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DIALOGUE AND DEBATE: SYMPOSIUM

Taxing data when the United States disagrees

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Abstract

What is the best way to tax data-driven business models without contravening the existing global quasi-constitutionalist order on tax, trade, and investment law? A number of countries in Europe and around the world have begun imposing standalone digital services taxes pending multilateral agreement on a coordinated reform of bilateral income tax treaties (aka the OECD-G20/Inclusive Framework's 'Pillar 1'). But if Pillar 1 fails to materialise and countries go forward with unilateral digital services taxes, the United States and U.S. firms will likely seek redress using domestic measures as well as trade and investment treaties where applicable. This Article argues that in the face of such U.S. resistance, EU member states and countries elsewhere ought to reconsider using the income tax system to achieve their goals instead. We first review the events that led countries to avoid the income tax in favour of standalone taxes only to become embroiled in domestic U.S. trade policies. We then explain how European and other source jurisdictions for business services related to data collection, mining, and commercialisation could revisit the income tax to get to the same tax base, namely by taking an ambulatory interpretation approach to provisions in existing tax treaties in a way that renders possible to accommodate withholding taxes on those services. We show that an ambulatory interpretation approach could achieve the underlying goals of taxing data-driven businesses, in some cases even without any domestic law or treaty reform, with treaty-based rules for dispute resolution a ready tool to draw upon if and when the United States disagrees.

Keywords: Tax law; trade law; investment law; data economy; treaty interpretation

1. Introduction

Why might countries seek to tax data-driven firms, and if there are good reasons to do so, what kind of rules would be most feasible to adopt without contravening the existing global quasi-constitutionalist architecture on tax, trade, and investment law? An independent surtax on a specified base, such as the digital services taxes that have proliferated in Europe and throughout the world over the past several years, appeared at one point to be the most viable option for taxing highly digitalised companies,[1] given the absence of a multilateral agreement to reform the international treaty-based tax regime. Yet the United States quickly demonstrated its opposition when it declared those taxes to be tariffs deserving of retaliatory measures. The Organisation for Economic Co-operation and Development (OECD) met the U.S. opposition by formulating a reform plan called Pillar 1. However, this multilateral solution now appears equally vulnerable to

[1]The popularised acronyms GAFA (Google, now called Alphabet; Amazon; Facebook, now called Meta; and Apple) or FAANG (Facebook, now called Meta; Amazon; Apple; Netflix; and Google, now called Alphabet) provide the ubiquitous case, with other producers of digital services and online platforms operating in the data sector, such as Microsoft, Airbnb, Uber, Instagram (owned by Meta), Twitter (now called X), LinkedIn, and TikTok also included.

U.S. resistance, and if the United States obstructs Pillar 1, other countries will revert to unilateral digital services taxes. The foreseeable scenario is that the United States will retaliate with countervailing tariffs.

This Article shows that there is (and always has been) a potentially more viable alternative to standalone digital services taxes, namely: bringing specified data-related income streams under domestic income tax withholding provisions. If existing national regimes are insufficiently clear on the matter, lawmakers at both the domestic and the EU level could consider explicitly defining such income streams as a distinct income category subject to withholding in their own right. Although some observers might protest that this kind of reform conflicts with various international tax norms or practices, the OECD at one point explicitly acknowledged that withholding might be a feasible tool for taxing the data economy. Nevertheless, the OECD quickly abandoned the idea with virtually no analysis. In light of the subsequent stalling of progress on the proposed multilateral solution and the clear risks that continue to attend to unilateral digital services taxes, revisiting the withholding option appears to be the better strategy.

This Article accordingly argues that given the range of possible legal challenges that the United States and U.S. firms might bring against new taxes created by other countries outside the international tax regime, extending to data-related service fees the withholding income-based tax treatment traditionally applied to outbound payments might currently be the best alternative to tax data. In Section 2 we investigate possible barriers to data taxation arising from the global constitutional-like order on tax, trade, and investment, by examining legal and political challenges that the United States and U.S. firms have pursued or are likely to pursue in opposition to foreign countries' attempts to tax data firms via unilateral digital services taxes or a multilaterally coordinated redesign of tax treaties. In Section 3 we argue that returning to the international income tax system, specifically by working strategically with treaty provisions that allow withholding taxes at source, such as royalties, other income, and technical services, might forestall such retaliatory action. In Section 4 we demonstrate that the proposed approach is legally defensible because international law allows various methods of treaty interpretation, including contextual and purposive readings that could be used to validate the withholding solution even when a standard tax treaty is involved.

2. The global quasi-constitutionalist order of tax, trade, and investment

The early adopters of digital services taxes designed them to fall outside the income tax system in order to avoid direct clashes with tax treaties on income and capital.[2] India took the lead with a 6 per cent-rated 'Google tax' (formally called an equalisation levy) in 2016, followed by Hungary's introduction of a 7.5 per cent-rated digital services tax that was, as of July 2019, reduced to 0 per cent.[3] In 2017, the United Kingdom issued a position paper accompanied by a consultation process and the year after the European Union proposed but did not adopt a digital services tax directive on revenues from targeted advertising and digital interface services.[4]

[2]Multiple scholars share the view that those taxes are not covered by tax treaties according to Article 2 of the OECD Model Tax Convention. D Hohenwarter et al, 'Qualifications of the Digital Services Tax Under Tax Treaties' 47 (2019) Intertax 140, 147; G Kofler and J Sinnig, 'Equalization Taxes and the EU's "Digital Services Tax"' 47 (2019) Intertax 176, 195; R Ismer and C Jescheck, 'Taxes on Digital Services and the Substantive Scope of Application of Tax Treaties: Pushing the Boundaries of Article 2 of the OECD Model?' 46 (2018) Intertax 573, 578; KE Karnosh, 'The Application of International Tax Treaties to Digital Services Taxes' 21 (2021) Chicago Journal of International Law 513, 547; W Cui, 'The Superiority of the Digital Services Tax Over Significant Economic Presence Proposals' 72 (2019) National Tax Journal 839, 852; YR(C) Kim, 'Digital Services Tax: A Cross-Border Variation of the Consumption Tax Debate' 72 (2020) Alabama Law Review 131, 171–2.

