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Declaration of Originality

I declare that the project report here submitted is original except for the source materials explicitly acknowledged and that this report as a whole, or any part of this report has not been previously submitted for the same degree or for a different degree.

I also acknowledge that I have read and understood the Rules on Handling Student Academic Dishonesty and the Regulations of the Student Discipline of the University of Macau.

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Abstract

We cannot live without the digital economy today. Google, Facebook, Paypal have become parts of our life. The digital economy plays an increasingly important role worldwide compared to traditional trade. Meanwhile, the digital economy brings a lot of challenges to present international rules. Among these challenges, the challenge of the digital economy to the current tax rules is frequently mentioned. In order to deal with the challenge of the digital economy to the current tax rules, international organizations such as OECD are trying to reach a consensus agreement at the international level. However, the negotiations did not go well. Before some results are achieved at the international level, the European Union has launched the "Proposal for a COUNCIL DIRECTIVE on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services" (the proposal). This proposal gives the European Union's solution on how to tax the digital economy. As an EU tax policy, the proposal can only be passed with the unanimous consent of the member states according to EU law. While some member states have expressed their support, other member states have expressed their opposition to it, which makes it difficult to reach a consensus and pass the proposal in a short time. Consequently, a lot of member states like France, Italy, Austria have established their own digital service tax act. But it also raises some concerns, such as whether these unilateral digital tax laws are compatible with EU law, especially the fundamental freedoms of movement. This report will try to argue that the DST will not lead to inconsistency with EU law combined with the implications brought by the judgement of the Court of Justice of the European Union in the Tesco and Vodafone case.

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Chapter 1 Introduction

1.1 Background

The digital economy is seen as one of the most important issues nowadays. In the era of digital economy, the development of science and technology has created a new business model. However, the current international rules did not keep up with the pace of the digital economy. For example, under the traditional business model, some cross-border business activities of enterprises need to establish institutions abroad. Profits obtained by an enterprise through a permanent establishment abroad may be taxed by the country in which the permanent establishment is located.[1] However, the digital economy makes it possible for enterprises to conduct long-distance transactions with overseas customers, so there is no need to establish physical institutions abroad. Instead, these companies can establish their institutions or branches in jurisdictions where tax rates are lower.[2] Therefore, the existing tax rules are challenged by the digital economy. To solve this problem, both international organizations and countries are taking actions. For example, the report of Base Erosion and Profit Shifting (BEPS) 2015 from the OECD discussed how to solve the tax challenges of the digital economy. In its "Addressing the Tax Challenges of the Digital Economy: Action 1-2015 Final Report", the OECD suggested three kinds of solutions, including a new nexus in the form of a significant economic presence, the withholding tax and the equalization levy.[3] Before the international organization reach some multilateral solutions to solve this problem, the Commission of the EU considered that the digital economy leads to imbalance between the place where the profits are taxed and the place where value is created. Therefore, in March 2018, a legislative proposal on digital service tax was put forward. According to its legal basis, the proposal needs the unanimous consent of all Member States before it can be adopted.[4] For some reasons, countries like Ireland, Denmark and Sweden expressed opposition to the DST proposal. For example, the Irish government, whose favorable corporate tax regime has attracted many large technology companies, criticized the DST since it would reduce the incentive for

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[1] Zhang Zeping, International Tax law, Peking University Press, 2013, pp.29-30.

[2] For example, the famous tech company Apple established its subsidiary in Ireland, where the corporate income tax rate is only 12.5%. See https://assets.kpmg/content/dam/kpmg/pdf/2014/06/Choose-Ireland-O-201405-c.pdf

[3] See OECD, Addressing the Tax Challenges of the Digital Economy: Action 1-2015 Final Report, OECD Publishing, 2015, pp.13.

[4] COM(2018) 148 final,Proposal for a COUNCIL DIRECTIVE on the common system of a digital services tax on revenues resulting from the provision of certain digital services, Brussels, 21.3.2018, pp.6.

companies to invest in Ireland. These different opinions led to a deadlock at the legislative level. Concerned about the erosion of the tax base and pessimistic about the possibility of reaching a global consensus as well as an EU consensus on the issue, some Member States such as France[5], Italy[6], and Austria[7] have proposed or implemented their domestic "digital tax" bill on the basis of the proposal. The legislation, especially the French one, even leads to a strong reaction. On July 16, 2019, the United States initiated a Section 301 Investigation[8] of France's digital services tax.[9] On January 23, 2020, France and the U.S. temporarily reached an agreement. France prepared to postpone the digital tax and the United States abandoned sanctions temporarily.[10] However, on June 18, 2020, the U.S. withdrew from global digital tax talks.[11] This brings uncertainty worldwide again. Not only has the DST encountered challenges at the international level, but many scholars have also questioned whether these unilateral DST laws in each Member State are in line with the EU law. The major controversies are in the following two areas: (1) the fundamental freedoms; and (2) the state rules laid down in the Treaty on the Functioning of the European Union (hereinafter referred as "TFEU").[12]

1.2 Research Goals and Objectives

This report will try to argue that the DST will not lead to inconsistency with the fundamental freedoms under EU law. This argument can be supported in particular by the implications brought by the judgement of the Court of Justice of European Union in the Tesco and Vodafone cases. Although these two cases are not directly related to the DST, they have common features with the DST because the Hungarian measures in these two cases are progressive revenue taxes, which are very similar to the DST.

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[5] See https://ustr.gov/sites/default/files/enforcement/301Investigations/Initiation_of_Section_301_Investigation.pdf
[6] See https://ustr.gov/sites/default/files/enforcement/301Investigations/Report%20on%20Italy%E2%80%99s%20Digital%20Services%20Tax.pdf
[7] See https://ustr.gov/sites/default/files/files/Press/Releases/AustriaDSTFRN.pdf
[8] Section 301 refers to that the United States investigates the trade practices of other countries that the United States considers "unfair" according to Section 301 of the Trade Act of 1974.
[9] Initiation of a Section 301 Investigation of France's Digital Services Tax (July16, 2019) https://ustr.gov/sites/default/files/enforcement/301Investigations/Initiation_of_Section_301_Investigation.pdf.
[10] Philippe's Government, Digital tax(28 January, 2020), https://www.gouvernement.fr/en/digital-tax.
[11] Sam Fleming and Jim Brunsden, US upends global digital tax plans after pulling out of talks with Europe, FINANCIAL TIMES (18 June, 2020),https://www.ft.com/content/1ac26225-c5dc-48fa-84bd-b61e1f4a3d94.
[12] See Chris Forsgren, Xixian Song, and Dora Horvath, Digital Services Taxes: Do they comply with International Tax, Trade and EU Law?, Tax Foundation, pp. 9.

Therefore, the author believes that these two cases have important implications to the DST.

1.3 Research Methodology and Design

This report will analyze the following articles including but not limited to Article 56-62, TFEU and Article 49, 54-55, TFEU. This report will analyze the following cases including but not limited to Judgment in Case T-20/17, Hungary v Commission, Judgement in Case C-323/18, Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, Judgement in Case C-75/18, Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága and so on. Doctrinal Literature will also be used as the research methodology.

1.4 Organization of the Report

A brief challenge of the digital economy to taxation will be first discussed. In the second part of the report, EU's Digital Service Tax will be briefly introduced. Then the Challenges against DSTs from fundamental freedoms will be analyzed according to the norms and cases. Last but not least, the author will introduce two related cases which are thought to be important and try to get some implications from the cases.

Chapter 2 The Digital Economy's Challenge to Taxation

Digital economy refers to an economy that is based on digital computing technologies. OECD refers digital economy to the economy model adopting Information and Communication Technology (ICT) to enhance productivity. [13] On one hand, as professor Walter Brenner of the University of St. Gallen in Switzerland states: "The aggressive use of data is transforming business models, facilitating new products and services, creating new processes, generating greater utility, and ushering in a new culture of management."[14] On the other hand, as stated in the introduction, such kind of new economy model brings us some troubles in the field of taxation. In the era of digital economy, the scope of tax collection and administration extends from offline to online, with the characteristics of cross-border business without entities, dependence

[13] See Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, pp. 54.
[14] What is digital economy? Unicorns, transformation and the internet of things, Deloitte, https://www2.deloitte.com/mt/en/pages/technology/articles/mt-what-is-digital-economy.html

on intangible assets and participation of data and users, and the challenges to the tax system mainly focus on the complexity of tax sources, difficulty in controlling tax bases, ambiguity in permanent establishments, difficulty in determining the attribution of profits, and other aspects.

