Response to the HM Treasury position paper “Corporate tax and the digital economy”

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This document comments on the possible enactment of a tax on the revenues that businesses generate from the provision of digital services to the UK market (see Chapter 4, paras 4.8-4.12 of the position paper).

Our response will focus specifically on the interim solution that the UK government is considering with respect to online advertising service providers. Apart from established multinational players, such as Google and Facebook, for whom this is their core business model, online advertising is increasingly utilized either as a main or as a complementary source of income by other businesses that provide services or goods through an online platform (e.g. online newspapers, online video games, online retailers, platforms of the sharing economy, etc.).

1. Analysis of the online advertising business model

What differentiates the online from the offline advertising business model is the multi-party character of the transaction. It is more than just a series of transactions between the service provider (e.g. social media platforms, search engines, etc.) and the service recipient (advertisers), because users’ participation in and contribution to the value chain plays a vital role. The user, this “shadowy” third party, is neither the payor nor the payee in the transaction, but its actions (e.g. searches, clicks, likes, purchases, etc.) are the triggers which generate income for the service provider. Unless the user acts in a specific way, depending on the agreed pricing model, no payment will be made by the advertiser to the service provider.

Before proceeding to the tax issues raised by this business model, it is important to determine whether this multi-party model comprises of one transaction, between the service provider and the user on the one hand and the advertiser on the other, or two transactions performed by the service provider with the user and the advertiser separately. The answer to this question affects the tax treatment of this business model, since each separate transaction constitutes a separate taxable event and should be examined on its own merits for tax purposes.

There is a strong argument that this business model cannot be broken down into two separate transactions[1]. The defining elements of a transaction are the provision of a good or

[1] A. Prussak, ‘The Income of the Twenty-First Century: Online Advertising as a Case Study for the Implications of Technology for Source-Based Taxation’ [2013] Tul. J. Tech. & Intell. Prop. 39, 52.

service for a consideration, either in cash or in kind. In the examined relationship, no consideration is paid from the user to the service provider. The access to the provider's platform is provided without charge, while the claim that the provision of the user's data constitutes a consideration in kind in exchange for the "free" use of the platform is unconvincing in a tax context[2]. The reason for this is that the data provided by the user do not have any potentially taxable value, at least at the time they are provided, and the value those data subsequently acquire (if any) differs depending on various factors. Treating this use of the platform as a separate taxable transaction would require acceptance that the value of the consideration supplied by the user cannot be identified at the time of the transaction, but rather that the price paid is to be determined by assessing the subsequent value which the service provider is able to generate by use of the data in combination with other data. This value might be assessable in aggregate, but seems to us impossible to break down into the value contributed by each individual user's specific platform activities.

This conclusion could be also supported by HM Treasury's statement regarding users' "sustained engagement and active participation" (para 3.16), based on which the users do not appear as the service providers' counterparties but instead as their partners, acting as contributors and co-creators of value in the supply chain[3].

Therefore, based on this analysis we conclude that the online advertising business model consists of only one transaction, i.e. the provision of online advertising services to the advertiser who in return pays an amount to the service provider depending on the advertiser's bid and which (amount) is paid upon the occurrence of an event depending on the agreed pricing model, e.g. Cost-Per-Mille (CPM) views, Cost-Per-Click (CPC), Cost-Per-Action (CPA), etc.

From a tax perspective, this means that the users' activities, or more accurately the collective of activities by users in the UK, are not to be considered as taxable transactions but rather as the possible basis of a nexus for treating the income generated from the transactions between the service provider and the advertiser as being sourced in the UK, and thus as being taxable in the UK.

2. Meaning of an "active user base"

The HM Treasury consultation adopts the terms "user base", "sustained engagement and active participation" and "active involvement of users" in this context. It is important to analyze the meaning of these terms, and then determine whether, and if so how, this user

[2] There may well be a contractual relationship, with the data providing consideration from user to service provider, but taxation is based on revenue or income rather than on the mere exercise of a contract.

[3] Martijn L Schippers and Constantijn E Verhaeren, '*Taxation in a Digitizing World: Solutions for Corporate Income Tax and Value Added Tax*' (2018) 27 EC Tax Review 61, 64. This article presents the main points of the Forum Discussion on the EFS Seminar held at the Erasmus University Rotterdam on 11 October 2017. In this forum Professor Colin referred to the users' contribution in the creation of value and to the fact that the users are no longer at the end of the value chain, but are instead active and shifting to the middle of the chain.

base contributes to the value chain in a way that creates an appropriate nexus for tax purposes.

