it would appear that WTO judges would need to rule that digitally supplied services and the suppliers of such services are not "like" similar services that are supplied through "traditional" means. Such an approach would go against previous WTO rulings and jeopardize the principle of technological neutrality that has had support from the WTO membership. Other arguments to say that there is not "likeness" and therefore no discrimination could center around distinguishing the suppliers at issue, e.g. that their size or business models render them not "like". Precedent for such an approach could have systemic implications and render likeness analysis unworkable.

Some "defenses" are open to the EU to justify any violations of NT and MFN. Most notably, a breach of NT can be justified where the DST is "aimed at ensuring the equitable or effective imposition or collection of direct taxes" from foreign services and suppliers. While the DST appears to be an indirect tax, the definition of direct tax would be relevant in this context.

In the end, WTO law is most concerned where the cost of a tax is passed through to a consumer and commentators suggest that the DST will be borne (at least in part) by consumers, while the EU suggests that there will be no tax bearer.

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Introduction

There has been some commentary about whether the Digital Services Tax (DST) is consistent with both World Trade Organization (WTO) law and WTO policy. This paper explores some of the WTO aspects that the proposed DST raises.

What is the WTO?

The WTO is a forum for negotiations and rule-making, including on e-commerce. It is also a forum in which WTO Members, through their representatives, can raise specific trade concerns in the context of council and committee meetings hosted at the WTO in Geneva and facilitated by the WTO Secretariat. The WTO also has a role in reviewing economic measures (including tax measures) introduced by its Members. For example, the trade policy review (TPR) mechanism of the WTO provides an opportunity to review developments in a WTO Member.

The WTO includes a rulebook. It is viewed as one of the most effective systems of "hard" international law. WTO law can be characterized as "hard law" because it is binding and enforceable. The WTO dispute settlement system which is a system of state-to-state dispute settlement is known as the "jewel in the crown" of the WTO. The system aims to ensure compliance with the WTO rulebook, thereby safeguarding the "delicate balance" of rights and obligations embodied in the WTO rulebook which WTO Members negotiated and bound themselves to. The compliance record with WTO rulings is viewed as a positive one. Indeed, the WTO rulebook itself sets out mechanisms to induce compliance with rulings (e.g. compliance panels to assess whether measures taken bring a Member into compliance).

WTO Rulebook

The law of the World Trade Organization (WTO) sets parameters on what trade and trade-related measures its Members can introduce and maintain, including tax measures and non-tax measures. It is useful to view WTO law as the global trade constitution. Laws, regulations and administrative measures of WTO Members must be consistent with WTO law. That means that EU laws must respect WTO law (the EU is a Member of the WTO) and the laws of EU Member States must be consistent with WTO law (all 28 EU Member States are also Members in their own right).

The WTO rulebook covers a whole range of matters that are central to the global economic order – including global value chains and the internationalization of business – that has developed over the past decades.

The WTO rulebook, which is treaty law, represents the results of decades of negotiations between WTO Members. These treaties are called "agreements" at the WTO. There are agreements on goods covering tariffs and other indirect taxes, quantitative restrictions, licensing, non-tariff barriers such as product requirements, trade-related aspects of intellectual property, trade-related investment measures, when subsidies (state aid) can be afforded and trade defense/remedy measures (e.g. when/how anti-dumping duties can be imposed) etc. There are important rules on services which encompass services-linked foreign investment. Most WTO agreements have cross-sectoral effect, although there are some sector-specific rules, e.g. information technology and financial services.

While the oldest rules (dating from the original 1947 **General Agreement on Tariffs and Trade)** reflect multilaterally agreed rules on tariffs and other indirect taxes on goods, there was increased recognition that taxation can constitute protectionist measures in the same way as non-tax measures. Some of the agreements that entered into force with the establishment of the WTO in 1995 further constrained what tax measures WTO Members could introduce, for example the **Agreement on Trade-Related Investment Measures and the Agreement on Subsidies and Countervailing Measures**. Also, it was with the establishment of the WTO that the **General Agreement on Trade in Services** entered into force.

The purpose of the WTO – Not free and predictable trade at any cost

A certain economic theory that is considered good policy is reflected in WTO law. The WTO, and its rulebook, has a number of key aims and principles:

- free trade/regulation of trade distortions (market opening and sustainable market access),
- predictability and security for traders (trading conditions/WTO law that they can rely on; WTO law requires certain transparency for changes of laws), and
- core non-discrimination obligations reappear throughout the WTO rulebook (ensuring equality of competitive opportunities, an important limit on distortive, power-based trading relationships).

Included in WTO law are some important flexibilities, "exceptions" and "carve outs", that allow Members to maintain otherwise-WTO inconsistent measures. WTO law is not about free, non-discriminatory trade at any cost. Sometimes non-trade concerns can trump trade. Measures can be maintained for legitimate policy purposes which are enumerated in the WTO agreements, such as the protection of health, environmental protection, protecting the tax base or measures taken for prudential purposes. Therefore, there is a balance between trade and non-trade concerns. However, WTO law as interpreted at WTO dispute settlement is careful to ensure that Members do not rely on exceptions and carve-outs to avoid their WTO obligations and maintain protectionist, distorting measures. (The precise legal test depends on the specific treaty provision being invoked).