[3]A Christians, 'CTF Digital Tax Log' (July 10, 2020) Entry #2B <https://www.ctf.ca/EN/Newsletters/Blogs_and_Reports/Digital_Services_Updates/Entries/Entry02B.aspx> accessed 9 December 2024.

[4]Ibid.

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In January 2019, Belgium proposed a 3 per cent tax on the sale of user data that was first rejected but then reintroduced in July of the same year.[5] New Zealand and France released proposals in February and March of 2019, with France adopting, later in the year, a retroactive 3 per cent-rated digital services tax on gross revenues from the provision of digital interfaces, targeted advertising, and user data transmission.[6] Entering into force of the French tax was delayed to the end of 2020 due to US threats of retaliation.[7]

In November 2019, the Czech Republic proposed a 7 per cent tax on revenues from targeted advertising, user data, transmission, and digital services.[8] In December 2019, Canada announced a plan to impose a 3 per cent tax on sales of online ads and user data that would only enter into force in 2024 after stalled negotiations on a multilateral solution at the level of the OECD. Also in December 2019, Slovenia opened a consultation on a proposed digital services tax and Slovakia announced it would submit a draft legislation.[9]

In January 2020, Austria adopted a 5 per cent tax on revenues from online advertising or any type of software or website rendered in the country, Italy adopted a 3 per cent tax on advertising on a digital interface, multiplatform for buying or selling goods and services, and transmission of user data generated from a digital interface, Latvia commissioned a study on a 3 per cent-rated digital services tax, and Norway announced the intention to introduce a tax in 2021 in case a multilateral agreement was not reached by the OECD by the end of 2020.[10] In February 2020, Spain adopted a 3 per cent tax on revenues from online advertising and user data transmission.[11] In March 2020, Turkey adopted a 7.5 per cent tax on advertising services via digital platforms, digital sales, and services provided on digital platforms, anticipating the possibility of raising the rate to 15 per cent.[12] Also in March 2020, Indonesia introduced a digital permanent establishment coupled with a specific tax on e-transactions (program-making and special events) applying to foreign merchants, service providers, and digital platforms.[13]

By April 2020, India had announced the expansion of its equalisation levy to include e-commerce supply and services, the United Kingdom adopted a 2 per cent-rated digital services tax on revenues of search engines, social media platforms, and online marketplaces, and Poland announced a plan to introduce a 1.5 per cent surcharge on revenues from video-on-demand platforms.[14] In May 2020, Brazil proposed to apply its contribution for intervention in the economic domain (CIDE—*contribuição de intervenção no domínio econômico*) to digital advertising, service, and user data transmission revenues, with a progressive rate structure of 1 per cent, 3 per cent, and 5 per cent.[15] In June 2020, the European Union reintroduced a proposal for a 3 per cent digital services tax on revenues from targeted advertising and digital interface services. This proposal failed to obtain unanimous approval by member states and in 2023 the Commission submitted but then suspended an EU digital levy directive pending completion of Pillar 1 negotiations.[16]

Summing up the state of digital services tax adoption in Europe in 2024, Austria, Denmark, France, Hungary, Italy, Poland, Portugal, Spain, Switzerland, Turkey, and the United Kingdom

[5] Ibid.
[6] Ibid.
[7] Ibid.
[8] Ibid.
[9] Ibid.
[10] Ibid.
[11] Ibid.
[12] Ibid.
[13] Ibid.
[14] Ibid.
[15] Ibid.
[16] JM Vázquez, 'Digital Services Taxes in the European Union' (14 February 2023) Kluwer International Tax Blog <https://kluwertaxblog.com/2023/02/14/digital-services-taxes-in-the-european-union-what-can-we-expect/> accessed 9 December 2024.

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have all implemented the tax, Belgium and the Czech Republic have so far only put forward proposals, and Latvia, Norway, Slovakia, and Slovenia have either announced a plan or shown intentions to do so.[17]

Against this background, the following sections examine the legal and political barriers that the United States and U.S. firms have leveraged or are likely to leverage in opposition to these taxes. Such barriers arise from the confluence of global power imbalances with various treaty-based tax, trade, and investment norms that form a constitutional-like order that sets a framework for cross-border business activities while constraining individual state action and reform.[18] Beyond what countries voluntarily agree to under treaties on tax, trade, or investment, there is no overarching applicable legal system that restricts the exercise of the jurisdiction to tax.[19] However, a combination of practical enforcement difficulties as well as the historical and contemporary tax policy choices of economically influential states form a recognisable transnational legal order that effectively influences the range of policy choices states view as feasible at any given time. It is within this order that barriers to digital services taxes have arisen.

A. Barriers to digital service taxes

In a technical sense, digital services taxes are distinguished from income taxes in that the former are flat taxes on gross receipts (commonly referred to as an excise tax) while the latter are traditionally imposed on receipts net of expenses and losses. That said, this technical distinction is incoherent in that income tax regimes commonly feature gross-basis withholding taxes on payments made by domestic payors to foreign recipients.[20] Gross-basis withholding taxes are all but economically indistinguishable from any other excise tax. From an economic perspective, gross receipts are not income because income is a net concept, yet these gross-basis taxes are a constitutive feature of the international income tax landscape because of the basic logistical problems states face in collecting taxes from persons whose assets are beyond the jurisdiction of the tax authority.

The United States initiated an internal investigation into France's digital services tax in mid-July 2019, publishing its findings in a report by end of that year.[21] The report declared that France's digital services tax 'discriminates against U.S. companies, is inconsistent with prevailing principles of tax policy and [is] unusually burdensome for affected U.S. companies'.[22] The United

[17]C Enache, 'Digital Services Taxes in Europe, 2024' (7 May 2024), Tax Foundation Europe <https://taxfoundation.org/data/all/eu/digital-tax-europe-2024/> accessed 9 December 2024.