2.1. First option - Broad definition

Under a broad definition, a user could be considered as any person that provides data (even unconsciously) through various actions (e.g. searches, uploading of documents, posting of information relating to his/her status, etc.) that allow the provider to create an as accurate as possible profiling for this user. In this broad sense, “active user base” actually means data.

Data have no intrinsic value, but instead the collection, processing and sale of these processed data are the functions that generate value for the service provider[4]. These value generating functions are performed by the service provider who possesses the relevant IT resources and algorithms. Thus, at first, sight, it might seem that the user plays no role in this value creation.

However, the active participation of the users and their contribution to the value creation through the provision of their data can justify the proposition that they “melt into” the service provider, in such a way that they become part of the production of the service rather than mere consumers of the service[5]. But this does not produce a nexus for taxation in the UK. On this view, the value that is created through their contribution is sourced from and should, thus, be attributed to the origin jurisdiction (the jurisdiction from which the service is provided), rather than the market jurisdiction (the jurisdiction where the user is located)[6]. This approach is also consistent with the conclusion that the examined multi-party business model comprises of one transaction (see section 1 above), based on which the user does not transact with the service provider but instead collaborates with the latter in the process of value creation.

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[4] The mere collection of data is regarded as a preparatory or auxiliary activity. Para. 42.7 of the *OECD Model: Commentary on Article 5* (2003) states that: “Another issue relates to the fact that no permanent establishment may be considered to exist where the electronic commerce operations carried on through computer equipment at a given location in a country are restricted to the preparatory or auxiliary activities covered by paragraph 4. The question of whether particular activities performed at such a location fall within paragraph 4 needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. Examples of activities which would generally be regarded as preparatory or auxiliary include: - […] gathering market data for the enterprise”.

[5] Task Force on Taxation of the Digital Economy, *Report to the Minister for the Economy and Finance, the Minister for Industrial Recovery, the Minister Delegate for the Budget and the Minister Delegate for Small and Medium-Sized Enterprises, Innovation and the Digital Economy by Pierre Collin, Conseiller d'État, and Nicolas Colin, Inspecteur des finances*, 18 Jan. 2013, available at http://www.economie.gouv.fr/rapport-sur-la-fiscalite-du-secteur-numerique (Collin and Colin Report), at p. 49: “User-generated data are put back into the production chain in the digital economy, blurring the dividing line between production and consumption”.

[6] Article 7 of the OECD, *Model Tax Convention on Income and on Capital* (2014) (hereafter, OECD Model) provides that “Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein”. Thus, under international tax law the right to tax business profits is granted to the state of residence rather than the state of source, where the company carries on its business or where the users are located, unless a permanent establishment exists in the source state, i.e. the income generating business activities reach a certain level of physical and temporal permanency in the source state.

This approach would not, therefore, produce a shift to a destination-based taxation in the market jurisdiction. Instead it is consistent with the current international tax principles of origin-based taxation in the place from which the profits/value is sourced. In the examined business model, this is the place of residence of the online advertising service provider who possesses the algorithms and the know-how to give value to the vast amount of raw data which the users provide.

This approach is also consistent with the transfer pricing framework. Under this framework, no profits may be attributed to the jurisdiction of the user being perceived as the consumer, since the market jurisdiction and destination-based approach are not relevant from a transfer pricing perspective. What is relevant is the origin of the income, which is determined based on significant people functions, assets used and risks assumed. In the online advertising business model, the data processing activities through the utilization of IT resources and algorithms are the relevant people functions and assets, which are performed and used by the service provider in its place of residence.

Under this analysis, there does not seem to be any frustration of the principle of aligning profits with value creation. The profits are attributed to the place where value is created, i.e. to the service provider's place of residence, thus excluding the UK where the users are located from exercising any taxing rights.

The UK will be able to exercise its taxing rights, only if it is the place where the intellectual property and algorithms that enable the collection and processing of user data have been developed or the place where raw data are converted into a tradeable product. In addition, by analogous application of the Commentary on Article 5 of the OECD Model (2003) on e-commerce[7], the UK could exercise its taxing rights, if the data centres and servers for the storing and processing of user data are located within UK territory.