Tax measures disputed at the WTO

As of the end of October 2018, 570 disputes have been initiated at the WTO. Approximately 8% of disputes have concerned taxation. Not all disputes initiated have proceeded to "litigation"; approximately half of them have.

Undoubtedly there have been, and there are, many more WTO-problematic tax measures that have not been subject to WTO dispute settlement. There are a number of reasons why WTO dispute settlement is a last resort for Members, including the sense that those in glass houses shouldn't throw stones.

WTO disputes have concerned both direct and indirect tax measures, although indirect taxes more often. There have been significant findings of WTO-inconsistency that have brought about changes in national tax laws. For example, the rulings on the US's Foreign Sales Corporation (FSC) scheme and the Extraterritorial Income Exclusion Act.

Various types of taxes have been examined in WTO dispute settlement, mostly concerning goods and whether foreign goods were subject to less favorable competitive conditions than domestic products (e.g. heavier tax burden; use of foreign products discouraged; means of administering and collecting taxes more burdensome for foreign traders). Measures disputed are generally "origin neutral" but it is their application in the particular circumstances that have revealed their WTO-inconsistency. **De facto** discrimination of facially origin-neutral measures is overwhelmingly the question that comes before the WTO (rather than **de jure** claims).

Types of tax measures at issue in previous disputes have included, for example:

- VAT measures and the entitlement to VAT refunds;
- sales taxes and sales tax exemptions;
- foreign products **de facto** discriminated against as subject to higher excise rates on the basis of how the bands were determined;
- higher rate of advance payments of direct and indirect taxes required by foreign taxable persons (foreign products);
- tax incentives and tax breaks (including direct taxes) that were export contingent, encouraged the use of domestic content or that caused adverse effects to the interests of another WTO Member (e.g. lost sales);
- additional administrative requirements in order to obtain same tax treatment as domestic products.

WTO Rules on Services

In terms of consistency of the DST with WTO law, the most relevant agreement may be the General Agreement on Trade in Services (GATS) because (as stated on the face of the draft DST) it is a tax that applies to revenues resulting from the provision of certain services. The General Agreement on Tariffs and Trade (GATT) may also potentially be relevant when considering the DST, for example in the event that the DST affected the internal sale, offering for sale, purchase transportation, distribution or use of foreign products in a less favorable manner than domestic products.[1]

While the WTO rules on services are more sparse than those on goods, the GATS extended core non-discrimination obligations to services trade. The national treatment (NT) obligation is to ensure equality of competitive opportunities for foreign services and service suppliers. The most-favored nation (MFN) obligation means that Members cannot favor certain countries over other countries (i.e. no favoritism); they must ensure equality of competitive opportunities for services and service suppliers of all WTO Members.

The GATS also ensured a certain level of market access, meaning that entry of services and service suppliers, and their treatment post-entry into a market, are regulated under the GATS. The inclusion of GATS in the WTO's rulebook in 1995 reflected the growing importance of services trade in its own right, that services are an important input into the production and trade in goods and generally "the growing importance of trade in services for the growth and development of the world economy" (GATS Preamble).

The parameters of a WTO Member's commitments under the GATS are not identical; each Member has its own schedule of commitments which must be consulted to determine whether a Member has undertaken commitments in a particular (sub) sector, as addressed below. Schedules are fixed and, in line with the purpose of the WTO and the GATS, further liberalization is encouraged. However, there it is possible for WTO Members to change their schedules (to remove/reduce a commitment on national treatment, for example). The provision that allows modification of schedules in certain circumstances require notification prior to withdrawal/medication of the concession and a process whereby impacted Members can seek "compensatory adjustment" (which must then be offered on an MFN basis to all WTO Members) and an arbitration process where agreement cannot be reached.[2]

Services Schedules Indicate Commitments of the EU and its Member States

The EU is a Member of the WTO and, because of its exclusive competence for trade matters, speaks for all EU Member States at the WTO and defends Member States in WTO dispute settlement. Therefore, although all EU Member States are individual Members of the WTO in their own right, if a national measure (e.g. law) of an EU Member State is challenged at the WTO, the dispute is initiated against the EU and the Member State concerned.

The EU has a WTO services schedule that binds all of the EU Member States. Member States may include limitations that are specific to them in that schedule but otherwise the schedule applies to all EU Member States in the same way. The UK has started the process of having its post-Brexit services schedule certified (i.e. agreed) by the WTO membership. There have not been significant objections to the UK draft services schedule, which is publicly available.[3] Irrespective of whether the schedule is agreed by the WTO membership in time for Brexit (29 March 2019), WTO case law supports the view that the UK can rely on the draft schedule as reflecting its commitments.

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[1] It is possible for the same measures (e.g. the DST) to be examined under both the GATT and the GATS.

[2] In the goods sphere, the EU has reached such agreements under the equivalent GATT provision. Where a tariff rate on a particular product has been increased due to the accession of a new EU Member State, the EU offers reductions to rates elsewhere, on an MFN basis.