[18]D Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge University Press 2008) 3 ('A constitutional lens is helpful analytically as the regime of investment rules can be understood as an emerging form of supraconstitution that can supersede domestic constitutional norms. From this external perspective, investment rules can be viewed as a set of binding constraints designed to insulate economic policy from majoritarian politics'.); M Kumm et al, 'How Large is the World of Global Constitutionalism?' 3 (2014) Global Constitutionalism 1, 1 (arguing that 'Constitutionalism is not to be understood primarily as the study and interpretation of a constitutive legal document, but as a reference frame for interdisciplinary research with a particular focus.'); SA Dean, 'A Constitutional Moment in Cross-Border Taxation' 1 (3) (2021) Journal on Financing for Development 10–13 (comparing the structure of tax treaties to a 'Classification and Assignment Constitution' and claiming that recent global tax reform efforts imply a new 'constitutional moment').

[19]For a thorough review of the literature demonstrating the lack of support for general international law limits to tax sovereignty, see TD Magalhaes and A Christians, 'Why Data Giants Don't Pay Enough Tax' 18 (2023) Harvard Law and Policy Review 119. See also A Christians, 'Who Should Tax Multinationals?' 39 (2023) Social Philosophy and Policy 208.

[20]Some withholding taxes are initially assessed on a gross basis, but taxpayers are permitted to recompute the tax on a net basis by filing prescribed forms, while other withholding taxes are not. When taxpayers are not allowed to deduct their expenses, the withholding tax is often referred to as a 'final' tax. A final tax withheld by a payor on a gross payment is economically indistinguishable from an excise tax collected by a vendor on the sale of a good or service.

[21]UTPR, 'Section 301 Investigation Report on France's Digital Services Tax' (2 December 2019) <https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf> accessed 9 December 2024.

[22]Ibid. at 1.

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States accordingly threatened to impose 'retaliatory' tariffs, potentially amounting to $2.4 billion, on various French products, including champagne, wine, cheese, and handbags.[23] But the punishment was delayed in January 2020, when then-U.S. President Donald Trump and French President Emmanuel Macron negotiated a truce, agreeing to suspend the dispute until the end of 2020.[24]

The intention was that the controversy would dissipate when, by the end of 2020, the OECD was expected to have brought the Inclusive Framework countries to a multilateral solution. A core element in this process is that member countries should dismantle their unilateral digital services taxes, thus eliminating any alleged violation of U.S. law. While the multilateral solution continues to be delayed, France and other countries that introduced digital services taxes have continued to collect revenues in amounts that increase every year. Estimates of collected revenues from the French digital services tax, for example, were close to €300 million in 2019, to €400 million in 2020, and to €500 million in 2021.[25]

Within six months of the introduction of the tax in France, then-U.S. Treasury Secretary Steven Mnuchin publicly reaffirmed U.S. opposition to digital services taxes and similar unilateral measures, in an announcement declaring that the United States was at an impasse with European countries in the OECD discussions.[26] Mnuchin warned that the United States would respond with appropriate measures if countries continued to collect or adopt such taxes. Consequently, on 10 July 2020, then-U.S. Trade Representative Robert Lighthizer announced his decision to impose an additional 25 per cent tariff on French products valued at $1.3 billion as a response to the French digital services tax.[27] Simultaneously, Lighthizer initiated a second set of internal investigations into digital services taxes of another 10 countries in Europe and elsewhere plus the European Union as a block.[28]

The pattern of U.S. resistance to foreign digital services taxes suggests that adopting new standalone taxes aimed at data is an unstable policy choice for most countries. Avoiding the income tax as a policy instrument not only failed to insulate European and other countries from controversy, but it evidently expanded the legal pathways for resistance by the United States and U.S.-based firms. In considering what policy strategies might be more feasible, it is helpful to understand the legal components in place that enable the United States to label foreign taxes as unfair trade practices and impose retaliatory tariffs without any process for review or appeal. This requires some familiarity with the interaction between U.S. domestic trade law and World Trade Organization (WTO) law, as described in the next Section.

B. The 'aggressive unilateralism' of the U.S. trade authority

The legal framework for U.S. resistance to foreign digital services taxes lies at the intersection of domestic U.S. trade law and WTO dispute resolution processes. The domestic component of this

[23] Eg, USTR, Notice of Determination and Request for Comments Concerning Action Pursuant to Section 301: France's Digital Services Tax, 84 Fed. Reg. 66,956 (6 December 2019).

[24] Reuters Staff, 'Macron and Trump Declare Truce in Digital Tax Dispute' (20 January 2020) Reuters <https://www.reuters.com/article/us-france-usa-tax-idUSKBN1ZJ24D> accessed 9 December 2024. Note that France retains the right to challenge the U.S. Trade Representative decision, as described in Part II.B.

[25] K Borders et al, 'Digital Service Taxes' (June 2023) EU Tax Observatory, 8 <https://www.taxobservatory.eu/www-site/uploads/2023/06/EUTO_Digital-Service-Taxes_June2023.pdf> accessed 9 December 2024.

[26] S Fleming, J Brunsden, and J Politi, 'US Upends Global Digital Tax Plans After Pulling Out of Talks with Europe' (17 June 2020) Financial Times <https://www.ft.com/content/1ac26225-c5dc-48fa-84bd-b61e1f4a3d94> accessed 9 December 2024.

[27] D Palmer, 'US Announces Duties on $1.3B in French Goods in Digital Tax Dispute' (11 July 2020) Politico <https://www.politico.eu/article/ustr-announces-duties-on-1-3b-in-french-goods-in-tax-dispute/> accessed 9 December 2024.

[28] USTR Initiates Section 301 Investigations of Digital Services Taxes <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/june/ustr-initiates-section-301-investigations-digital-services-taxes> accessed 9 December 2024.