Use of a broadly defined active user base in the UK market as a nexus criterion[8] would require a redrafting of the tax treaties, i.e. amendment to the tax treaty definition of permanent establishment[9], the profit attribution guidelines[10] and the transfer pricing guidelines[11], with a shift towards taxing profits or turnover in the jurisdiction where the service users or consumers are located. This could be achieved either through the adoption of a destination-based approach[12] or through the redefinition of the thresholds for allocating

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[7] OECD (2003), *Model Tax Convention on Income and on Capital: Condensed Version 2003*, OECD Publishing, Paris, in particular Art. 5 para. 42.1 et seq.

[8] Collin and Colin Report, *supra* n. 5, in which the authors propose that a PE should be found to exist when a company carries on a business in a country using data obtained through the regular and systematic monitoring of web users in that country, since according to the authors data is the main source of revenue for digital companies.

[9] Article 5 of the OECD Model.

[10] Article 7 of the OECD Model; OECD, *Report on the Attribution of Profits to Permanent Establishments* (OECD 2010).

[11] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017).

[12] P. Hongler & P. Pistone, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy - Working paper 20 January 2015* (IBFD 2015); Y. Brauner & P. Pistone, 'Adapting Current International Taxation to New Business Models: Two Proposals for the European Union'

taxing rights between the residence and the source state moving away from the physical presence threshold towards an expansion of the source taxation of business income[13]. The examination of these considerations goes beyond the scope of the present comments.

2.2. Second option - Narrow definition

Under a narrow definition of the "active user base", a user would be a person that proceeds to specific actions whose performance triggers the payment from the advertiser to the service provider of a specific amount, depending on the terms that have been agreed with between the advertiser and the service provider, and especially depending on the pricing model, e.g. CPM, CPC, CPA, etc. This definition attempts to find a direct causal link between the members of the active user base and the generation of income, and the most plausible link seems to be the occurrence of the event (e.g. search, click, purchase, etc.) that triggers the payment from the advertiser to the service provider and ultimately the generation of income for the latter. Under this approach, the mere existence of a user base in a jurisdiction does not suffice on its own to be used as a valid indication and criterion for value creation. Instead, the nexus for taxation is based on a revenue-generation criterion which is causally linked to individual users, i.e. deriving from their actions[14].

This definition is also consistent with the conclusion that the online advertising multi-party business model consists of only one transaction (see section 1 above). Even if it were conceptualized as a two-transaction scenario, in which case the provision of data would be considered as a payment in kind for the use of a platform, the profits generated by this remote provision of services would be attributed to the country of origin.

If this option is selected, the difficult task of data valuation is avoided. For example, in a CPA pricing model the only data which have value are those which match with an advertiser's bid/search keywords resulting in the appearance of that advertiser's advert to the user. Additionally, the data only have value after the performance of a particular action by the user (purchase, like, registration, etc.), which is what ultimately realizes a payment from that advertiser to the service provider. The value that could be attributed to these data will then relate to the amount that has been ultimately paid to the service provider. On the other hand, specific data which do not ultimately lead to the realization of a payment from the advertiser to the service provider, either because they did not match with an advertiser's bid or because, even though they matched, the user on whose platform the advert appeared did

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[2017] Bull. Intl. Taxn. 681, in particular section 3, in which, apart from the introduction of a new paragraph into article 5 of the OECD Model providing for "*a threshold based on the number of users and turnover within a given period*", an alternative option to be applicable at an EU level is also examined suggesting an intervention at the level of interpretation, thus avoiding any renegotiation of the tax treaties.

[13] D. Blum, 'Permanent Establishments and Action 1 on the Digital Economy of the OECD Base Erosion and Profit Shifting Initiative 0 The Nexus Criterion Redefined?' [2015] Bull. Intl. Taxn. 314, 316.

[14] See in this regard P. Hongler & P. Pistone, *supra* n. 12, in particular section 4.2, where reference is made to the four elements that should be fulfilled for the new PE nexus to exist, i.e. (i) digital services, (ii) user threshold, (iii) time threshold, and (iv) a *de minimis* revenue threshold, while emphasis is given to the requirement that this revenue is linked to the digital services. The requirement for this link is referred to in the indicative wording of the new nexus definition as follows: "if the total amount of revenue of the enterprise due to the aforementioned services in the other Contracting State exceeds XXX per annum".

not proceed to any action, do not generate any revenue to the service provider and, thus do not have any value. In any case, the tax base should be clearly defined, especially when users are not located in the same jurisdiction as advertisers.