[3] The UK's draft services schedule and its list of MFN exemptions is available at: https://www.gov.uk/government/publications/uk-goods-and-services-schedules-at-the-wto. This schedule and the MFN exemptions are effectively copied and pasted from the EU schedule with only changes made to reflect the fact that the UK is leaving the EU. There do not appear to be any differences between the EU schedule and the draft UK schedule that would be of relevance for the DST.

GATS National Treatment Obligation

Some have suggested that the DST appears discriminatory because its scope (including exclusions, exemptions and thresholds) captures US companies but not EU companies.

For the DST to violate the EU's GATS NT commitment, the following would be required:

- The EU accepted a national treatment commitment in respect of the services impacted by the DST and in respect of the mode of supply impacted (more below on modes of supply).
- The DST is a measure within the scope of the GATS.
- The DST "affects" "trade in services".
- The effect of the DST on the conditions of competition result in less favorable treatment of non-EU services and service suppliers when compared with "like" domestic services and service suppliers.
- Any breach of NT is not justified under a GATS exception allowing measures taken for legitimate policy purposes, e.g. the collection of direct taxes.

Whether the EU accepted NT commitments in respect of services (sub) sector impacted by the DST

DST may impact diverse range of services

While the DST is aimed at certain digital activities and only when certain revenue thresholds are met, the scope of its impact appears potentially large, extending beyond the services specifically named in the draft Directive.

While a company would need to review its activities and business model to assess what the direct and knock on impact of the DST would be for it, the DST could (theoretically at least) have a limiting impact on foreign services and service suppliers that span a range of sectors. For services that could potentially be impacted by the DST, the EU accepted NT commitments in its schedule, meaning **in the event that the DST results or has the potential to result** in less favorable treatment for foreign services and service suppliers in those sectors when compared with "like" domestic services and service suppliers.

Commentators have indicated the DST could have an impact on a diverse range of services. Sectors that could be impacted (either directly or indirectly) include advertising services, computer and related services, travel agencies, news and press agency services, betting exchanges, suppliers of video and audio streaming services (where funded through advertising), non-regulated financial intermediaries, peer-to-peer market places including crowdfunding, and distribution services. It's not inconceivable that even educational and professional services could be impacted due to the aspect of the DST that targets intermediaries.

The EU undertook commitments across these sectors with some exceptions, for example audio-visual services. In order to determine whether the EU accepted national treatment commitments for a particular (sub) sector, the precise WTO classification of the service anticipated to be impacted is key. There is only ever one correct classification for a service. This is done by reference to the EU's schedule, the international classification of services that all Members agreed to rely on when making their schedules of services commitments,[4] and WTO case law (where appropriate). It appears that there are relevant (sub) sectors in which the EU accepted national treatment commitments. See an **illustrative list** of potentially relevant services in Annex 1 to this paper.

Controversies over the scope of (sub) sectoral commitments

It has happened on a number of occasions that a Member responding to a challenge at the WTO has maintained the position that it had not intended to bind itself to a commitment in that sector, effectively disagreeing with the contended

[4] This is the 1991 United Nations Provisional Central Product Classification (CPC Prov).

scope of coverage of the (sub)sector.

For example, Members may have signed up to accept a NT obligation for a service or mode of supply mode that technology has transformed meaning that the commitment is broader than that Member might have been anticipated during the GATS negotiations.

The WTO has been careful to ensure that the schedules remain relevant over time in how it interprets generic terms. For example, such an issue arose in a 2010 WTO dispute taken against China. The question was whether China had made a NT commitment for the distribution of sound recordings **through electronic means.** The schedule entry read "sound recording distribution services". China contended that it only covered physical distribution. The top WTO judges – the Appellate Body Members – found that this covered both physical and electronic distribution.

This finding is also consistent with the generally agreed view that the GATS is a technological neutral agreement which does not distinguish between the various means through which a service can be supplied.

Initial Investigation Required as to whether DST is a Measure Covered by the GATS

Having determined that the EU has undertaken commitments in potentially relevant sectors, a further analysis of some preliminary matters is required before turning to assess whether the design and application of the DST is anticipated to potentially afford less favorable treatment to foreign services and service suppliers than that afforded to "like" domestic services and service suppliers.

To fall within the scope of the GATS, the DST must be a "measure by Members affecting trade in services". The DST is clearly a measure of the EU (a WTO Member). It is also expected that the DST will "affect trade in services", which is a broad concept. In effect, if there is no actual or potential impact on **trade** in services, the WTO rules do not apply. The EU is not prevented under WTO law from implementing a tax measure that has a purely domestic impact. WTO law and the national treatment obligation is concerned with equality of competitive opportunities for foreign services and service suppliers; a foreign dimension is required and it includes foreign companies that have set up in the EU (foreign investment).

DST is an EU measure within the scope of the GATS

The DST is attributable to the EU. "Measures" covered by the GATS can come in multiple forms, including as a law, regulation, rule, procedure, decision, or administrative action. EU Directives have previously been the subject of WTO dispute settlement and indeed found WTO-inconsistent (the **Beef Hormones** dispute brought by the US being a famous example).

The DST "Affects Trade in Services"

Understanding what constitutes "trade in services" within the meaning of the WTO is not instinctive for those of you who are not trade professionals.