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framework is section 301 of the US Trade Act of 1974,[29] now codified in Title 19 of the U.S. Code (but still colloquially referred to as section 301 or §301).[30] This law grants the U.S. President the right to unilaterally suspend or withdraw trade agreement provisions or impose import restrictions on foreign goods and services under specified circumstances.[31] Today, the authority to investigate and determine whether a foreign practice is objectionable, and to establish and carry out retaliatory actions, rests with the U.S. Trade Representative, currently Katherine Tai.[32] The range of available retaliatory measures afforded by §301 includes imposing duties or other import restrictions, withdrawing or suspending trade agreement concessions, or entering into binding agreements with foreign governments to 'either eliminate the conduct in question (or the burden to U.S. commerce) or compensate the United States with satisfactory trade benefits'.[33]

Following the 1994 establishment of the WTO, the United States committed to using the WTO's Dispute Settlement Understanding rather than its unilateral §301 authority whenever it investigated an issue involving an alleged violation of a WTO agreement.[34] This is substantively as well as procedurally impactful because the §301 rules address general notions of 'unreasonable or discriminatory' practices that 'impede or restrict U.S. commerce', all as defined within U.S. domestic law, while the WTO documents set out specific parameters for trade practices among the members. Prior to the introduction of the WTO Dispute Settlement Understanding process, authors had criticised the §301 investigative process as a form of 'aggressive unilateralism'.[35] In agreeing to the WTO framework, the United States ostensibly answered these criticisms by voluntarily reducing its own range of policy space for unilateral trade retaliation, at least in the case of WTO Member States.

The level of U.S. fidelity to this commitment has been inconsistent over the years, but the Dispute Settlement Understanding process has acted as an effective check in the past. For example, the United States used §301 during 1998–2000 to compel other countries to eliminate trade barriers and open up their markets to U.S. suppliers.[36] But some countries successfully deployed the Dispute Settlement Understanding process to have the U.S. actions declared WTO-

[29]USTR, Section 301 – Digital Services Taxes <https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-digital-services-taxes> accessed 9 December 2024.

[30]19 U.S. Code § 2411 – Actions by United States Trade Representative.

[31]At the time of its enactment, the President's authority was restricted only by limitations expressed within the law as well as then-existing international obligations. For analysis, see Congressional Research Service Report, §301 of the Trade Act of 1974 (last updated Sep. 2023) <https://crsreports.congress.gov/product/pdf/IF/IF11346> accessed 9 December 2024.

[32]19 U.S.C. §2411(c)(1); Office of U.S. Trade Representative <https://www.whitehouse.gov/ustr/> accessed 9 December 2024.

[33]Congressional Research Services, 'Section 301 of the Trade Act of 1974' (2020) <https://crsreports.congress.gov/product/pdf/IF/IF11346> accessed 9 December 2024; 19 U.S.C. §2481(1)(2).

[34]Statement of Administrative Action; WTO, Report of the Panel, United States – Sections 301–310 of the Trade Act 1974, para 4.534 n.91 ('The United States refers to 19 U.S.C. § 3512(d) as stating that "[t]he statement of administrative action approved by Congress under section 3511(a) of this title shall be regarded as an authoritative expression by the United States concerning the interpretation and application of the Uruguay Round Agreements and this Act in any judicial proceeding in which a question arises concerning such interpretation or application".') <https://www.wto.org/english/tratop_e/dispu_e/wtds152r.pdf> accessed 9 December 2024.

[35]See generally J Bhagwati and HT Patrick (eds), *Aggressive Unilateralism: America's 301 Trade Policy and the World Trading System* (University of Michigan Press 1991).

[36]WTO, Dispute Settlement, DS152: United States – Sections 301–310 of the Trade Act 1974 <https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds152_e.htm> accessed 9 December 2024; WTO, Report of the Panel, United States – Sections 301–310 of the Trade Act 1974 <https://www.wto.org/english/tratop_e/dispu_e/wtds152r.pdf> accessed 9 December 2024. See also A Chen, 'The Three Big Rounds of U.S. Unilateralism versus WTO Multilateralism During the Last Decade: A Combined Analysis of the Great 1994 Sovereignty Debate, Section 301 Disputes (1998–2000), and Section 201 Disputes (2002–Present)' 17 (2003) Temple International and Comparative Law Journal 409. See also AO Sykes, 'Constructive Unilateral Threats in International Commercial Relations: The Limited Case for Section 301' 23 (1992) Law and Policy in International Business 263; JR Silverman, 'Multilateral Resolution over Unilateral Retaliation: Adjudicating the Use of Section 301 Before the WTO' 17 (1996) University of Pennsylvania Journal of International Law 233; Z Harper, 'The Old Sheriff and the Vigilante: World Trade Organization Dispute Settlement and Section 301 Investigations into Intellectual Property

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inconsistent for their explicit breach of WTO obligations, thus permitting countries to impose punitive duties against the United States.[37] Similarly, in a 2018 dispute between China and the United States over another §301 investigation, a WTO panel found that certain U.S. tariffs violated WTO terms.[38]

However, since July 2017 the United States dismantled the Dispute Settlement Understanding by blocking appointments to its Appellate Body.[39] A WTO panel may still be assembled to review allegations of trade violations among the member states, but now an opposing party in any dispute can obstruct any WTO-sanctioned retaliatory measures simply by lodging an appeal. Since there is no one to hear the appeal, the matter is suspended indefinitely. For this reason, authors have come to describe the WTO dispute resolution process as one that involves appealing 'into the void'.[40] This means that until the WTO process is restored, the U.S. Trade Representative has effectively unopposable authority to impose measures against any foreign actions that she deems unfair or detrimental to U.S. commerce.[41]

With this dispute resolution impasse in place, the United States is using its unilateral §301 process to apply what it characterises as 'retaliatory' tariffs whenever its internal investigations find foreign conduct to be objectionable. This approach operates outside the scope of WTO dispute resolution procedures, focusing solely on the U.S. domestic legal framework.

Specifically regarding recent §301-based actions against digital services taxes, various scholars have opined that the U.S. Trade Representative has repeatedly failed to make a compelling legal and factual case for trade retaliation. For example, Stephen Shay calls the U.S. Trade Representative's report on France's digital services tax 'weak and unpersuasive', as the presented arguments 'range from dubious to wrong' and reflect a 'misalignment of expertise with the task'.[42] Further, Shay notes that the investigative report employed no 'objective standard' in its analysis.[43]

Chris Noonan and Victoria Plekhanova have examined issues raised by the U.S. Trade Representative with respect to discriminatory intent or outcome, deductibility against the corporate income tax for domestic companies, retroactivity, incompatibility with international tax principles, economic impact on businesses, and the justifications provided by France for

Disputes' 10 (2018) Trade, Law, and Development 107; SH Puente, 'Section 301 and the New WTO Dispute Settlement Understanding' 2 (1995) ILSA Journal of International and Comparative Law 213.