Under this approach, the jurisdiction in which (a part of) the online advertising profits should be attributable may easily be determined. This is the jurisdiction in which the user whose actions have triggered the payment of the agreed amount from the advertiser to the service provider has acted, e.g. searched keywords that caused the appearance of an advert in the search results, clicked on an advert, liked the advertiser's page, purchased a product, subscribed, etc. The approach thus justifies an element of destination-based taxation.

If this definition is adopted by HM Treasury, the tax contemplated could be structured according to one of three options: equalization levy, withholding tax[15] or transaction tax on revenues generated from the collection of digital data. A revision of the permanent establishment rules and the transfer pricing model could also constitute an option, but this can only be regarded as a long-term solution because its application requires a broad international consensus, so that it cannot be adopted as a unilateral measure as is envisaged by HM Treasury in the consultation.

It should be clarified that, as a general principle, withholding taxes are imposed on payments effected as a consideration for the provision of goods or services. In the online advertising business model, which, as already analyzed, only consists of one transaction, a payment is realized only between the advertiser and the service provider. The users do not make any payment to the service provider. So, considering that the rationale behind the examined interim solution is the existence of an active user base (narrowly defined) in the UK market, we need to ask on which payment is this new tax going to be withheld, bearing in mind that this active user base does not make any payment. Clearly the withholding tax would need to be computed by reference to the payments from advertisers, which means that the withholding tax option does not have any practical difference from the other two options.

All these three options are destination-based and turnover taxes which would result in the allocation of taxing rights to the market jurisdiction. In any of these three scenarios, unless a tax credit is granted by the origin state under the relevant tax treaties, resulting in a corresponding reduction of the origin state's tax revenues, multiple taxation of the same profits, i.e. advertising profits, would be suffered by the service provider. Thus adoption of any one of these options requires further consideration of those tax treaties, though this is outside the scope of our response.

[15] See OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD Publishing, Paris (hereinafter OECD/G20 BEPS Action 1), para. 7.6.3., where the option of a withholding tax on payments by residents is considered. A distinction is made between (i) a standalone gross-basis final withholding tax, and (ii) a non-final withholding tax used as a primary collection mechanism and enforcement tool to support the application of the nexus option based on the significant economic presence. In the present comments only the first approach is examined, which has a lot of similarities with an equalization levy, as well as with a transaction tax. The second approach requires an examination of the significant economic presence which, as already noted, is outside the scope of these comments. For a more thorough analysis of this option, see Y. Brauner & A. Baez Moreno, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy* (IBFD 2015).

Regard should be also given to the recent decision of Facebook to start recording advertising revenues in countries in which it has local offices. The revenues deriving from the actions of the UK user base could be attributed and recorded to this local office to constitute the taxable base for the imposition of the new tax. Nevertheless, such an option is not supported by the current OECD Model rules on attribution of profits, which preclude the application of a 'force of attraction' principle[16].

In any case, as an effective collection mechanism, related parties within the UK could be made jointly and severally liable. In this way, the tax may be collected directly from the UK related party of the social media/search engine owner without the use of financial intermediaries, even though the provision of online advertising services is made through a company located outside the UK. This collection mechanism does not offer a solution for the case of companies with no UK office/subsidiary. Alternatively, the withholding mechanism that is used for VAT purposes could be used as a role model, i.e. the MOSS (mini one-stop-shop), in which case the service provider would be liable to withhold the tax[17].

3. Possible tax implications of a tax on revenues

Any novel tax on revenues, either according to an arbitrary threshold or based on the approach explained under 2.2. above, is potentially open to challenge.

3.1. Tax on gross income

Taxes are imposed either on (gross or net) income or on sales. When taxes are imposed on gross income (e.g. withholding taxes), it should be examined whether a credit is provided under a tax treaty in the taxpayer's residence state. If no tax credit is available under the tax treaties, the taxes being considered would be functionally equivalent to the predecessors of value added tax (VAT), i.e. cumulative cascade taxes (sales and use taxes). Taxes of this nature have been replaced by VAT because they distorted the functioning of the internal market.