There is no definition of "trade" or "service" in the GATS. Instead, "trade in services" is defined as the supply of a service in any of the four modes of supply. The concept of "supply of a service" under the GATS is also broad and not limited to the sale of a service, but also production, distribution, marketing and delivery. Thus it is not only sale that will bring a supply of a service within the scope of the GATS, but also its production etc.

Being able to characterize the intangible supply chain to determine the mode of supply at issue is important to determine whether an EU NT commitment is active because, as highlighted in the table in Annex 1, commitments were scheduled by reference to the modes of supply.

Factors distinguishing the various modes include the origin of the service supplier and the service consumer, as well as the degree and type of territorial presence at the moment of service delivery. The **table** below explains the four modes and provides some illustrative examples.

The DST could conceivably "affect" all modes of supply. Although the impact on certain modes may be more direct and

concentrated in certain sectors, the impact on other modes may be more diffused across an array of sectors. For example, perhaps the impact will be spread across many different types of trade in services enabled through the connections made through multisided interfaces and subsequently supplied through a variety of modes including 1, 2 and 4. Whereas, the impact may be more blunt and concentrated on mode 3 service suppliers that have established a commercial presence in the EU to make available an interface that connects those people. Again, it is worth recalling that understanding the intangible supply chain or the "footprint" of the supply is key.

Identifying the correct mode is not without difficulty. For example, some WTO Members have suggested that it is mode 2 "consumption abroad" where the consumer visits a foreign website and engages in transactions on those sites. Deciphering between the applicability of different modes becomes acutely relevant where a Member has scheduled "unbound" (no commitment) or a limitation in respect of mode 1 supply of a particular service but accepted full commitments respect of mode 2 of that same service ("none" marked in the schedule means full commitment undertaken). Members generally made more extensive mode 2 commitments.

In terms of the requirement that the measure must "affect" trade in services; affect is broadly understood. A measure "affects" trade in services where it bears upon the conditions of competition in the supply of a service. WTO case law has confirmed that having "an effect on" trade in services is sufficient. Indirect effect is enough; even a border measure has been found to "**affect** trade in services" although it was aimed at regulating goods trade, not services.

While the EU 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, a tax of 3% on a service suppliers' **turnover** must have some consequence for the conditions of competition.

Mode		GATS Language	Supplier Presence	Other Criteria	Example
1	**Cross-border supply**	The supply of a service from the territory of one Member into the territory of any other Member.	Service supplier **not present** within the territory of the Member.	Service delivered **within** the territory of the Member, from the territory of another Member.	**Computer and related services example:** A Brazilian software developer with a physical presence in Brazil works for a client based in the UK (EU).
2	**Consumption abroad**	The supply of a service in the territory of one Member to the service consumer of any other Member.	Service supplier **not present** within the territory of the Member.	Service delivered **outside** the territory of the Member, in the territory of another Member, to a service consumer of the Member.	**Tourism services example:** An Irish (EU) national stays in a hotel in Zimbabwe during her holiday (having analyzed reviews online prior to departure).
3	**Supply by commercial presence**	The supply of a service by a service supplier of one Member, through commercial presence in the territory of any other Member.	Service supplier present within the territory of the Member.	Service delivered within the territory of the Member, through the commercial presence of the supplier	**Advertising services example:** A US tech company opens a branch/affiliated company in the UK to provide advertising.
4	**Supply by presence of natural person**	The supply of a service by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.	Service supplier present within the territory of the Member.	Service delivered within the territory of the Member, with supplier present as a **natural** person.	**Educational services example:** Having connected with his customer online, an Indian yoga instructor travels to the EU to offer a yoga teacher training course.

Whether the DST Affords Less Favorable Treatment to Foreign Services/Suppliers than that Afforded to "Like" Domestic Services/Suppliers

Multiple commentators have assessed that the design of the DST means that foreign companies (particularly US tech companies) are caught by the DST, whereas EU companies are excluded both as a result of the thresholds for applicability of the DST but also the exclusions and exemptions provided under the DST.

Where the EU has undertaken NT commitments, which it has for a number of services of interest/potentially affected by the DST, the EU is under an obligation to ensure equal competitive opportunities for foreign and "like" domestic services and service suppliers. GATS Article XVII reads that Members must:

accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than that it accords to its own like services and service suppliers

Assessing whether less favorable treatment is being afforded requires identification of "like" foreign and domestic services and service suppliers.

EU and foreign services and service suppliers are "like"

Determination of likeness will always depend on the specific circumstances. Likeness does not mean identical or same, for there to be likeness, it's enough that there is a number of shared identical **or** similar characteristics or qualities. A non-exhaustive list of factors can be analyzed to determine whether services are "like", these include the services' CPC classification, consumers' preferences, and the nature and characteristics of the services (e.g. their nature and quality).

The case law has revealed that the core, persuasive factor is whether and to what extent the services and service suppliers are in a **competitive relationship** or could be in a competitive relationship (if no competitive relationship is possible, there can't be protectionism). A market-based analysis should be undertaken to reveal the degree of competition and substitutability. Although the Appellate Body has left the door open to find that not all services/suppliers in a competitive relationship are "like", if a measure modifies the conditions of competition in favor of domestic services, which implies a strong suggestion of likeness.