[37]JJ Nedumpara, 'Skirmishes over Digital Service Taxes: The Perils and Systemic Costs of Section 301' 13 (2021) Trade, Law and Development 63, 73; Shay, infra note 42 at 11.

[38]WTO, Dispute Settlement, DS543: Panel Report, United States – Tariff Measures on Certain Goods from China <https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds543_e.htm> accessed 9 December 2024; WTO, Tariff Measures on Certain Goods From China, Notification of an Appeal by the United States under Article 16 of the DSU, WT/DS543/10 (27 October 2020) <https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/DS/543-10.pdf&Open=True> accessed 9 December 2024.

[39]WTO, 'Members Briefed on Informal Dispute Settlement Reform Talks' (31 March 2023) WTO News <https://www.wto.org/english/news_e/news23_e/dsb_31mar23_e.htm> accessed 9 December 2024 ('The United States repeated that it does not support the proposed decision to commence the appointment of Appellate Body members as its longstanding concerns with WTO dispute settlement remain unaddressed'.). For a discussion of the implications, see PC Mavroidis, 'The Future of Dispute Resolution and Arbitration at WTO' in J Chaisse and C Rodríguez-Chiffelle (eds), *The Elgar Companion to the World Trade Organization* (Edward Elgar 2023).

[40]J Pauwelyn, 'WTO Dispute Settlement Post 2019: What to Expect?' 22 (2019) Journal of International Economic Law 297, 303–39.

[41]Cf. Bhagwati and Patrick (eds) supra (n 35); KM McDonald, 'The Unilateral Undermining of Conventional International Trade Law via Section 301' 7 (1998) Journal of International Law and Practice 395; RE Hudec, 'Retaliation Against "Unreasonable" Foreign Trade Practices: The New Section 301 and GATT Nullification and Impairment' 59 (1975) Minnesota Law Review 461.

[42]SE Shay, 'Trade Enforcement Tools and International Taxation: A Digital Services Tax Case Study' in J Chaisse and C Rodríguez-Chiffelle (eds), *The Elgar Companion to the World Trade Organization* (Edward Elgar 2023).

[43]Ibid.

introducing the tax.[44] Nooman and Plekhaova find little support for using §301, further noting that '[t]he "discriminatory" effect is also within the power of the US to correct through permitting DST [digital services tax] paid in a foreign jurisdiction by a US resident to be a deductible expense for the purpose of US CIT [corporate income tax]'.[45]

In a thorough analysis in light of the WTO's international trade law regimes, Alice Pirlot and Henri Culot conclude that 'arguments based on WTO law do not provide a convincing ground to oppose such taxes'.[46] Pirlot and Culot outline three main points. First, it is not obvious that the services targeted by digital services taxes are 'like' or 'comparable' to services provided by other companies that are not taxed. Second, allowing the digital services tax to be deducted from the corporate income tax base is a regular practice in accounting for deductible expenses when calculating taxable profits, which therefore cannot be equated with a 'gain' or 'advantage' for domestic companies. Third, the fact that multiple countries agree that the international tax regime is not fit for the digital economy weakens the claim that the tax was introduced with a discriminatory purpose.

Despite the views expressed by these and other scholars, a destabilised multilateral trade regime and an aggressively unilateral U.S. stance creates a world in which resistance to digital services taxes will likely continue to be expressed in the form of effectively unappealable trade-based retaliation measures. Since there exists no legal process to resolve the matter, some countries have delayed the effect of these measures by negotiating delayed implementation of their digital services taxes pending the multilateral adoption of coordinated reform via the OECD's Inclusive Framework, as explained in the next Section.

C. Barriers to Pillar 1

A postponement of various countries' digital services taxes and the U.S. trade retaliation measures emerged in October 2021 with a moratorium set by the OECD Inclusive Framework. The moratorium required all parties to remove or abstain from enacting digital services taxes or similar measures from 8 October 2021, to 31 December 2023, while a multilateral solution was underway. But the United States itself complicated the success of these multilateral efforts, not least by signaling its own disinclination to adopt conforming legislation.[47] On 20 February 2023, Pillar 1 became blocked once again by disagreements voiced by the United States, India, and Saudi Arabia.

However, the clock on the moratorium has passed. Once the OECD's Pillar 1 multilateral convention was not in effect by 31 December 2023, members of the OECD Inclusive Framework were politically free to restore or impose new digital services taxes, ending their pledge to refrain from doing so.[48] Unsurprisingly, as a result of stalling negotiations and the U.S. reluctance to find a multilateral resolution, some countries signaled their intention to revert to digital services taxes as the moratorium expired. For example, as of 2024, the previously delayed Canadian digital services tax legislation entered into force, despite the multilateral commitment. Canada's Parliamentary Budget Office estimates that over the course of five years, the tax would increase federal revenues by CA$7.2 billion.[49]

[44]C Noonan and V Plekhanova, 'Digital Services Tax: Lessons from the Section 301 Investigation' 1 (2021) British Tax Review 83, 102–10.

[45]Ibid. at 106.

[46]A Pirlot and H Culot, 'When International Trade Law Meets Tax Policy: The Example of Digital Services Taxes' 55 (2021) Journal of World Trade 895, 906–18.

[47]Cf. RS Avi-Yonah, 'Pillar 1 and DSTs: OECD Optimism and U.S. Reality' 111 (2023) Tax Notes International 299.

[48]NA Sarfo, 'DSTs, Destabilization, and the Rocky Road to Pillar 1' (20 February 2023) Tax Notes.

[49]Office of the Parliamentary Budget Officer, 'Digital Services Tax' (17 October 2023) <https://www.pbo-dpb.ca/en/publications/LEG-2324-013-S–digital-services-tax–taxe-services-numeriques> accessed 9 December 2024.