In addition, taxes imposed on gross income have no relationship with net income, which is the only proper base for a corporate income tax, and thus are incompatible with the ability-to-pay principle. In particular, a tax on revenues does not allow any costs to be deducted in the origin state and also it takes no account of the enterprise's capacity to fund or bear its taxes from profits. This method appears problematic especially with respect to loss making companies, an incidence that is common in the case of startups engaged in the provision of digital services. And even once a startup becomes an established player, it may be many years before it generates profits. A tax on revenues cannot properly be described as a tax on income, because it is automatically levied irrespective of whether a company is profitable or

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[16] OECD Model, Commentary on Article 7, para. 12: "The second principle … is that the right to tax of the State where the permanent establishment is situated does not extend to profits that the enterprise may derive from that State but that are not attributable to the permanent establishment…[T]he general force of attraction approach … has now been rejected in international tax treaty practice".

[17] Blum, *supra* n. 13, 324.

not. Turnover-related taxes can even transform activities that are profitable before tax into loss-making activities after tax. These consequences distort the market and discourage investment in new and innovative products and services.

Market distortion could be also caused by the resultant increase in the cost price of goods and services supplied digitally, in the examined case the cost of providing online advertising services, considering that some players in this business sector operate as quasi-monopolies.

3.2. Compatibility with tax treaties

All three options seem to be outside the scope of tax treaties (art. 2 of the OECD Model)[18]. With respect to the option of a withholding tax, as already explained, since no payment is taking place in the jurisdiction where the users are located, the characteristics of this withholding tax are similar if not identical to those of an equalization levy[19].

The imposition of an equalization levy, withholding tax or transaction tax by the UK market where the users are located would create a risk of international double taxation, since the residence state of the online advertising service provider would not be obliged to provide relief under the applicable tax treaty[20].

3.3. Compatibility with EU Law

The new tax should be examined with a view to assessing its compatibility with EU primary law, i.e. fundamental freedoms and state aid rules, and secondary law, i.e. Directives. The UK will need to comply with these laws at least until the end of the Brexit transition period and will be subject to any tax obligations negotiated as part of the new UK/EU relationship.

As a first remark, if the intention of the new tax is to operate as an "equalizer", it would be in principle contrary to the Court of Justice of the EU (CJEU) jurisprudence. Any tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used by another Member State to justify less favorable treatment in tax matters given to recipients of services established in

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[18] See A. Mehta, *Is the Indian equalisation levy compatible with India's existing tax treaty network?* (White Paper 1), available at https://dramarmehta.com/Equalisation-Levy-White-Paper-2-June%202016.pdf, where it is argued that the equalization levy seems to be in the nature of a tax on income, in which case art. 7(1) of the applicable tax treaty is likely to preclude its imposition in the absence of a permanent establishment in India. The author concludes that, since the equalization levy is incompatible with the existing Indian tax treaty network, so that its application may amount to treaty dodging, the only way forward is the renegotiation of the tax treaties.

[19] If this withholding tax was imposed on a payment (e.g. payment effected by the advertiser to the online advertising service provider), it would fall within the scope of tax treaties, in which case an amendment of the OECD Model would be required through the addition of a new paragraph in article 7, otherwise tax treaty override would occur; see in this regard, Y. Brauner & A. Baez Moreno, *supra* n. 15, in particular para. 5.7.

[20] OECD/G20 BEPS Action 1, in which the OECD suggested that an equalization levy is structured so that it applies only to 'situations in which the income would otherwise be untaxed or subject only to a very law rate of tax'.

the latter State[21]. Such a tax would be incompatible with the freedom to provide services within the EU, under Art. 56 of the Treaty on the Functioning of the EU (TFEU).

From an EU primary law perspective, a domestic measure that distinguishes between residents and non-residents could be incompatible with the fundamental freedoms provided under the Treaty on the Functioning of the European Union (TFEU)[22], unless justified by overriding requirements in the public interest. Revenue losses are not considered, on their own, as a valid justification for a restrictive measure[23]. By contrast, the need to prevent tax avoidance and evasion could constitute a justification, but only if the domestic measure specifically targets wholly artificial arrangements[24]. If the examined options are applied only to non-residents, the measure will be contrary to the freedom to provide services because it is not possible to argue that the online advertising model is a 'wholly artificial' arrangement.

Such taxes could be compatible with the EU fundamental freedoms only if they were applied identically to resident and non-resident online advertising service providers operating under comparable circumstances. Even so, a tax on revenues is contrary to the parity requirement, under which resident and non-resident taxpayers need to be treated in an equivalent way, because the new taxes would be levied on a gross basis whereas profit taxes in equivalent domestic situations are levied on a net basis[25].