Interestingly, the European Union seems to effectively accept that there is competition between foreign services and suppliers impacted by the DST and services/suppliers that are not caught by the tax. The specified aim is to tax a certain segment of companies that supply digital services and not to tax "like" services that are supplied by companies not meeting the revenue threshold or "like" services that are delivered by non-digital means. Indeed, the EU maintains that one of the aims of the DST is 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.

The Appellate Body has stated in recent rulings that account can be taken of the supplier when determining whether a service is "like" and that similarly the "likeness" of suppliers requires reference to the services. While specific likeness analyses are required, it is understood that some foreign services impacted by the DST are "like" domestic services not caught by the DST.

What might be more controversial is whether significant weight should be given to **supplier** differences in particular in this instance, i.e. in order to contend that foreign services suppliers impacted by the DST and domestic suppliers not impacted are not "like" and therefore the NT obligation, and MFN obligation discussed later, are not operative. This seems to be the suggestion of the EU and some commentators – that big tech is new and distinct from smaller tech or other "traditional" businesses that supply "like" services.

Some commentators have suggested that factors such as the technological equipment, size, scale of a business (number of employees, types of assets, etc.) could be relevant factors in determining supplier likeness. Compared with the goods' field where the producer is less important to determining likeness of the products, the GATS provide scope for supplier likeness to be taken into account, however this is arguably not aimed at distinguishing suppliers on the basis of size but rather a recognition that the quality etc. of a service and nature of a supplier are inextricably linked. Whether factors such as size could be taken into account in a likeness analysis has not been tested at the Appellate Body. To employ such criteria would present some challenges. For example, it's not clear why such criteria would be relevant if the services compete on a given market; WTO Members have in the context of the Council on Trade in Services sought to avoid distinctions based on size; such criteria could effectively make it impossible to find "like" suppliers and could thereby

reduce the scope of National Treatment (and MFN) obligations. Suppliers come in all forms and it would be challenging to find very similar ("like") suppliers for the purpose of an analysis. There is also a danger that size or other such factors become a proxy that could target "tech" or "digital" companies in order to distinguish them.

Any ruling that reduced the scope of the disciplines – negotiated during the Uruguay Round and agreed by the WTO membership – risks being viewed poorly by the WTO membership, perhaps particularly given that DST-type measures are viewed as targeting companies from only a few Members (notably from the US).

In terms of the taxable persons for the payment of the DST[5], for example, the core EU position seems to be that the business model of the supplier (concept of user value creation) distinguishes these suppliers meaning they are not "like". The main problem with that proposition is that it would seem to jeopardize the principle of technological neutrality. Technological neutrality still has broad support from the WTO membership, although the concept and its parameters are being discussed by the membership in the context of the WTO work programme on e-commerce (including at recent meetings) and some Members say that there is not membership consensus on technological neutrality (e.g. Cuba).[6] A WTO finding that suppliers of services supplied digitally are not "like" suppliers of like services that are supplied through more "traditional" means (e.g. bricks and mortar presence and so forth) would obviously have significant implications. The fact that all types of businesses are increasingly "going digital" also presents challenges to an approach that distinguishes on this basis. Moreover, the digital aspects of a business can complement its traditional/bricks and mortar activities, and vice versa. A single supplier could be supplying services digitally that compete with "like" services that it supplies through traditional means; while at the same time both offerings enhance the position of the supplier.

Given the international efforts, including at the WTO and OECD, to reach multilateral answers on these questions and the question of how digital services should be regulated/taxed, it would be suboptimal if WTO dispute settlement made the final decision in this regard. However, if submitted to WTO dispute settlement, the WTO would be obliged to make a ruling.

Less favorable treatment

Continuing on the assumption there are foreign services and service suppliers that are "like" (they compete), it seems that the DST must result in less favorable treatment for those foreign services and service suppliers.

The key question is whether the DST would modify the conditions of competition to the detriment of "like" services and service suppliers.[7] The starting point is scrutiny of the DST's design, structure and intended operation and an examination of its implications for the marketplace (not necessarily its actual effects). Commentators have suggested that the measure's design and operation will result in less favorable treatment for foreigners. Those caught by the tax will be subject to a higher tax bill, complex requirements to facilitate the collection of the tax, and face challenges in being able to obtain information on revenues generated from the covered taxable activities. Moreover, there is **not** agreement with the EU's contention that the DST will not be passed to consumers, meaning that competition could be impacted. In terms of those who are caught directly by the DST, commentators agree that it will be foreign suppliers. Previous WTO case law has found less favorable treatment when the design leads disproportionately capturing foreign products under higher tax rates.[8] It appears that the current DST proposal may have been designed in this way.[9]

In the context of disputes involving "pioneering" or first of a kind measures or disputes where the impacts of the measures concerned are only beginning to emerge, econometric analyses and other exhibits (studies, expert evidence) can be introduced to state what the predicted impact will be. Panels in disputes such as **US – COOL** and **Australia – Plain**

[5] For other services for which the DST has a potential knock on limiting effect, this would not apply.
[6] In terms of WTO policy, the WTO work programme on e-commerce is also relevant when considering the DST because it is in that work programme that WTO Members (including the European Union) undertook to move forward a multilateral initiative to examine all trade-related issues relating to global electronic commerce because of the opportunities that e-commerce presented for trade. It started in 1998 and there has recently been a renewed focus on it, with the real hope that work in this area towards multilateral rules can be reinvigorated. There are differing views among Members, including on the degree to which internal taxation issues should be treated.
[7] A Member may meet its GATS NT obligation by according to services and service suppliers 'either formally identical treatment or formally different treatment'.
[8] While this was in the context of a different WTO provision (national treatment under the GATT) and concerned goods, it is still a relevant reference while differences between the GATS and GATT NT provisions need to be considered (WTO has confirmed that GATT caselaw is relevant to interpreting the GATS).
[9] For example, the thresholds finally agreed under the current proposal, the "Spotify exemption", the digital services captured and those excluded.