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In July 2023, the OECD released a new statement announcing the moratorium on new digital services taxes would be extended by one year to 31 December 2024, provided certain conditions are met, with the possibility of another extension to 31 December 2025, depending upon progress on the multilateral convention to implement Pillar 1.[50] Some jurisdictions, including Canada, rejected the one-year extension, despite growing U.S. threats of retaliation under §301.[51]

Since the United States is the home jurisdiction of most big data companies and the world's largest exporter of data-related services, it is easy to see why the United States has been so resistant to both multilateral and unilateral solutions to the taxation of digital profits.[52] It is also easy to see why the United States, as a superpower within the global political economy, has not shied away from trade-related threats against a multitude of countries, despite the questionable grounds of the §301 investigations. Accordingly, the content and scope of U.S. cooperation in the rollout of Pillar 1 remains to be seen. However, if countries are committed to taxing data as a policy choice, navigating the potential legal and geopolitical barriers to doing so in the likely scenario of no multilateral reform is key.

In particular, owing to the impasses created by the United States with respect to both Pillar 1 and digital services taxes, it might be time to reconsider the possibility of countries adopting income-based tax measures to capture more of the wealth generated by data-driven firms. Engaging the income tax system, including tax treaties, potentially disentangles the taxation of data firms from the trade and investment regimes. In particular, withholding taxes on advertising fees and other forms of income associated with the sale of customer data may be more resilient to a legal challenge through trade and investment agreements, depending on the country and the content of their relevant cross-border agreements. When imposed under a general income tax system, such taxes are usually respected under trade and investment agreements.[53] Under the General Agreement on Tariffs and Trade (GATT), a longstanding view posits that, since the regime concerns import barriers to goods, covered taxes are mostly indirect ones,[54] but this view is not universally shared among scholars.[55] Under the General Agreement on Trade in Services

[50]OECD, *Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (11 July 2023).

[51]U.S. Trade Representative, 'USTR Opposes Canada's Digital Services Tax Act Proposal' (22 February 2022) <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2022/february/ustr-opposes-canadas-digital-services-tax-act-proposal> accessed 9 December 2024.

[52]An anonymous reviewer raised the question of why U.S. large data-driven firms have managed to repeatedly influence the international tax policy of both Republican and Democratic administrations, despite the plurality of political views and national interests in the United States. There could be a number of different explanations, but the phenomenon has been observed for decades in respect to U.S. corporations in general, especially multinationals. See CH Hanna and CA Wilson, 'U.S. International Tax Policy and Corporate America' 48 (2023) Journal of Corporation Law 261; A Christians, 'Trust in the Tax System: The Problem of Lobbying' in B Peeters, H Gribnau, and J Badisco (eds), *Building Trust in Taxation* (Intersentia 2017); CH Hanna, 'Corporate Tax Reform: Listening to Corporate America' 35 (2009) Journal of Corporation Law 283.

[53]Regarding investment agreements, income tax withholding is formally outside the scope of such agreements to the extent it is covered by standard carveout clauses for (direct) tax measures. See generally PHM Simonis, 'BITs and Taxes' 42 (2014) Intertax 234; RA Green, 'The Interaction of Tax and Non-Tax Treaties' 56 (2002) Bulletin Tax Treaty Monitor 254; J Owens et al, 'What Can the Tax Community Learn from Dispute Resolution Procedures in Non-Tax Agreements?' 69 (2015) Bulletin for International Taxation 577; S Castagna, 'ICSID Arbitration: BITs, Buts, and Taxation—An Introductory Guide' 70 (2016) Bulletin for International Taxation 370; RJ Danon and S Wuschka, 'International Investment Arbitration and the International Tax System: The Potential of Complementarity and Harmonious Interpretation' 75 (2021) Bulletin for International Taxation 687.

[54]The GATT Rules on Border Tax Adjustments, Note by the Secretariat at 3 (31 May 1968) <https://docs.wto.org/gattdocs/q/GG/SPEC/68-55.pdf> accessed 9 December 2024 ('At Havana it was recorded that "neither income taxes nor import duties fall within the scope of Article 13 (of the Havana Charter – Article III of the GATT) which is concerned solely with internal taxes on goods".'). See generally M Lang, H Herdin, and I Hofbauer (eds), *WTO and Direct Taxation* (Kluwer International Law 2005).

[55]M Daly, 'WTO Rules on Direct Taxation' 29 (2006) World Economy 527, 532, 536 (arguing that direct taxes fall within the scope of the GATT and that the GATS' specific exceptions to direct taxes imply they would otherwise be covered); AC Warren Jr., 'Income Tax Discrimination Against International Commerce' 54 (2001) Tax Law Review 131, 167 ('Taking

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(GATS), Articles XIV(e) and XXII(1) establish that the nondiscrimination principles, namely most favoured nation (Article II) and national treatment (Article XVII), cannot be invoked in respect to measures dealt with by double tax treaties.

Withholding has ample precedents. Many non-OECD countries, notably in Latin America, have long imposed withholding taxes on technical services and technical assistance fees paid to taxpayers abroad even though some OECD countries (and presumably many taxpayers) would argue that such fees should be taxed only when the payee is physically present in the relevant territory.[56] Brazil and India have been among the key players from the Global South that have experimented with different legal instruments (eg, internal regulations, interpretive acts, and treaty protocols) to expand source-based taxation by 'dehydrating' Article 7.[57] Brazil, in particular, has been the locus of much national and international debate regarding its tax policy approach of equating outgoing payments for technical services with royalties or 'other' income within the language of tax treaties,[58] as discussed in greater detail in Section 3 below.

3. Why withholding is better

As seen above, standalone digital services taxes are likely to lead to a trade war as the U.S. turns to unilateral countermeasures. The OECD is currently in the process of developing a multilateral solution in the form of a negotiated expansion of taxation at source but there is no guarantee that this solution will conclude in a timely manner, or with the cooperation of the United States. As such, it is wholly appropriate for EU member states and other countries to consider income-based measures to achieve their shared domestic policy goals. In this Part, we demonstrate that income tax-based withholding on specified payments is commendable as a well-established, as well as

nondiscrimination more seriously in international taxation would also call into question the long-standing practice of reciprocal withholding rates, which do not achieve equal treatment of domestic and foreign investors in any particular source country.'). But see HD Rosenbloom, 'What's Trade Got to Do with It?' 49 (1994) Tax Law Review 593, 597 (rejecting the view that withholding taxes could be analogised with tariffs). Some further argue that because withholding falls on gross amounts it in effect constitutes an indirect form of taxation, similar to an excise tax. This would appear to clearly bring withholding into the WTO legal framework. Nevertheless, countries have traditionally imposed withholding taxes on foreign recipients of source income in lieu of the domestic corporate income tax that normally applies to domestic recipients of the same kind of income. Cf. AJ Cockfield and BJ Arnold, 'What Can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model' 2 (2010) World Tax Journal 1, 2–3, 5.