In addition, EU state aid law could be applicable (Art. 107 TFEU), if the condition of selectivity is met. This would be the case if a new tax is imposed on online advertising service providers and results in a higher burden for certain undertakings as compared to other undertakings that are in a comparable legal or factual situation[26]. Therefore, the design of the new tax would need to consider these limitations and avoid creating asymmetric burdens.

From an EU secondary law perspective, EU law precludes Member States from introducing turnover taxes in addition to VAT[27]. To be considered as a turnover tax, the new tax must exhibit the main characteristics of VAT. Considering that the new tax will be borne by the service provider, instead of the service recipient and ultimately the consumer, and thus that

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[21] See in particular, Case C-294/97 *Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna* [1999], ECR I-07447, paras 44 – 45.
[22] Consolidated Version of the Treaty on the Functioning of the European Union [2008] OJ C115/47 [hereinafter TFEU].
[23] Case C-307/97 *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt* [1999], ECR I-06161, para. 50; Case C-136/00 *Rolf Dieter Danne* [2002], ECR I-08147, para. 56; Case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-07995, para. 49.
[24] *Cadbury Schweppes* [2006] ECR I-07995, para. 55.
[25] Case C-234/01 *Arnoud Gerritse v Finanzamt Neukölln-Nord* [2003] ECR I-05933; Case C-265/04 *Margaretha Bouanich v Skatteverket* [2006] ECR I-00923; Case C-18/15 *Brisal - Auto Estradas do Litoral SA and KBC Finance Ireland v Fazenda Pública* [2016] ECLI:EU:C:2016:549.
[26] See in this regard, Case C-143/99 *Adria-Wien Pipeline GmbH, and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten* [2001] ECR I-8365; Case C-308/01 *GIL Insurance Ltd and Others v Commissioners of Customs & Excise* [2004] ECR I-4777; Case C-88/03 *Portuguese Republic v Commission of the European Communities* [2006] ECR I-7115, with regard to the assessment of the presence of legal and factual selective advantages.
[27] See Art. 401 of Council Directive 2006/112/EC of 28 November 2006.

it is not an all-phase, input-deduction tax, it could be argued that this new tax does not meet the characteristics of a turnover tax[28]. Therefore, it does not seem to be covered by the prohibition on introducing turnover taxes.

3.4. Compatibility with International Trade Law

As the tax base of the new tax will be online advertising services, the part of the World Trade Organization (WTO) agreements that is relevant is the General Agreement on Trade in Services (GATS). GATS is applied to state measures, e.g. laws, regulations, rules, procedures, administrative decisions, etc., that affect the trade of services. GATS incorporates two non-discrimination clauses: the most-favored nation (MFN) and the national treatment clauses. Under the MFN obligation, a state has the duty to grant another state a treatment no less favourable than the one granted to a third state (Art. II). Since the new tax is not intended to be applicable in a different way to different states, the MFN rule, which concerns discrimination between foreigners, is not relevant.

On the other hand, the national treatment rule is relevant (Art. XVII). This rule concerns the obligation of a state to grant the services and service suppliers of another state a treatment that is not less favourable than the one granted to its own like services and service suppliers. If the new tax is structured so that it only applies to foreign online advertising service providers, thus levying an additional burden to the latter unlikely to be creditable by the state of residence, the application of the national treatment rule will be triggered.

Although GATS does not define the concept of services[29], each WTO member must set out in a schedule the specific commitments it undertakes, i.e. choose the service sectors and modes of supply to which the national treatment requirement applies (Art. XX (1)). Once the services and modes of supply are determined, WTO members are free to impose national treatment limitations[30].

Advertisement services are included in the Schedule of Specific Commitments to National Treatment under GATS which applies to the EU[31], and thus the UK[32]. Based on this schedule, no limitation on national treatment applies with respect to the provision of advertising services from the territory of one WTO member into the territory of another WTO member (cross-border mode of supply 1). Even though no express reference is made to online

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[28] G.W. Kofler, G. Mayr & C. Schlager, 'Taxation of the Digital Economy: "Quick Fixes" or Long-Term Solution?', [2017] Eur. Taxn. 1, 11.

[29] GATS Art. I (3b) states that "*"services" includes any service in any sector except services supplied in the exercise of governmental authority*".

[30] During the Uruguay Round of negotiations (1986-1994), WTO participating countries made market-access commitments and exemptions on a number of services sectors. The Schedule of Commitments for each participating country may be found at the following link: https://www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm.