2.1 Conflicts with the Traditional Tax Jurisdiction

First, the trans-regional nature of tax sources under the digital economy conflicts with the regional characteristics of traditional tax jurisdiction, and digital enterprises are free from the shackles of entities, making it difficult to identify the source of sales income and attribution of profits. The internationally accepted tax principle is to levy tax at the place where the profits are generated, but it is difficult to apply to the digital tax. Most mature digital companies have several business lines with more diversified sources of income, new business models emerge one after another. The boundaries between digital business and industries become increasingly blurred. Production and sales continue to decrease. Merge and value creation is separated from the real business. Transaction has the feature of digitalization, concealment, virtual nature, cross-regional nature, and strong mobility. The concealment of many tax-related transaction information makes it difficult to monitor tax sources, which further leads to difficulties in tax collection, such as the difficulty in determining the place of value production and determining tax jurisdiction. Internet companies mainly in light assets, high proportion of intangible assets, can obtain valuable business model from the externalities of free products. It is becoming more difficult to identify and value objects and to determine the jurisdiction of the place of production of value. Moreover, many digital services often span one or more countries or regions, making it difficult to define where the profits come from.

2.2 Conflicts with Determination of Permanent Establishments

Secondly, the digital economy is affecting the determination of permanent establishments. Permanent establishments, as the generally accepted traditional taxation rules for international taxes, are the threshold for determining whether a country has the right to levy taxes or not. However, the highly digitalized operation mode of enterprises makes the current rules on taxation linkage and profit distribution out of order. Along with the transfer of economic activities from offline to online, the traditional permanent establishments cannot accurately match the taxation with the place where economic activities take place or value creation, which challenges the

business venues, fixity and business activities. Under the digital economy, enterprises have more flexible means to carry out their business. They can use a virtual network platform as a channel to move their core business from divestiture to overseas, easily cross regional barriers to realize global operation and reduce their dependence on physical places. The traditional permanent establishment rules can no longer reflect the economic connectivity with the characteristics of digital economy, thus making it difficult to determine the right to levy taxes on multinational digital enterprises and to judge the permanent establishment and its profit level. In simultaneously/concurrently, the essence of the digital economy is to exchange data as objects and means, and the data is virtual and exists with the help of servers. If the servers are to form a permanent organization, they need to be fixed. However, in practice, it is difficult to prove whether the servers are moving or not, and the long-term identification of the servers in a certain location lacks standards, resulting in differences between countries, creating difficulties for international tax collection and management.

2.3 International Tax Avoidance

Thirdly, it is more difficult to prevent international tax avoidance. As the digital economy keeps striking at the existing general tax jurisdiction, the two parties of a digital deal to a transaction have reached a contract, it is no longer necessary to use the entity as a medium to "de-materialize", which makes it more convenient to implement tax avoidance and avoidance. The digital business of transnational Internet giants is scattered all over the world and carried out in the global cyberspace. There is no need to establish an entity in most countries except for the establishment of headquarters. The complex enterprise organizational structure makes it more difficult to regulate international tax avoidance and avoidance. Transnational Internet giants rely excessively on intangible assets and tax incentives, while cross-border digital economies benefit from low-tax regimes. Through tax planning, they tend to settle in countries or regions with lax tax systems and low tax rates. Taking advantage of the characteristics of the digital economy, deficiencies in tax rules, differences in tax systems and loopholes in tax collection and administration, they construct complex tax avoidance structures that legally reduce the overall global tax burden to a minimum, or even double non-taxation, resulting in base erosion and profit shifting (BEPS).

Chapter 3 EU’s Digital Service Tax

Actually, in order to address the tax challenge posed by the digital economy, the idea of taxing the digital economy has been proposed. The issue of digital taxation has a long history. As early as the beginning of this century, discussion began on the necessity and feasibility of taxing the Internet economy. Since 2010, international multilateral organizations have begun to study digital taxation, and the European Union expected to reach a more global draft agreement with the OECD. However, due to the slow progress of the coordination of international tax rules, in order to make up for the loopholes, the EU decided to impose a temporary tax on certain digital commercial activities before the completion of the tax reform plan, and took the lead in launching the digital tax plan, which is EU's Digital Service Tax.

Digital Service Tax refers to the tax levied by the state on digital services generated by companies within a country. General digital services include search engines, social media, online video, instant message, etc. EU's DST, in the author's opinion, is divided into narrow sense and broad sense. In a narrow sense, EU digital service tax refers to the DST proposal proposed by the EU Commission in 2018. In a broad sense, the EU's DST also includes the DST bills promoted by EU Member States after the proposal met some problems. In this section, the author will briefly introduce both the proposal and DSTs in member states.

3.1 EU's proposal

On March 21, 2018, the European Commission established a new proposal to ensure that digital business activities are taxed.[15] In this proposal, the European Commission claimed that the digital companies are growing fast these days, with less physical presence and lower tax rates, which leads to unfairness. Before a consensus at a global level is reached, a fairer tax rules should be developed. Hence, the Commission proposed two solutions. The first one is a common EU solution for digital activities.[16] Under the first solution, the digital companies would have to pay tax in each Member State if they satisfy the following thresholds: revenues from supplying digital services exceeding 7 million euros, number of users exceeding 100,000 and number of online business contracts exceeding 3,000. The second solution is an interim tax to fix the urgent gaps. The Commission claimed that some Member States are already taking

[15] Press Release, Digital Taxation: Commission proposes new measures to ensure that all companies pay fair tax in the EU, 21 March, 2018, source: https://ec.europa.eu/commission/presscorner/detail/en/IP_18_2041
[16] European Commission, Fair Taxation of the Digital Economy (2018), pp.3.

unilateral measures, which will further fragment the Digital Single Market, so it is important to propose a way to stem the most urgent losses. An interim tax of 3% on revenues made from three main types of services, where the main value is created through user participation.[17] The companies whose total revenue worldwide is above 750 million euros every year or revenue from digital activities in the EU is above 50 million euros every year should be taxed. The revenues from three types of digital service should be taxed, including online placement of advertising, sale of collected user data and digital platforms that facilitate interactions between users (also known as C2C). The EU's DST in this article refers to the second solution.

On 13 December 2018, the European Parliament revised the proposal and voted overwhelmingly for the DST. The report on the digital services tax directive was adopted with 451 votes in favor, 69 against and 64 abstentions.[18]

However, since the proposed directive was based on Article 113 of the Treaty on the Functioning of the European Union (TFEU), it would be up to the Council to decide by unanimity on the final content of the rules. Many member states have different opinions on DST as the article mentioned before. It is difficult to obtain unanimous backing for a digital tax at the level of the Council of the EU, where all countries would have to sign off on the proposal. The EU's proposal stalled after Denmark, Ireland and Sweden said they could not support it. The table below shows the number of EU Member States who are opposed, supportive, neutral and on the fence as of 19 December 2018:

Supportive	Opposed	Neutral and on the fence	
United Kingdom[19]	Ireland	Germany	Austria
France	Denmark	Czech Rep.	Bulgaria
Italy	Netherlands	Slovenia	Lithuania
Spain	Belgium	Sweden	Slovakia
Portugal	Greece	Finland	Croatia
Poland	Luxembourg	Estonia	Cyprus
Hungary	Malta	Latvia	Romania

[17] Ibid, pp.4.
[18] Press Release, MEPs agree on new rules to tax digital companies' revenues, 13 December, 2018, source: https://www.europarl.europa.eu/news/en/press-room/20181205IPR20944/meps-agree-on-new-rules-to-tax-digital-companies-revenues
[19] United Kingdom has withdrawn from EU on 31 January, 2020.