Packaging have worked with such evidence as part of the parties' submissions.

Unlike the GATT national treatment provision (GATT Article III) which refers to the use of measures "so as to afford protection", the GATS NT provision does not make any such reference. As for making out a regulatory intent to afford protection to domestic over foreign services and suppliers, that is not required.

The EU has a number of stated aims in introducing the DST, among aims stated as its regulatory intent are: fair taxation, addressing competition issues within the EU, preventing a situation where multiple EU Member States introduce their own individual digital taxes. One would expect these stated aims to be addressed should the EU invoke exceptions to justify any discriminatory impact of the DST but they need not be addressed in the context of whether the DST results in less favorable treatment. Moreover, WTO judges need not sort through the many reasons that legislators stated in order to find its regulatory intent. Where government's statements have been taken into account by WTO judges, they are not determinative of intent. Rather, WTO case law has found that (where required) the "protective application" of a measure can be found from examining it as a whole, i.e. from the measure's design, structure and architecture. Defenses to a Breach of NT

GATS Article XIV provides for a number of exceptions that can justify otherwise WTO-inconsistent measures (e.g. breach of the NT obligation).[10] This article reads in relevant part:

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:

(c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:

(i). the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;

(ii). the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;

(iii). safety;

(d) inconsistent with [the NT obligation], provided that the difference in treatment is aimed at ensuring the equitable or effective[6] imposition or collection of direct taxes in respect of services or service suppliers of other Members

[6] Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:

(i). apply to 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; or

(ii). apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or

(iii). apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or

(iv). apply to 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; or

(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

[10] Other defenses could be relevant in the context of the DST however this paper focuses on the principal defenses. Most relevant, aside from the defenses addressed in this section and the section addressing the potential MFN violation, may be the GATS "prudential carve-out" that is relevant only for aspects of the DST as it relates to discriminating between financial services. The prudential carve-out effectively affords relatively wide discretion to WTO Members to maintain measures for the security and stability of the financial system and so forth.

(vi). determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.

Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.

As indicated previously a two tier test must be passed for an otherwise WTO-consistent measure to be justified; (i) there must be a sufficient nexus to the legitimate policy objective enumerated in the paragraphs of Article XIV (must meet the requirements of the paragraph) and (ii) the chapeau requirements must be met (preventing abuse of right).

Whether the DST is necessary to secure compliance with GATS-consistent laws or regulations

When recently interpreting the scope of this possible defense, the Appellate Body endorsed the importance of a Member's ability to protect its tax system (including the tax base), combat harmful tax practices and have effective tax collection.

While the EU could argue that the DST is law seeking to secure compliance with EU tax law and EU law on the approximation of laws throughout EU Member States, aimed at ensuring the functioning of the EU internal market[11] and that this WTO-compatible (as indicated above), this may be challenging. The extent to which the DST contributes to the realization of the stated end pursued and its necessity is debatable as the objective under the Treaty on the Functioning of the European Union is so large/broad and there may be differing views (even among Member States) as to what measures ensure the functioning of the internal market and/or protect the tax system.

The greater the contribution to the stated objective, the easier it is to say that the DST is necessary. Importantly in the case of the DST, it is possible to envisage reasonably available less trade restrictive alternative measures that could make the same contribution to the achievement of the EU's objective, which is a way of proving that the DST is not "necessary" within the meaning of paragraph (c). For example, a less blunt and discriminatory alternative DST might cover an expanded scope of services supplied digitally and capture more services that are in a competitive relationship by using different revenue thresholds. Or better, an EU approach that taxes profits on the basis of digital presence

Whether the DST falls under direct tax exception

This provision has not been examined in WTO dispute settlement. The text suggests that this exception applies to collection/imposition of **direct taxes.** The DST appears to relate to the imposition and collection of an **indirect tax** (a turnover tax). However, it is understood that the EU itself may seek to **not** characterize the DST as an indirect tax for miscellaneous reasons including the fact that the EU asserts that there is only a tax payer and no tax bearer. Commentators disagree with the EU's position that the DST will not be passed on. If passed on, surely any EU position that the DST is not an indirect tax would be untenable.