[56] Cf. SB Law, 'Technical Services Fees in Recent Tax Treaties' 64 (2010) Bulletin for International Taxation 250; AB Moreno, 'The Taxation of Technical Services under the United Nations Double Taxation Convention: A Rushed—Yet Appropriate—Proposal for (Developing) Countries?' 7 (2015) World Tax Journal 1; FS De Man, *Taxation of Services in Treaties between Developed and Developing Countries: A Proposal for New Guidelines* (IBFD 2017); J Pal, 'Taxation of Fees for Technical Services: An Analysis of Indian Tax Treaties and Their Journey Through the Courts' 23 (2017) Asia-Pacific Tax Bulletin 1; M Castelon, *International Taxation of Income from Services under Double Taxation Conventions: Development, Practice and Policy* (Kluwer International Law 2018); A Riccardi et al, 'Swimming Against the Current? Taxation of the Digitalized Economy in Latin America' 73 (2019) Bulletin for International Taxation 514; BJ Arnold, 'Taxation of Income from Services' in A Trepelkov, H Tonino, and D Halka (eds), *Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (2nd ed., United Nations 2017); PA Harris, 'Taxation of Rents and Royalties' in A Trepelkov, H Tonino, and D Halka (eds) *Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (2nd ed. United Nations 2017).

[57] PDC Machado, 'Evolution of the Concept of Technical Services and the Policy Considerations Driving Their Development' 3 (2021) International Tax Studies 1, 12–14.

[58] Cf. PA Hornbostel, 'Brazil: Withholding Taxes on Foreigners' Income' 6 (1974) Law and Policy in International Business 987; VA Ferreira, 'Service Income under Brazilian Tax Treaties: The Possible End of Article 7 v. Article 21 Battle, but the Start of a New Old One?' 42 (2014) Intertax 427; VA Ferreira, 'The New Brazilian Position on Services Income under Tax Treaties: If You Can't Beat'em, Join'em' 43 (2015) Intertax 255; MF Furtado, H Verboom and C Lütter, 'No Brazilian Withholding Tax on Payments for Technical Services?' 69 (2015) Bulletin for International Taxation 558; LT Pignatari, 'The Qualification of Technical Services in Brazilian Double Tax Treaties and the Possible Impacts of the Adoption of Article 12B, UN Model Convention' 49 (2021) Intertax 674; FJ Calazans, 'Treaty Treatment of Offshore Remittances of Consideration for Technical Services' 12 (2005) International Transfer Pricing Journal 235.

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normatively and legally justifiable, approach. We acknowledge the range of arguments against such reform, but argue that on balance, it is more feasible to use the income tax than a standalone excise tax to get at the desired income stream.

First, we explain why withholding is a common way of taxing the kind of income that is at stake in the debate over taxing data, and we note the role of tax treaties in both implementing and restricting source-based withholding. Second, noting that the space for policy reform is limited by existing tax treaties, we suggest three possible categories for an income-based withholding tax on data fees, namely as royalties, as 'other' income, and as technical services, in each case carving these income streams out of what would otherwise presumably be categorised as business profits. Our argument is that states could tax data income via withholding even in the presence of tax treaties. In Section 4 thereafter, we explain why withholding on data-based income is consistent with the overall context and purpose of tax treaties, as applied within the context of the modern, highly digitalised economy.[59]

A. Withholding as an appropriate income tax strategy

Withholding is a familiar way to tax cross-border income flows because it attaches to a local payor that can be linked to a local source.[60] The justification for withholding taxes in general is to ensure the state can enforce national tax laws in a consistent manner. With respect to cross-border transfers, the idea is that a source state will find it difficult to pursue payment directly to a nonresident who lacks sufficient physical contact with the jurisdiction.[61] The source state's best option is therefore to turn to the local payor of the income to impose an obligation to report the payment to the tax authority and, in some cases, withhold tax as well. Typically, withholding is imposed on a gross basis since the payor is presumed to lack sufficient information to calculate the taxpayer's net income.[62]

Even though gross-basis taxes are in nature more of an excise than an income tax, the withholding mechanism is a staple in income tax systems around the world. Residence states, even in the absence of an agreement to mitigate double taxation, frequently provide foreign tax credits for amounts withheld at source.[63] If there are historical barriers to withholding, they would generally be compliance based, in that countries might find it challenging to attach tax burdens to individuals or assets in respect of foreign entities whose physical ties to the jurisdiction are low or non-existent. Domestic law, accordingly, should be able to place data income – as a special form of

[59]On different modes of legal interpretation applied to tax treaties, see RA Rocha, *Tax Treaty Interpretation: Challenges in a Post-BEPS Multilateral World* (Kluwer International Law 2022).

[60]Withholding is a well-established and widely used mechanism to effectuate taxation in both domestic and cross-border contexts. In the United Kingdom, the mechanism was already in use by the 16th century. PE Soos, 'Taxation at the Source and Withholding in England, 1512 to 1640' 1 (1995) British Tax Review 49, 51. The United States first experimented with withholding in 1894, as applied to salaries of U.S. government employees, but the mechanism was declared unconstitutional. In 1913, it was reintroduced to cover salaries, wages, and interest income, abandoned in 1917, and reintroduced again thereafter, this time also covering certain payments to nonresidents. GE Lent, 'Collection of the Personal Income Tax at the Source' 50 (1942) Journal of Political Economy 719, 723–74.