The purpose of taxation is to support public sector activities. It is one of the most important economic and social policy tools. Since the EU is not a federal government and has no right to tax its own budget. Therefore, Member States still have their own tax sovereignty. Member states can decide the size of the public sector on their own and have the right to determine the tax system that is most suitable for them.

To some extent, the origin of EU comes from fiscal purpose. Article 3 (3) of the European Union's mission statement provides for the establishment of a common market and the implementation of common policies. This requires the elimination of unequal conditions of competition and the removal of barriers to cross-border activities within the common market. However, the normal operation of the domestic market may be hindered, such as differential tax treatment of domestic and imported goods, the tax burden of cross-border transactions and administrative difficulties in dealing with a number of different EU systems and so on. These barriers may affect the behavior of economic partners, thereby impeding the free flow of internal markets.

Therefore, the customs union is one of the basic elements to realize the function of the single market. Only when the external boundary has the common application of common rules, can the single market function normally. This means that the 27 customs authorities of the European Union have to act like one.

This is also as stipulated in the Article 28 of TFEU. First, it provides that the European Union should form a customs union. Obviously, the customs union also means the application of the common tariff regulated in Article 31 of the Union Customs Code outside the union borders, which came into effect on 1 July 1968.

In addition to the customs union, what other achievements have the EU made so far? The answer is that there is not much tax content in the primary law of the EU, but many rules are indirectly applicable to taxation. Either these rules empower the EU to coordinate taxes, which is what we call positive integration, or prohibit taxes that pose obstacles to cross-border transactions, which is called negative integration.[20] The only clause in TFEU that deals specifically with positive integration and taxation is article 113, which stipulates that the EU has the right to coordinate turnover tax, excise duty

[20] Fabio Wasserfallen, Political and Economic Integration in the EU: The Case of Failed Tax Harmonization, Journal of Common Markets Studies, pp. 3.

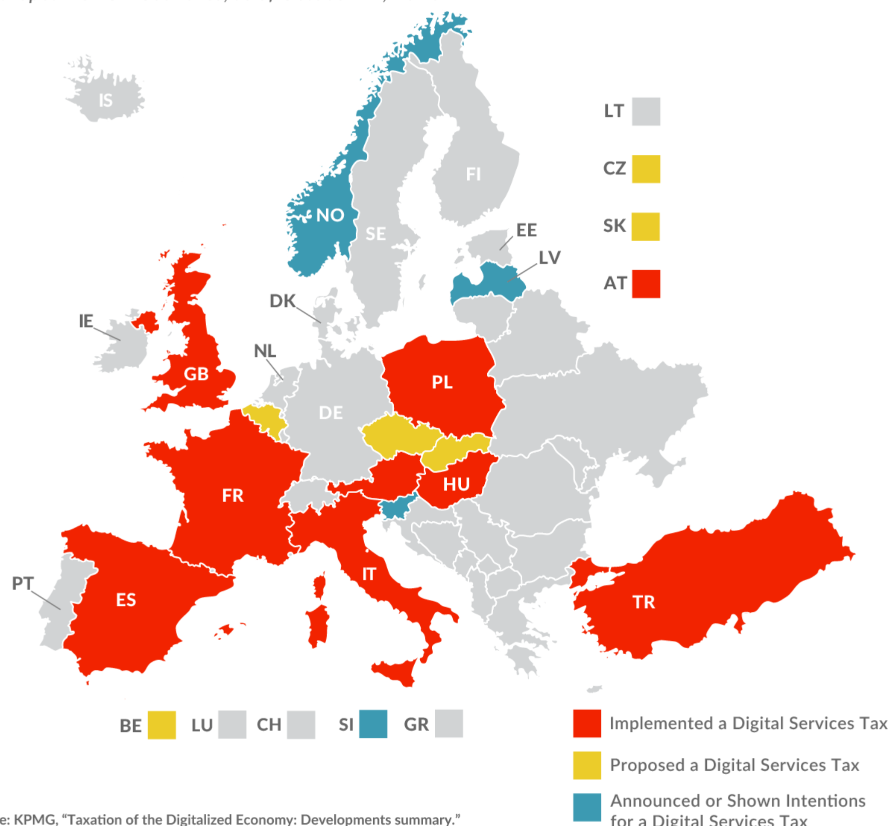
and other forms of indirect tax. Such coordination is necessary to ensure the establishment and operation of the internal market and to avoid distortions in competition. So in short, we can say that harmonization of taxation is possible, because the institutions of the EU are given the necessary competence to harmonize indirect taxes, as long as they are within the framework of the establishment and operation of the EU. But this is not the case for direct taxes. In fact, Article 115 of the TFEU stipulates that the Council shall act in accordance with special legislative procedures with regard to direct or unrelated indirect taxes. It can be sufficient to hold consultations in the European Parliament and the Economic and Social Committee in order to issue laws, regulations or directives of administrative provisions to directly affect the operation of the internal market.

Up to now, however, only a few of these direct guidelines have been implemented in the field of mutual assistance and cooperation in tax matters, even in the field of savings tax or corporate tax. Therefore, it is almost expected that such a tax, which will lead to conflicts of interest between member states and the EU, has not been passed.

3.2 The Development of Digital Services Tax in the Member States

Because DST proposal cannot be agreed at the EU level, many countries are developing or have developed their own regulations or policies. The table below shows the status of digital tax legislation in European countries as of 14 October, 2020.[21]

[21] Source: KPMG, "Taxation of the Digitalized Economy: Developments summary." from TaxFoundation, https://taxfoundation.org/digital-tax-europe-2020/



In EU Member States, Austria[22], France[23], Hungary[24], Italy[25], Poland[26] and Spain[27] have implemented their own legislation. Belgium, the Czech Republic, and Slovakia have established proposals to enact a DST, and Latvia and Slovenia have officially announced or shown intentions to implement such a tax.

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[22] Austria: Legislation introducing digital services tax, KPMG, 29 Oct., 2019, https://home.kpmg/us/en/home/insights/2019/10/tnf-austria-legislation-introducing-digital-services-tax.html, Austria: Update on digital services tax, KPMG, 25 Feb., 2020, https://home.kpmg/us/en/home/insights/2020/02/tnf-austria-update-digital-services-tax.html.

[23] See France: Digital services tax (3%) is enacted, KPMG, 25 July, 2019, https://home.kpmg/us/en/home/insights/2019/07/tnf-france-digital-services-tax-enacted.html. Origin Version at https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000038811588?r=E4lXkdx6l7

[24] https://taxfoundation.org/digital-tax-europe-2020/.

[25] Italy: Digital Services Tax applicable from 1 January 2020, KPMG, 17 Oct. 2019, http://kdocs.kpmg.it/Marketing_Studio/171019_Italy_Digital_Services_Tax_applicable_from_1_January_2020.pdf

[26] Taxation of the digitalized economy: Developments summary, KPMG,6 Oct., 2020, https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf.

[27] See Spain: Draft legislative proposal for digital services tax, KPMG, 19 Feb., 2020, https://home.kpmg/us/en/home/insights/2020/02/tnf-spain-draft-law-proposal-digital-services-tax.html. The origin instrument is at http://www.congreso.es/public_oficiales/L14/CONG/BOCG/A/BOCG-14-A-1-1.PDF#page=1.

3.3 Common features of DST legislation

There are some differences in the legislation of digital tax in each country. Specifically speaking, it includes their legislative purpose, tax object, tax rate and so on. For example, Austria has implemented Digital Tax Act 2020 Effective from January 2020. The proposal to eliminate unfair competition between traditional advertising services and online advertising services. Since 2000, Austria has been levying an advertising tax, but only on "classic" advertising services (e.g. on TV, radio, print media or posters). As it was done in various other EU Member States, Austria likewise taxes online advertising, thus contributing to increasing tax justice.[28] France implemented an act to tax provision of a digital interface and advertising services based on users' data, which can be retroactively applicable as of January 1, 2019.[29]

Although the tax policies of these countries are slightly different, they still have something in common. The author thinks that the main reason is that they are all influenced by the proposals put forward by the European Commission.