The GATS and other WTO Agreements provide definitions of direct and indirect taxes, which would appear to be consistent with the view that the DST is an indirect tax.[12] The most relevant being under rules of treaty interpretation being the definition of direct tax set out in the GATS. However, paragraph (d) states that tax terms and concepts contained therein (i.e. "direct tax") are to have the meaning assigned under **domestic law**, which means an enquiry into real scope of the terms/concepts under "domestic law" and whether any EU characterization of the DST as being a direct tax is consistent with its practice.[13] Of course, should the EU assert that the DST is a direct tax and therefore falling within the

[11] In itself arguably compatible with the WTO because economic integration agreements are permissible under WTO law.
[12] See ibid.
[13] Noting that while the EU might maintain a position that the DST is not an indirect tax, Member States' characterization of the DST might differ. Member State's definitions of "direct taxes" could be relevant in the context of any dispute initiated against the EU. Moreover, of course if a DST-type measure of a Member State is challenged, its domestic characterization of what is/is not a direct tax would be relevant. Note also that the WTO also provides definitions of indirect and direct taxes, and these definitions make it clear that direct taxes are taxes *on income*, suggesting that WTO Members negotiating the agreements had that common view of what is a direct vs. indirect tax. The GATS itself defines "direct taxes" as comprising "all taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation". The WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) also defines direct and indirect taxes. The SCM Agreement provides that "the term 'direct taxes' shall mean taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real

direct tax exception, it would need to provide support for such a position. WTO judges would not be required to accept such an assertion without question.

While the illustrative example of compliant measures set out in subparagraph (iv) references measures applying to consumers, it suggests that a nexus to taxes on "sources" is envisaged here. While the EU maintains that the DST is aimed at addressing the challenges of taxing **profits** of the digital economy, it is not linked to profits, it is a tax on gross turnover.

One view is that the DST is an indirect tax that the EU is introducing to right (what it views as) a shortcoming in the EU's direct tax system. However, that would not seem enough to fall under paragraph (d) because it would still be aimed at the equitable or effective imposition or collection of **indirect** tax (not direct taxes as is required).

Chapeau – Preventing abuse of the exceptions

In order to benefit from one of the exceptions, the second tier of the test requires that the application of the DST cannot be characterized as "arbitrary or unjustifiable discrimination …, or a disguised restriction on trade in services" contrary to the chapeau.

The anticipated operation of the measure suggests that it might pose issues under the chapeau, e.g. how the revenue thresholds were designed, the exclusion of VAT, etc.

Absence of consistency can result in a measure not passing the chapeau test. One of the fundamental objectives that the EU declared was to have a "fair" system of taxation. At least in some respects, the scope of the DST seems counterproductive to that stated objective, particularly the thresholds and the choice of services covered by the tax. Also, the rationale underlying user value creation seems difficult, especially because it seems that the use of digital interfaces is something that creates value for all companies that use them including excluded businesses, e.g. those that supply certain investment services for example. The application of the measure suggests that rather than taxing user value creation (which would capture a broader range of services/suppliers), the EU wants to tax companies where the degree of value created by users is at a particular level and these happen to be US companies primarily.

Other objectives of the EU are to ensure the functioning of the internal market and prevent distortion of competition but has the tax profile of suppliers caught by the tax impacted competition in that sector? Or is it that technological advances and consumer habits have are the cause of the rising numbers of consumers turning to digitally supplied services?

Finally, even if considered a direct tax and thus potentially justifiable under the exception discussed previously, as has been pointed out by commentators, the evidence suggests that suppliers directly targeted by the DST currently pay about the same percentage of direct taxes as multinational companies not caught the DST. This suggests that the DST may be an arbitrary/unjustifiable discrimination (against foreign/US services and suppliers) and a disguised restriction on trade (protectionist element).

property". Under the SCM Agreement, the "term 'indirect taxes' shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and
equipment taxes, border taxes and all taxes other than direct taxes and import charges".

DST and the EU's MFN Obligation

Some have suggested that the DST may not be compatible with the EU's MFN obligation, particularly because it has the potential to afford less favorable treatment to US services and service suppliers than "like" services and service suppliers from other Members.

For the DST to violate the EU's MFN commitment, the following would be required:

- The DST "affects" "trade in services" and is a measure within the scope of the GATS.
- The DST is a measure within the scope of the GATS MFN obligation. No "horizontal" or sector-specific MFN exemption limits the EU's MFN commitments for the particular services.
- The effect of the DST on the conditions of competition result in less favorable treatment to US (or another Member's) services and service suppliers than treatment given to "like" services and service suppliers from any other country.

Preliminary matters

For the reasons discussed above, the DST is a measure that falls within the scope of the GATS and that "affects" "trade in services".

Like other Members, the EU listed MFN exemptions in 1995, meaning that it can maintain MFN-inconsistent measures **provided that** they are within the scope of the listed exemption. A review of the MFN exemptions listed by the EU reveals that the EU's MFN obligation still extends to large array to services that are potentially impacted by the DST.[14] The same is also true for individual Member States that are contemplating DST-type measures and also the UK's new draft services schedule.

Less favorable treatment contrary to MFN

There will be US services and service suppliers impacted by the DST that are "like" other non-EU services and suppliers not impacted by the DST. (The same case by case analysis drawing on considerations previously explored apply here to determine "likeness"; competitive relationship being key.)

The apparent US-focus of the DST has drawn much attention by commentators, who maintain that the DST will modify the conditions of competition in favor of services or suppliers of other countries (discussed previously).