[31] The EU Schedule of Specific Commitments may be found at this link: https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=31391,10335,2244,15832,33570,37471,26509&CurrentCatalogueIdIndex=6&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True. The market access and national treatment limitations for advertising services are referred to in sector F. Other Business Services, subsector a) Advertising (CPC 8710).

[32] The UK is a WTO member partly in its own right and partly as a member of the EU.

advertising, the GATS commitment should be considered as covering this service as well. So long as the technology involved does not alter the intrinsic nature of the service outputs, the latter's classification should not be affected (technological neutrality)[33]. In addition, because the digital economy is becoming the economy itself, any attempt to ring-fence it from the rest of the economy, and thus exclude from GATS commitments any service in which information technology is applied, is almost impossible[34] and runs contrary to the technological neutrality principle[35].

Nevertheless, some exceptions apply to the national treatment rule, subject to the general requirement that they do not constitute arbitrary or unjustifiable discrimination or disguised restrictions on trade in services (Art. XIV). With respect to the fiscal measures of a WTO member, these may be justified as legitimate exceptions to the national treatment obligation, if they are "*aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members*" (Art. XIV (d)). However, the new tax to be imposed on revenues derived from the provision of online advertising services could not be legitimated by this exception, since, based on the definition of direct taxes[36], this exception only covers taxes on income or on capital, thus excluding taxes on turnover or taxes that have the characteristics of sales taxes.

It should be noted that, when the UK leaves the EU, it will remain a WTO member, but without specific commitments[37]. Since the intention of the UK is to seek to replicate the existing set of commitments[38], our above comments will remain relevant.

We therefore conclude that any new tax is likely to be incompatible with WTO commitments, and in particular with the UK's national treatment obligation under GATS. A potential solution to this probable violation of the national treatment rule in GATS is to ensure equal treatment of domestic and foreign service providers by imposing the tax on both domestic and foreign service providers[39].

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[33] WTO Working Paper, *Covered or Not Covered: That is the Question*, (2015), 9, where specific reference is made to online advertising services.

[34] OECD/G20 BEPS Action 1, p. 11

[35] The Indian equalisation levy, which is imposed on the consideration for the provision of digital advertisement, has not raised any GATS compatibility issues, because India has not included advertising services in its schedule of commitment to national treatment.

[36] As provided for under Art. XXVIII (o): "*"direct taxes" comprise all taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation*".

[37] Roberto Azevedo, the Director-General of the WTO, said that "*Britain is a member of the WTO and will continue to be a member of the WTO. But it will be a member with no country-specific commitments*" (The Guardian, Tuesday 7th June 2016).

[38] On 5 December 2016 Dr Liam Fox made a written statement, in which it stated that: "*In order to minimize disruption to global trade as we leave the EU, over the coming period the Government will prepare the necessary draft schedules which replicate as far as possible our current obligations*" (UK'S COMMITMENTS AT THE WORLD TRADE ORGANIZATION: Written statement - HCWS316, available at https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2016-12-05/HCWS316/).

[39] G. Rajgopalan, 'Equalisation Levy – Applicability of Non-Discrimination Rules in International Agreements', available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2815109.

4. Conclusions

i) The online advertising business model comprises of one transaction, between the service provider and the user on the one hand and the advertiser on the other. This approach is supported by the concept that the user is a contributor to the value creation rather than a consumer.

ii) The application of a broad definition of 'active user base' does not lead to the attribution of any taxing rights to the UK but rather to the origin jurisdiction, whereas the application of a narrow definition creates a suitable nexus for tax purposes in the UK market. This definition links the generation of income with specific actions performed by the user in the UK market (e.g. search, click, purchase, etc.).

iii) A new tax imposed on the revenues derived by foreign online advertising service providers is contrary to the ability-to-pay principle and performs as a cumulative cascade tax having distortive consequences and hindering the investment.

iv) This new tax will be out of scope of the UK's double tax treaties and will not create any obligation to the residence state to provide a credit, thus creating a risk of double taxation.

v) This new tax will be contrary to the freedom to provide services within the EU (Art. 56 TFEU). The condition of selectivity for state aid purposes could be applicable, in case this new tax creates a higher burden for certain undertakings as compared to others that are comparable.

vi) This new tax will be contrary to GATS national treatment obligation without the possibility of applying any exception, unless it also applies to equivalent UK service providers.