First of all, digital services tax is an indirect tax. DST is a destination-based turnover tax levied on gross revenues. Costs cannot be deducted from the tax base and losses cannot be carried forward.[30] It hits narrower income sources and tax the revenue that is not made in their jurisdiction, but determines tax rates according to worldwide revenue. For example, the French DST is levied at a flat rate on the gross revenues of targeted companies and no expenses are deductible for calculating the tax base.[31]

Secondly, the DST basically targets companies that make revenue from user data. For example, Austria[32] only targets the companies providing online advertising. Belgium proposed to tax the companies whose revenue is derived from selling of user data. France targets companies that provide advertising services based on users' data and digital interface services. Italy[33] aims at the companies who acquire revenues from advertising on a digital interface, multilateral digital interface that allows users to

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[28] Digital Tax Act 2020, General information, https://www.bmf.gv.at/en/topics/taxation/digital-tax-act.html
[29] Translation of French DST Law, Art. 299, II.2.
[30] Article 8, Directive.
[31] Translation of French DST Law, Art. 299 I.A
[32] Austria: Legislation introducing digital services tax, KPMG, 29 Oct., 2019, https://home.kpmg/us/en/home/insights/2019/10/tnf-austria-legislation-introducing-digital-services-tax.html, Austria: Update on digital services tax, KPMG, 25 Feb., 2020, https://home.kpmg/us/en/home/insights/2020/02/tnf-austria-update-digital-services-tax.html.
[33] Italy: Digital Services Tax applicable from 1 January 2020, KPMG, 17 Oct. 2019, http://kdocs.kpmg.it/Marketing_Studio/171019_Italy_Digital_Services_Tax_applicable_from_1_January_2020.pdf

buy/sell goods and services and transmission of user data generated from using a digital interface as well.

Thirdly, rather than the permanent establishment rule which limits the source countries' tax jurisdiction and only allows them to levy taxes on profits attributable to the physical presence/permanent establishment of multinational companies within their territory,[34] DST choose to target digital companies at the group level such as France,[35] Austria[36] and so on.

Chapter 4 The Challenges against DSTs from fundamental freedoms

In general, there are four major challenges facing the EU DST. First, there is disagreement among EU Member States on the DST, as is in the table above. Secondly, the EU digital service tax may face disputes on compatibility with international law, especially with the obligations of countries and economic entities regulated under General Agreement on Trade in Services (hereinafter referred as "GATS").[37] Thirdly, the DST of each member state may face incompatibility with EU law. Fourthly, the EU's DST has caused conflicts at the international level, especially with the United States.[38] In this report, the author only discuss the third challenge, that is, the dispute of compatibility with EU law.

At present, the mainstream thinks that according to the EU law, there are some potential challenges in DSTs: (1) The articles of freedom to provide services and the freedom of establishment under TFEU; and (2) The state aid rules laid down in the TFEU.[39] Ruth Mason also argues that the unilateral digital taxes may violate state aid rules and run against nationality discrimination.[40] However, the author finds the state aid rules hardly applicable to this issue. A strong argument against the eligibility of the DST as state aid is that, although member states have the necessary and

[34] See OECD Model Tax Convention on Income and on Capital 2017 (hereinafter referred to as "OECD Model"), Art. 7, 21 Nov., 2017.
[35] Translation of French DST Law, Art. 299 III.
[36] Austria: Update on digital services tax, KPMG, 25 Feb., 2020, https://home.kpmg/us/en/home/insights/2020/02/tnf-austria-update-digital-services-tax.html.
[37]See Petros C. Mavroidis, And You Put the Load Right on Me Digital Taxes, Tax Discrimination and Trade in Services, Trade, Law and Development, pp. 78.
[38] *Supra* 9.
[39] Digital Services Taxes: Do they Comply with International Tax, Trade, and EU law? Chris Forsgren, Sixian (SUZIE) Song, Dora Horvath, TAXFOUNDATION.
[40] Ruth Mason and Leopoldo Parada, Digital Battlefront in the Tax Wars, Tax Notes International, 17 Dec., 2018, page. 1183.

discretionary power to implement it, it is approved by EU lawmakers. It first means that the measure cannot be attributed to member states (but rather to a bill from the EU legislature) and, second, that it amounts to a declaration that the measure is not "affecting trade between member states". Therefore, this report mainly discusses the possibility that the DSTs may violate the fundamental freedoms laid down in the TFEU.

4.1 Legal Basis

There are four kinds of fundamental freedoms regulated in TFEU, which are free movement of goods, free movement of persons, freedom to provide and receive services and free movement of capital. Fundamental freedoms have the characteristics of direct effect and supremacy. If the member state's laws violate the four fundamental freedoms, then this domestic legal provision cannot be used. In the present case, the possibly applicable legal basis is the freedom to provide services or the freedom of establishment. In fact, freedom of establishment and freedom to provide services complement each other. Therefore, this report will focus on the analysis of these two freedoms.

The legal basis for freedom to provide and receive services are Articles 56-57, TFEU. It generally prohibits the restrictions on the freedom to provide services within the Union. Under the articles, a measure capable of influencing cross-border trade must be applied in a nondiscriminatory manner. The discriminatory measures are divided into distinctly applicable measures and indistinctly applicable measures. In Gouda Case, the Court confirmed that unjustified indistinctly applicable measures, which means that those measures imposing a dual burden on foreign service providers, are not allowed unless they can be justified by overriding reasons.[41] The legal basis for freedom of establishment, on the other hand, is Article 49, TFEU, which prohibits the restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State including agencies, branches or subsidiaries. In such situation, the problem becomes whether the DSTs constitute an obstacle to the exercise of fundamental freedoms.

Generally speaking, CJEU usually judges incapability between domestic laws and fundamental freedoms through the following steps: (1) Scope. (2) Restriction. For example, does a company have been treated differently in cross-border and domestic

[41] The substantive Law of the EU, page 385, para. 2.

situations? It is worth noting that the restrictions include not only direct discrimination, but also indirect discrimination. As mentioned in the Sotgiu case[42], the provisions restrict all forms of discrimination. For example, requiring companies to hold special permits or licenses will be regarded as causing indirect discrimination. (3) Justification. For example, in some cases, fundamental freedoms can be justified, if there are more important objectives to be protected, such as preventing tax avoidance. (4) Proportionality. It mainly examines whether the important objectives in (3) does not unduly restrict fundamental freedoms. Generally speaking, the latter two are often put together to judge comprehensively.

4.2 Analysis

In the present case, the first argument that the DST may violate the fundamental freedoms is that the way DST choose to target digital companies at the group level may violate Article 49[43] mentioned above as it treats groups worse, who are more likely to be active in cross-border provision of services. This happened once in the Hervis Sport Case. Hervis was a sports shop in Hungary under the name of Hervis Sport. It belongs to the SPAR group. Hungary's tax law provides for progressive taxation of net turnover, which means that the higher the net turnover is, the higher the tax rate will be applicable.[44] Under the law on the special tax, the net turnover of all "linked undertakings" belonging to one group acquired in Hungary will be calculated together. Therefore, Hervis was subject to an average rate of tax considerably higher than that of its competitor, who only included the tax payable on the turnover of its own stores as the result of the application of the sharply progressive scale of the special tax to the overall turnover of that group.[45] Hence, Hervis maintained that the law on the special tax were contrary to European Union law.

The Court held that the question was whether Articles 49 TFEU and 54 TFEU must be interpreted as precluding legislation relating to the turnover tax, where such tax has possibly discriminatory effects in regard to taxable legal persons constituting, within

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[42] C-152/73 Sotigiu v. Deutsche Bundespost [1974] ECR 153.

[43] National legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activites flls within the scope of Article 49, TFEU on freedom of establishment. See Test Claimants in the FII Group Litigation[2012] ECR, para.90-91 and case-law cited.

[44] Paragraph 5 of Law No XCIV of 2010 on the special tax on certain sectors, (hereinafter referred to as "the law on the special tax").

[45] C-385/12, Hervis Sport Case, Para 14.

a group, undertakings "linked", within the meaning of that legislation, to a company whose registered office is located in another Member State.[46]

The Court firstly used the criterion of differentiation to show the adverse effect to the undertakings which are linked to other companies within a group.[47] Then the Court held that if the taxable persons who belongs to a group of undertakings and covered by the highest tax rates in the specific market are, in most cases, linked to companies which have their registered offices in other Member States, the application of the sharply progressive tax should be responsible for the adverse effect the taxable persons linked to companies which have their registered offices in other Member States.[48] At last, the Court left the question of whether the condition mentioned above is fulfilled to the referring court.