Defenses to a breach of MFN

As is the case for justifying otherwise NT-inconsistent measures, there is a two tier test that examines (i) whether the measure meets the requirements of the particular paragraph being invoked and (ii) whether the measure meets the test in the chapeau of GATS Article XIV (for which effectively the same issues as discussed above under the NT section).

Like for a breach of the NT obligation, GATS Article XIV(c)[15] is available to potentially justify MFN-inconsistent measures.

The direct tax exception – discussed above – is not available for breaches of MFN. However, there is a separate exception only available for measures found to be inconsistent with the MFN obligation and it relates to double taxation. GATS Article XIV(e) provides:

[14] Some of these MFN exemptions may be relevant, the most obvious one of potential relevance being the exemption for the treatment of audiovisual services.
[15] Concerning measures necessary to secure compliance with GATS-consistent laws or regulations.

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:

(e) inconsistent with [the MFN obligation], provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.

This exception does not appear to be applicable to the DST. If anything, it appears that the DST may give rise to double taxation concerns.[16] Although that may be relevant evidence of less favorable treatment, this is not necessarily a breach of WTO rules and the above is an exception that Members can rely on, rather than requiring Members to take action on double taxation grounds.

[16] Although the EU maintains that the DST should not give rise to double taxation and that it will be possible to deduct DST from the corporate tax base.

Summary of WTO Dispute Settlement Process

The WTO rulebook is enforced through a dispute settlement system that has proven to be effective and prolific system.[17]

The system of state-to-state dispute settlement means that WTO Members only have standing; traders cannot initiate, defend or have third party participation rights in a WTO dispute. However, it is not uncommon for traders to be instrumental in the bringing of a dispute. Indeed, in the vast majority of cases, dispute settlement is a last resort for Members and therefore requires an actual or potential injury to (domestic) industry to encourage the initiation of dispute settlement.

There are three main stages to WTO dispute settlement. A significant proportion of disputes initiated do not proceed through all stages but, of course, the most controversial and intractable of matters do.

- **Members must seek formal consultations before proceeding to the first instance stage.**
  - This is done by lodging a request for consultations (RfC) with the WTO. In reality, there may have been informal consultations prior to the formal RfC so this effectively launching the formal dispute settlement process.
  - Two months must pass before proceeding to the next stage, in an effort to encourage resolution/withdrawal of the dispute (which happens often).
- **First instance is the panel stage.**
  - The panel stage should take 6-9 months.
  - To initiate the panel stage, a request for a panel must be submitted to the WTO. This will be followed by panel establishment and panel composition, for which there are timelines/requirements.
  - Three "panelists"[18] (judges) appointed **ad hoc** by the disputing Members decide the dispute. Generally the Members to the dispute appoint the panelists, who should have expertise in the particular matters raised in a dispute. It can be hard for disputing Members to reach agreement and the WTO Director-General may be called on to assist in the appointment process.
  - Third party participation by other Members is possible, which allows them some access to the dispute without being a disputing party and also allows them to provide their opinions as to the matters raised in the dispute. Controversial disputes can attract a large number of third parties.
  - Panel findings (rulings) are circulated to the WTO membership in a document called a "panel report" and, if a violation is found, there will be a ruling to bring measures into compliance with WTO law.
  - This report can be appealed by either party to the dispute.
  - If not appealed, the consensus of the entire WTO membership is required **not** to adopt the report (which never happens and means that reports automatically become part of the WTO legal system).
- **Panel Reports can be appealed to the Appellate Body.**
  - Any appeals are decided by the Appellate Body, which is made up of a standing/permanent body of 7 Appellate Body Members.
  - Appeals are decided in divisions of 3 Members, although the process allows for an "exchange of views" involving all Appellate Body Members (ensuring consistency).

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[17] Although there are some recent concerns the past few years about the system, specifically issues around the appointment of Appellate Body Members, it is anticipated that the system (and an acknowledgment of its importance in terms on security and predictability) for traders will prevail.
[18] Possibility of 5 but that is not used.

- As is usual for an appellate stage, appeals can only be based on points of law and legal interpretation.
- The AB should typically circulate its report (called an “AB report”) within a 90 day deadline but due to a variety of factors, it has been taking longer (sometimes much longer).
- Similar to the adoption of panel reports, AB reports are effectively automatically adopted and the findings and rulings set out therein make up an important part of WTO law.

As mentioned previously, the compliance record with WTO rulings is viewed as a positive one. Members overwhelmingly tend to amend or remove measures that have been found to be WTO-inconsistent in order to bring themselves into compliance with WTO law.[19] The WTO rulebook itself also sets out mechanisms to ensure that rulings are implemented (e.g. compliance panels can be requested to assess whether measures taken bring a Member into compliance has in fact done so; it is possible to seek arbitration to agree the period of time to be afforded to bring the measures into compliance).

Where a Member persists in its non-compliance with the rulings (worst case scenario, either because an unwillingness or inability), the WTO provides that retaliatory action may be taken by the “winning” Member in the dispute. Remedies in WTO dispute settlement are effectively prospective and aimed at inducing compliance; damages are not awarded. There is provision for WTO Members to agree to pay compensation, however this has very rarely happened.

[19] There have been a few exceptions to this.

Thank you

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