We can learn from the case that the calculation of turnover on a group basis may lead to the possible discrimination between group companies and non-group companies, which may lead to EU law issues. If it is said that levying digital services tax at the group level will lead to higher taxes on companies with branches in other Member States than on non-group companies and it happens that most of domestic companies are non-group companies, while foreign companies are group companies, then such digital services tax may be considered as indirect discrimination on the basis of nationality.

The second argument is about the company size. It is argued that DSTs in these countries set a relatively high revenue threshold. For example, France[49] Italy[50] and Austria[51] sets a threshold of 750 million euros. It means that the DSTs aims at the big companies.

[46] C-385/12, Hervis Sport Case, Para 29.
[47] C-385/12, Hervis Sport Case, Para 33.
[48] C-385/12, Hervis Sport Case, Para 39.
[49] See France: Digital services tax (3%) is enacted, KPMG, 25 July, 2019, https://home.kpmg/us/en/home/insights/2019/07/tnf-france-digital-services-tax-enacted.html.
Origin Version at https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000038811588?r=E4lXkdx6l7
[50]
[51] Austria: Legislation introducing digital services tax, KPMG, 29 Oct., 2019, https://home.kpmg/us/en/home/insights/2019/10/tnf-austria-legislation-introducing-digital-services-tax.html,
Austria: Update on digital services tax, KPMG, 25 Feb., 2020, https://home.kpmg/us/en/home/insights/2020/02/tnf-austria-update-digital-services-tax.html.

As French DST Law as an example, the United State Trade Representative(USTR) figures out approximately twenty-seven company groups that will be covered by the DST, as depicted in the chart below.[52]

Company Groups Expected To Be Covered by the DST			
Company Group(Covered Brands)	Nationality	Advertising	Interface Marketplace
Airbnb	USA		X (travel services)
Alibaba	CHINA		X (retail)
Alphabet Inc. (Google, YouTube)	USA	X	X (apps stores)
Amadeus	Spain		X (travel services)
Amazon	USA	X	X (retail)
Apple	USA		X (apps store)
Axel Springer (Seloger)	Germany		X (real estate)
Booking Holding Inc.	USA		X (travel services)
Criteo	France	X	
eBay	USA	X	X (retail)
Expedia	USA		X (travel services)
Facebook (Facebook, Instagram)	USA	X	
Groupon	USA		X
Match Group (Match, Meetic, Tinder)	USA		X (dating services)
Microsoft	USA	X	
Rakuten	Japan		X (retail)
Randstad	Netherlands		X (human resources)
Recruit	Japan		X (human resources)
Sabre	USA		X (travel services)
Schibsted (Leboncoin)	Norway		X (retail)
Snapchat	USA	X	
Travelport	UK		X (travel services)
Twitter	USA	X	
Uber Technologies, Inc.	USA		X (transportation)

[52] USTR Report, Office of the USTR, Section 301 Investigation: Report on France's Digital Services Tax, 2 December, 2019, pp. 26, source: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf

Verizon Communications Inc.	USA	X	
ContextLogic Inc.(Wish)	USA		X (retail)
Zalando	Germany		X (retail)

From the form above, we can see that only one company is from France. Five companies are from other member states in the EU, including two German companies, one Spanish company, one Dutch company and one company from Norway. Although nearly two thirds are American companies, they more or less have subsidiaries and branches in the member states of the EU. In this way, almost all the companies that have met the threshold are non-local companies. It can be seen that through the establishment of the revenue threshold, the taxed companies have a certain degree of connection with their nationality. Although only the quantity is not enough to causal relationship, this "coincidence" still puts the legitimacy of DST at risk. In Hervis Sport case, Advocate General Kokott pointed to an open doctrinal question. How to distinguish harmless or incidental correlation from harmful correlation that constitutes indirect nationality discrimination that violates the fundamental freedoms. Advocate General Kokott believed that the facially neutral rules that are not intrinsically linked to nationality should be considered discriminatory only when the classification "in the vast majority of cases" is actually related to nationality although she didnot define the specific meaning of vast majority.[53] Big usually means foreign. Some study shows that the Commission and the CJEU are more and more aware of member states' use of size as a shield for nationality.[54]

The third possible reason why digital taxes may violate fundamental freedoms is the "technology neutrality". Technology neutrality means that the same regulatory principles should apply regardless of the technology used.[55] Other believes that all products and services should be available to most users, regardless of the platform, operating system or mobile device used. In this report, the word technology neutrality means that digital service and traditional service should be regarded as similar or like service, so as to be recognized as one market, without considering their different

[53] C-385/12, Hervis Sport Case, Opinion of Advocate General, para. 41.
[54] Ruth Mason,Leopoldo Parada, Company Size Matters, British Tax Review, Issue 5, 2019, page 610.
[55] Winston Maxwell, Marc Bourreau, Computer and Telecommunications L. Rev. (2014), Forthcoming, 24 Nov 2014, page 1.

technical means. In other words, these digital services are considered as the traditional services but in a digital way. For example, the online advertising (e.g. Facebook) and the traditional advertising(e.g. newspaper) should belong to one market, and they should not be treated differently. Taking the advertising as an example, the DSTs of some countries will tax the revenue generated by online advertising services, but it will not tax the traditional advertising services. Some countries such as Hungary will even have tax incentives for the traditional advertising services, which will indirectly lead to a kind of discrimination caused by taxation.

The idea of technology neutrality also seems to be reflected in the jurisprudence of the CJEU. In the Uber case, the a professional taxi drivers' association in Spain called Elite Taxi brought a suit against Uber Spain, claiming that Uber conducted unfair competition because it violated the Spanish law that urban taxi services is subject to the prior grant of a license entitling the license holder for each vehicle intended to carry out that activity.[56] Uber is a company contacting or connecting with non-professional drivers to whom it provides a number of software tools -- an interface -- which enables them, in turn, to connect with persons who want to make urban journeys and who gain access to the service through the eponymous software application.

It came to the question whether the company like Uber Spain that use technology as an intermediary between passengers who want to ride and private cars owners to make money should be defined as providing transport services consisting of the physical act of moving persons or goods from one place to another by means of a vehicle or merely an electronic intermediary service.[57]

The Court held that Uber should not be considered to be the intermediation service but a service in the field of transport.58 Because the service at issue is more than a simple intermediation service. The company simultaneously provides urban transport services. As the Court demonstrated[59]:

> *"In that regard, it follows from the information before the Court that the intermediation service provided by Uber is based on the selection of non-professional drivers using their own vehicle, to whom the company provides an*

[56] C-434/15, Uber Case, Judgement, para. 13.
[57] C-434/15, Uber Case, Judgement, para. 33-34.
[58] C-434/15, Uber Case, Judgement, para. 42.
[59] C-434/15, Uber Case, Judgement, para. 39.

application without which (i) those drivers would not be led to provide transport services and (ii) persons who wish to make an urban journey would not use the services provided by those drivers. In addition, Uber exercises decisive influence over the conditions under which that service is provided by those drivers. On the latter point, it appears, inter alia, that Uber determines at least the maximum fare by means of the eponymous application, that the company receives that amount from the client before paying part of it to the non-professional driver of the vehicle, and that it exercises a certain control over the quality of the vehicles, the drivers and their conduct, which can, in some circumstances, result in their exclusion."

Although the case only refers to the legal classification instead of the factual elements, we can learn through the court's argument that the way of technology does not make a service necessarily special and thus become another service. We should consider the nature of the service on how to identify the type of service. Of course, since Uber is classified as a service in the field of transport, it is not covered by the freedom to provide services in general but by Art. 58(1), TFEU.[60] However, in other service market, such as advertising, if only technology companies such as Facebook are taxed heavily just because they are "digital", but other traditional advertising service companies in the same competitive market such as the newspaper companies are not taxed, the risk of violating freedom to provide service exists. If it happens that the majority of the digital advertising service companies are foreign and the traditional advertising companies are domestic, the risk of being criticized will become greater.

It is noticed that even if the state has no malicious intention to lay down measures for discrimination based on nationality, it does not mean that the state does not violate fundamental freedoms. If a tax on the basis of an apparently objective criterion of differentiation but have disadvantageous impact, in most cases, on companies who sits in other Member States and that are in a comparable situation to companies who sits within the Member State where that tax is charged, is regarded to cause indirect discrimination based on the nationality of the companies.[61]

However, it should be emphasized that the above arguments are still insufficient to prove that DSTs are indirect discrimination based on nationality, although they are

[60] C-434/15, Uber Case, Judgement, para. 44. Also see judgment of 22 December, 2010, Yllow Cab case, C-338/09.

[61] Judgment of C-236/16 and C-237/16, ANGED case, para. 18.

more or less causal with nationality. Moreover, even if the discrimination is well established, it can be justified by overriding reasons relating to the public policy interest as long as it is a convincing reason which is suitable and proportionate to achieve the objective. As mentioned earlier, the indistinctly applied measures and those hinder the provision of services between countries can be justified. The reason for justification is related to public interests. Such public interests include various situations, such as public health, public safety, public policies, public service exceptions, etc. The Court has stated many times that anyone who abuses the rights stipulated in the Treaty will lose his right to rely on the free movement. Since 2005, a new method to evaluate whether the national tax law can be justified has been supported in the Court. In the past, different arguments were divided according to the cited reasons, and were clearly divided into different categories.[62] Nowadays, ECJ tends to comprehensively consider various reasons and make a brief assessment.

The objective to prevent tax avoidance can be invoked as a justification for restrictive national laws. In order for them to be accepted as legitimate reasons, state tax laws must be designed only against artificial arrangements. Although the word of artificial arrangement is found in several ECJ decisions,[63] only in 2006, in Cadbury Schweppes Case, did the Court explained what exactly does artificial arrangement mean.[64] This case involves the compatibility of the freedom of establishment and British CFC rules, which prevent resident taxpayers from transferring their income to companies under their control. Those companies are usually residents of countries with low or non-taxation rates. Although the rules in question are regarded as incompatible to the fundamental freedom, the Court found the restriction justified because they are used to prevent tax avoidance. These rules are deemed justified only in the case of wholly artificial arrangements which do not reflect economic realities, and aim at avoiding taxes which should be payable in respect of profits derived from activities carried out in the territory of a country. The Court further noted that such arrangements undermine the balanced allocation of tax right among member states.[65] The ECJ therefore highlighted the link between the two arguments, which are the need to prevent tax

[62] See Lang, Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions, EC Tax Rev. 106–108 (2009) and Helminen, EU Tax Law 121 (IBFD 2011).
[63] See e.g. Case C-264/96 ICI, para. 26 and Case C-324/00 Lankhorst-Hohorst, para. 37.
[64] For an account of the development of this justification prior to Case C-196/04 Cadbury Schweppes, see Terra & Wattel, European Tax Law page. 913–922 (2012)
[65] Case C-196/04 Cadbury Schweppes, para. 56.

avoidance and the need to maintain a balanced allocation of tax powers among member states. Therefore, we have reason to believe that the DST in Member States can also have similar reasons. Anti-tax avoidance can become a reasonable justification, thus making the EU DST consistent with the fundamental freedoms.

To sum up, the author thinks that DSTs may violate the fundamental freedoms because of their narrow scope and high-revenue triggers that may leads foreign companies disproportionately pay more, but the overall situation is still unclear whether the challenge to the DSTs would prevail. In addition, even if the EU DST does violate fundamental freedoms, member states can eliminate such restriction by advocating justification. Under these circumstances, in this case, more arguments are needed to reach a more likely conclusion. It seems that the recent judgment of the court can give us some implications.

Chapter 5 Implications from the cases

5.1 Introduction of the cases

Vodafone is a public limited company in Hungary active in the telecommunications market. It is a subsidiary of Vodafone Group, whose registered office is in the United Kingdom. Vodafone is one of the largest undertakings on the Hungarian telecommunications market with over 20% market share. There is a kind of special tax in Hungary, which applied only to specific types of turnover in telecommunications activities. If the net turnover from telecom activity is under 500 million Hungarian forint (hereinafter referred to as "HUF"), the tax rate will be 0%. If the net turnover is between HUF 500 million and HUF 5 billion, the tax rate will be 4.5%. If the net turnover is more than HUF 5 billion, the tax rate will be 6.5%.[66] According to the tax law, Vodafone was required to pay a large amount of tax. Therefore, Vodafone brought an action. In practice, only the Hungarian subsidiaries of foreign parent companies pay the special tax at the rate laid down for the highest band of turnover.[67] So the question becomes whether the effect of that tax, which is based on turnover and is calculated in accordance with a scale that comprises progressive rates applicable to various tax

[66] Judgment of C-75/18, Vodafone Case, para. 9.
[67] Judgment of C-75/18, Vodafone Case, para. 15.

bands, is an indirectly discriminatory measure to taxable persons owned by foreign natural persons or legal persons.

Similarly, Tesco is also a company based in the UK and had subsidiaries in Hungary. It is subject to the special tax on the retail activities. According to Hungarian law, the tax rate will be set at 0% if the net turnover is not exceeding HUF 500 million; 0.1% between HUF 500 million and HUF 30 billion; 0.4% in excess of HUF 30 billion but not exceeding HUF 100 billion, and 2.5% if the net turnover is more than HUF 100 billion.[68] The taxpayers made the same claim as Vodafone case before the Hungarian national courts.

Actually, their complaints seems to be well-founded. In the Hervis case we mentioned above, the Court established a simple majority rule. If most of the taxpayers who will be affected by the adverse tax treatment are resided in other EU member states or were linked to such other EU companies, then the national tax law will be considered as contrary to EU fundamental freedoms because of its illegal discrimination.[69] As Tesco claims, all the companies that fall within the lower bands are companies which are owned by Hungarian natural persons or legal persons. Conversely, the companies that fall within the highest band are, with one exception, undertakings linked to companies that have their registered office in another Member State.[70] Such reasons seem to prove that although Hungary does not overtly discriminate on the basis of nationality, it covertly causes nationality discrimination. In this way, according to the jurisprudence, both cases may have a greater chance of winning.

That has not been the case, however. Hungary won both cases. In the case of Tesco and Vodafone, the Court did not think the cases are similar to the Hervis case. The Court considers that:

> *it is necessary, in order to resolve the dispute in the main proceedings, to determine whether the progressive scale, using bands, of the special tax may constitute, in itself, irrespective of the application of that consolidation rule, indirect discrimination vis-à-vis taxable persons that are controlled by natural*

[68] Judgment of C-323/18, Tescol Case, para. 8.
[69] Judgment of C-385/12, Hervis Sport Case, Para 39.
[70] Judgment of C-323/18, Tesco Case, para. 16 and 67.

persons or legal persons of other Member States, who bear the actual tax burden, and, therefore, be contrary to Articles 49 and 54 TFEU.[71]

The court held that the Hervis case was about the application of the very progressive turnover tax and the rule of consolidation of turnover at the group level. As a result, a separate legal person was inflated. In other words, the calculation basis is fictitious. Such unreasonable link can have disadvantage on the companies which have their registered offices in other Member States.[72] The tax law itself is neutral. Consequently, these two cases can be distinguished from the Hervis case.

The Court put their eye mainly on the progressive scale itself this time. The Court recalled that the Member States are free to establish the system of taxation that they believe it is suitable under the current situation of harmonization of EU tax law.[73] So the establishment of the progressive turnover taxation is the discretion of each Member State. In this case, it can be read in the preamble of the tax law that the aim is to impose a tax on taxpayers who are capable of paying "that exceeds the general obligation to pay tax".[74] Hungary only taxes on the basis of the market share. Tesco is taxed more because it dominates Hungary's store retail trade market and makes more revenue. Therefore, the Court declared that the progressive tax rates do not, by themselves, violate the fundamental freedoms of the EU. The same conclusion was made in the Vodafone case.[75] From this point, it can be inferred that there is a difference between two purposes. One is to tax big companies because they are foreign. The other is to tax big companies and these big companies happen to be foreign.

Generally speaking, the criterion on whether the measures will bring discrimination is very subtle. There are two reasons for this subtle relationship in the author's opinion. The first reason is that on one hand, the country has discretion tax law. On the other hand, it must be restricted by the EU primary law. In this way, it is important for the Court to make these two seemingly contradictory purposes harmonious. The Court often uses its discretion to harmonize the relationship. It makes the Court sometimes more inclined to protect the state's sovereignty to make tax laws, and sometimes to protect the values of the European Union. The second reason is that, although there is

[71] Judgment of C-323/18, Tesco Case, para. 48. See also Judgment of C-75/18, Vodafone Case, para. 38.
[72] Judgment of C-323/18, Tesco Case, para. 75.
[73] Judgment of C-323/18, Tesco Case, para. 69.
[74] Judgment of C-323/18, Tesco Case, para. 71.
[75] Judgment of C-75/18, Vodafone Case, para. 56.

a precedence saying that a tax with an objective purpose may still be considered to cause discrimination if it has disadvantages. However, the so-called objective purpose should also be differentiated. For example, in this case, the measure also has discriminatory effect on the basis of nationality in practice, but it does not matter because the steeply progressive turnover tax itself does not cause discrimination and the purpose is reasonable too. On the contrary, tax at the group level is more unreasonable, so the discrimination caused by it becomes not indifferent.

2.2 Relationship with the DSTs

In this section, the author will try to connect the two cases above with the DSTs. These two cases have become a starting point for laying the foundation for the future of the DSTs. For the reasons why these cases are of great significance to the DSTs, we can learn from the opinions of the advocate general. In Vodafone case, , advocate general Kokott (hereinafter referred to as "AG"), intensively mentioned 8 times DSTs in the opinion. The same is true in Tesco case. Kokott believed that the Court must rule on the compatibility of progressive tax rates with EU law because progressive rates have a historical development in many Member States. Moreover, progressive tax rates form the basis of the DSTs, which are proposed across the EU and have been implemented in some Member States.[76] In addition to the importance of the issued Hungarian taxation for the DSTs, AG even used a lot of DST as examples to demonstrate the legitimacy of the issued tax, which reflects the common points between them as well.

First of all, as mentioned above, the digital services tax has one thing in common with the taxes involved in the two cases, that is, they are both turnover taxes. It becomes the reason some tax practitioners and academics argued that the revenue thresholds that trigger could constitute discrimination under EU law. Through the Court's decision on the same kind of turnover tax, we can also find the implications they bring to the DSTs. Therefore, in these cases the Court is concerned with questions relating to tax law and the rules on Freedoms which at the same time are very important to the turnover-based digital services tax currently being proposed by the European Commission as well as being unilaterally enacted by many Member States.

[76] Opinion of Advocate General, C-75/18, Vodafone Case, para. 4.

The second similarity is that all of the turnover taxes are progressive. In another word, they basically used the same taxation technique.[77] The opportunity of engaging in aggressive tax planning lies with larger companies. Focusing on turnover gives less scope for organizational models of the large multinational enterprises (hereinafter referred to as "MNEs") which can be more accurate and effective. This is also one of the main points of the BEPS debate over last ten years.

The third similarity is that they all focus on one special activity. The DSTs aims at the digital service activities. In Vodafone case, the special tax was designed to tax the Telecommunication activities. In the Tesco case, they put their eyes on retail undertakings. It is argued that the tax on a single activity may lead to somewhat discrimination because the large foreign companies are not encouraged to enter the domestic market by being taxed. Therefore, the Court's decision on the special in Hungary can also enlighten the DSTs.

The fourth common point is their intention of legislation. In Vodafone and Tesco case, the large MNEs can minimize their profits in Hungary. As a result, they can "reasonably" avoid taxes and the tax burden falls mainly on small and medium-sized enterprises (hereinafter referred to as "SMEs"). The special tax law in the case aims to prevent this situation from happening. In 2010, the statistical data provided to the Court showed that only half of the top 10 enterprises with the highest turnover in Hungary paid the corporate tax. The companies owned by Hungarian nationals are seriously affected. Therefore, levying the progressive turnover tax can certainly make up for this. The AG noted that this is also consistent with the approach adopted by the European Commission in the proposed DST and implemented by the Member States in their DSTs. If these MNEs gain profits but are not subject to the income tax, then they should be taxed somewhere else.[78]

Last but not least, although their intention is to avoid the base erosion and profit shifting, they objectively cause discrimination based on nationality, which is mentioned as facially neutral manner. This point has been mentioned above. In Vodafone case and Tesco case, most companies being taxed under the first level are foreign companies. The DSTs are in the same situation. For example, most of companies that will be taxed by French DST are foreign companies. This is one of the

[77] Opinion of Advocate General, C-75/18, Vodafone Case, para. 101.
[78] Opinion of Advocate General, C-75/18, Vodafone Case, para. 96.

main reasons why DSTs have been criticized. Therefore, the court's interpretation of this situation is very helpful for us to understand the situation and criticism of the DSTs.

In conclusion. The DSTs have a lot of similarities with these two Hungarian special tax. First and foremost, they all belong to the turnover tax. Secondly, their tax are divided into different level according to the amount of the turnover, which is called progressive. Thirdly, they mainly focus on one activity. Their intention is to avoid the base erosion and profit shifting. However, despite of their intention, they caused the discrimination based on nationality from the objective perspective.

2.3 Implications from the referred cases

Because they have so much in common, the Court's judgment on these two cases can be a great reference for the DSTs, which is also the view expressed by AG Kokott in the opinion. In the light of their connections and common points, we can sum up several implications in the cases.

First and foremost, the legitimacy of turnover tax has been confirmed by these two cases. In other words, the progressive turnover tax itself does not constitute discrimination against the providing services or the establishment of companies. As two judgments say, the fact that the progressive turnover tax, in itself, to advantage of taxable persons owned by Hungarian and to disadvantage of taxable persons owned by natural persons or legal persons of other Member States in the way of achieving highest turnover in the market concerned will not violate the fundamental freedoms regulated in TFEU.[79] Specifically speaking, the Court may consider that the DSTs, like these two cases, does not pose a risk of violating the fundamental freedoms of EU law. The reasons are as follows.

First, the Court may not recognize a connection between the discrimination and the number of foreign companies paying more tax. As AG stated in the opinion, the idea that whether the tax is in line with the fundamental freedoms depends on whether the majority of the total revenue from the special tax falls to foreign undertakings is not convincing.[80] AG believed that there is no causal relationship between them but just accidental. The cases would not be covered, for example where individual foreign undertakings are subject to quite significant tax rates, whilst many smaller domestic

[79] Judgment of C-75/18, Vodafone Case, para. 56. Also see the judgment of C-323/18, Tescol Case, para. 76.
[80] Opinion of Advocate General, C-75/18, Vodafone Case, para. 66.

undertakings with low tax rates nevertheless contribute so much to the total revenue from the special tax that the correlation would have to be rejected.[81]

In refuting the Commission's suggestion that it must be asked whether the majority of the total revenue from the special tax falls to foreign undertakings, Kokott used the French DST as an example to show that a purely quantitative examination would also have the disadvantage of causing considerable legal uncertainty in so far as regard is not had to a specific threshold. As Kokott mentioned:

> *According to press reports, the "digital services tax" just concluded in France currently covers approximately 26 undertakings, only 4 of which are resident in France. If a change in these figures in the next year led to a different legal assessment, the existence of a restriction of the fundamental freedoms (assuming the other 22 undertakings are able to rely on the fundamental freedoms) would always depend on those statistics, which are available only years later.*[82]

It can be said that this opinion basically cuts off the arguments of those who oppose the DSTs. The reason why they feel that the DSTs do not comply with the fundamental freedoms provisions of EU law is that companies paying more tax are foreign. But in fact, it may be an accidental phenomenon rather than a causal one.

Secondly, the intention of legislation will be an important factor to judge whether a tax is a discrimination or not. It is not reasonable to argue that the tax purportedly show the discriminatory objective based on what it showed. AG confirmed in the opinion that both DSTs and Hungarian taxes are enacted or proposed on the purpose of avoiding base erosion and profit shifting. Making a link to turnover could certainly attempt to remedy the inferiority of calculating profits. The same is true for DSTs. We can see the purpose in the proposal of the directive. Most technology companies get benefits from EU Member States, but they avoid paying a lot of taxes by means of transfer of profits. According to the report of EU legislators in charge of corporate tax reform, EU countries lost 5.4 billion euro in tax revenue due to tax avoidance by Google and Facebook between 2013 and 2015.[83] From this point of view, the court may consider the legislative purpose of DST and affirm its legitimacy.

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[81] Opinion of Advocate General, C-75/18, Vodafone Case, para. 67.

[82] Opinion of Advocate General, C-75/18, Vodafone Case, para. 71.

[83] EU lost up to 5.4 billion euros in tax revenues from Google, Facebook: report, Francesco Guarascio, 13 September 2017, https://br.reuters.com/article/us-eu-tax-digital/eu-lost-up-to-5-4-billion-euros-in-tax-revenues-from-google-facebook-report-idUSKCN1BO226 (accessed on 26 October 2020)

The third point is that the turnover tax itself is a very reasonable tax. According to AG, turnover is a good indicator of a company's financial capacity. The Commission raised the objection in the two cases that turnover is an indication only of an undertakings' size and market position, but not its financial capacity[84] because the Commission believed the increase in turnover does not automatically mean an increase in profit. There is no direct connection between an undertaking's turnover and its financial capacity. However, in AG's opinion, what the Commission said and what the Commission did is different because the opposite reasons are given for the proposed DST at EU level. Actually, in some situation, an indirect connection between the annual turnover generated and financial capacity can be identifiable. AG suggested that:

> *This is suggested, first, by the fact that high profits are not actually possible without high turnover and, second, by the fact that as a rule the profit from additional turnover (marginal profit) increases with falling fixed unit costs. It would therefore appear by no means unreasonable to regard turnover, as a reflection of an undertaking's size or market position and potential profits, also as a reflection of its financial capacity and to tax it on that basis.*

However, the second implication is that, we also need to realize that even though progressive turnover tax does not per se constitute the restriction of the freedom to provide services and the freedom of establishment, there are still risks in taxing in the form of groups.

As stated above, the court in the Vodafone and Tesco case held that in the Hervis case, the basis of the calculation is fictitious, leading to the inflation of an independent legal person. Thus, the law in question would be advantageous to companies that do not have their registered offices in other member countries. The tax law itself is neutral. Thus, the two cases can be distinguished from the Hervis case. However, we have noticed that in the DST, the revenue statistics are also carried out at the group level. This leads to the possibility that the result of the digital service tax may be more in favor of the Hervis case than the Vodafone and Tesco cases, which also leads to certain legal risks still existing in the DST.

[84] Opinion of Advocate General, C-75/18, Vodafone Case, para. 119.

The third implication is that, from these two cases above, we can see the attitude brought by both judges and advocate general. Actually, especially from the fact that advocate general's opinion mentioned the DST so many times, it can be seen that advocate general tries to connect these two cases with the DST and provides a positive signal for the DST from the conclusion of the two cases. In fact, this is not difficult to understand, because, first of all, the DST laws of various member states are carried out on the basis of the EU's DST proposal, and the EU itself is also devoted to the implementation of the DST. So the EU has a positive attitude towards DST. Secondly, the contents of the laws of each member state do not differ too much from the DST proposal. From this perspective, the EU does not need to worry about the situation that the implementation of the DST laws of each member state will lead to the split of the digital single market, which is one of the main values EU is now launching. Therefore, the EU's attitude towards the DST laws of member states is at least not negative. Therefore, we can also understand the role played by the CJEU in these two cases, which also expresses the Court's attitude towards the DST to some extent indirectly. From a broader perspective, it is not only about the DST itself, but also the EU's determination to govern the digital economy. The general data protection regulation (GDPR), the DST proposal, and the recent implementation of the Digital Services Act (DSA) and the digital Markets Act (DMA)[85], all mark the EU's determination to coordinate the digital single market and regulate the digital economy. Therefore, we seem to think that the overall trend of attitudes towards the digital economy is moving in favor of the DST.

Chapter 6 Conclusions

6.1 Conclusions

To sum up, the current international tax rules are challenged by the digital economy. After failing to reach an agreement at the international level for a long time, the EU chose to regulate the digital economy from the tax level by itself. Therefore, in 2018, the EU's DST proposal was introduced to tax the digital service turnover generated by big giant technology companies in the EU. However, according to Article 113 of TFEU, if the proposal is to be passed and become a formal directive, it needs the

[85] The Digital Services Act package, https://ec.europa.eu/digital-single-market/en/digital-services-act-package

unanimous consent of all Member States. Because many member states have expressed their opposition to the DST, the bill has not been passed and become a direct one even though the Parliament supports it warmly.

In this context, the member states that support the proposal have begun to implement their own DST Act, and their contents are more or less similar to those in the EU's DST proposal. However, such a digital service tax will face some problems, including the issue discussed in this paper, that is, whether these DST Acts will be inconsistent with the fundamental freedoms which are forbidden by the EU.

This paper argues that the DST Acts may produce legal risks inconsistent with the fundamental freedoms of the EU. The reason is that, first of all, as a kind of progressive turnover tax, it tries to target large enterprises with high turnover, and big often means foreign, which leads to the possible discriminatory effect of such tax laws and restricts foreign enterprises to carry out digital services in the country because the small domestic digital service providers can afford less taxes. Secondly, the calculation of digital services revenue on the group level further makes those foreign enterprises more likely to be taxed more, which increases the risk of unfair competition. Thirdly, according to the principle of technology neutrality, digital services only provide customers with traditional services through digital means. If the tax is only imposed on digital service providers rather than those traditional service providers, it may cause the possibility of discrimination. Since domestic service providers often use the traditional way to provide services, it may also have the effect of restricting foreign service providers.

However, the reasons mentioned above are just likely to lead to such legal risks. In fact, it is difficult to prove that there is a causal relationship between taxation and discrimination based on nationality. Secondly, even if it can be proved that such causal relationship exists rather than by accident, then the state can defend it through justification, because the goal of preventing tax avoidance can be considered as a reasonable justification.

Moreover, the argument that DST does not violate fundamental freedoms can also be seen in two recent decisions of the Court of Justice of the European Union. The two cases are Vodafone case and Tesco case. The industries involved in these two cases are the telecommunications industry and the retail industry. Hungary has enacted special tax laws for both industries. The Hungarian government taxes companies based

on the level of turnover. In this case, the court held that such a progressive turnover tax per se did not violate fundamental freedoms.

There are many similarities between the EU digital services tax and the tax laws involved in these two cases. First of all, their taxes are the same as the progressive turnover tax. Secondly, they all levy taxes on a special industry. Thirdly, their legislative intention is essentially to combat tax avoidance. Fourth, even though their legislative intention is to combat tax avoidance in essence, they have objectively caused discrimination based on the nationality. In fact, the Advocate General in these two cases mentioned the DST several times in the opinion, which further confirmed the connection between them.

For DSTs, these two cases are of great significance, because first of all, they have confirmed that the progressive turnover tax per se does not violate fundamental freedoms, and that discrimination against nationality is more likely to be accidental. Secondly, the two cases demonstrate the EU's positive attitude towards the digital services tax, which can also be seen from the EU's commitment to the digital economy. Of course, it is worth mentioning that these two cases did not solve the legal risk of levying tax from the group perspective for DST. But on the whole, it is less likely that digital services tax will be deemed as incompatible with fundamental freedoms.

6.2 Limitations of Current Study

At present, the limitation of this paper is that even though advocate general has compared the two cases with DST in his opinion, comparing DST with the two cases may still fall into the risk of analogy. Another limitation is that this report only discusses the possibility that the DST may violate the fundamental freedoms laid down in the TFEU. Other circumstances that may lead to disputes over DST are not considered.

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