[61]The taxing authority can always request compliance, but enforcement tools generally must include the capacity to seize books and records as well as, in cases of serious noncompliance, assets and even taxpayers themselves. Historically, jurisdictions would not assist each other in tax collection efforts as a corollary of the so-called 'revenue rule', so the power of the state would traditionally not extend to physically seizing people or their property outside of the territorial jurisdiction. See generally BA Silver, 'Modernizing the Revenue Rule: The Enforcement of Foreign Tax Judgments' 22 (1992) Georgia Journal of International and Comparative Law 609. This situation has evolved so that there is more assistance in enforcement and collection across borders than in the past, but only under negotiated agreements. See generally P Baker et al, 'International Assistance in the Collection of Taxes' 65 (2011) Bulletin for International Taxation 281.

[62]In some cases, taxpayers are permitted to file on a net basis and thereby request a refund of over-withheld amounts, but this is typically not the rule in the case of cross-border passive income payments such as dividends, interest, or royalties.

[63]For a classic explanation, see EA Owens, *The Foreign Tax Credit: A Study of the Credit for Foreign Taxes under United States Income Tax Law* (Harvard University Press 1961) 26–60.

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private earning that is deeply connected to the territory of the source state – under existing withholding tax regimes.[64]

There are, however, conceptual barriers to doing so. The most challenging of these may be found in the delineation of different types of income into categories, which are reflected in tax treaties. Under most income tax systems, the types of income that data-driven firms earn from most market countries in Europe and elsewhere would almost certainly be characterised as business profits as opposed to property income. This is an uncontroversial observation since the profits generally arise from the act of combining labour and capital (a classic marker of business income) to gather and mobilise user data in various ways and sell advertising space on media platforms to vendors seeking to reach a customer base in a given location. As such, a threshold difficulty in building the case for withholding is to explain why it would be appropriate for countries to extricate from business profits only those income streams earned through commercialising user data or selling advertising.

An answer to this challenge is that it has always been the case that a given stream of income may be simultaneously characterised as both business profits and a subcategory of such profits, such as royalties, and when both apply, treaties prioritise the subcategory.[65] This hierarchy is clearly seen in the way that tax treaties reflecting the OECD, UN, and U.S. models deal with the interaction of the business profits and property income provisions. In each model, the article on business profits starts with the familiar threshold rule that a state will only tax the business profits of a non-resident to the extent connected to a local permanent establishment. Later in the article, however, the model explicitly preserves the source-based taxation of specific forms of business profits when covered by another article, namely those delineating negotiated withholding rates on specified property income streams. Thus, each of the models states that when profits include items of income 'dealt with separately in other Articles of this Convention', those Articles 'shall not be affected by the provisions of this Article'.[66]

OECD Model Commentary notes as a 'rule of interpretation' that this provision 'gives first preference' to the specific income articles on dividends, interest and so on, such that the business profits article applies to business profits that 'do not belong to categories of income covered by' the other articles.[67] The OECD further notes its understanding that 'the items of income covered by the special Articles may, subject to the provisions of the Convention, be taxed either separately, or as business profits, in conformity with the tax laws of the Contracting States'.[68]

Therefore, to the extent the specific types of income data-driven firms earn may be covered by the other articles, the structure of tax treaties already accommodates withholding at source even in the absence of a permanent establishment. The question is whether the parties that negotiated a particular tax treaty can be said to have intended that data-related income streams be covered by the property income articles as opposed to the business profits articles. Judging from the decision European lawmakers made to avoid entangling themselves in tax treaty interpretation by adopting

[64]Digital service taxes have instead been designed as standalone gross basis (turnover) taxes levied on specified payments, such as advertising fees paid to non-resident digital service suppliers. To be sure, some countries – especially developing ones – already extend gross-basis withholding to all forms of cross-border income, including business profits. When there is no tax treaty at play, withholding taxes are a straightforward and well-established way to tax the income of multinationals earned from domestic sources.

[65]Cf. K Vogel, 'The Schedular Structure of Tax Treaties' 56 (2002) Bulletin – Tax Treaty Monitor 260, 261.

[66]U.S. Model Tax Convention (2016), Art 7(4); UN Model, Art 7(6); OECD Model, Art 7(4).

[67]OECD Model Commentary (2017) at 193–4 (providing commentary on Art 7 para 4 and stating that '[i]n conformity with the practice generally adhered to in existing bilateral conventions, paragraph 7 gives first preference to the special Articles on dividends, interest etc. It follows from the rule that this Article will be applicable to business profits which do not belong to categories of income covered by the special Articles, and, in addition, to dividends, interest etc. which under paragraph 4 of Articles 10 and 11, paragraph [4] of Article 12 and paragraph 2 of Article 21, fall within this Article . . . '); reproduced in UN Model (2017) at 237.

[68]Ibid.

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standalone digital services taxes, it seems that the parties cannot be said to have intended this outcome.

Yet, by adopting digital services taxes, the relevant tax treaties have not been tested to determine how they would interact with a domestic extension of the withholding regime to cover data-based income streams. Instead, by adopting standalone digital services taxes, lawmakers have tested the conformity of these taxes with existing trade and investment regimes. The ensuing procedural battles described above suggest that the prospects for conformity are uncertain at best.

For this reason, it seems appropriate to alter the approach. The question is whether lawmakers can apply new withholding taxes under existing tax treaties (in particular, but not exclusively, those with the United States). To answer this question requires a detailed analysis of the relevant agreements in play. Some treaties are more restrictive than others, and some treaty terms are less ambiguous than others.[69] In the discussion that follows, we explore which of the 'special' income categories as described in the OECD Model Commentary might encompass data-based profit streams, and we provide a contextual and purposive interpretation to make the case for countries in Europe and around the world to trigger this interpretive exercise to separately delineate data-based profit streams.

B. Three ways to withhold on data-based income (when a treaty is involved)

There are many ways to alter tax systems to cover data services via bilateral or multilateral agreement. In 2017, the European Commission rejected a digital services tax, and then proposed a directive in 2018 that failed to obtain unanimous support.[70] In June 2020, the Commission reopened discussions and by 2023 it had put forward a EU digital levy that was, nonetheless, postponed until finalisation of the Pillar 1 process.[71] Given that this EU digital levy would create the same kinds of trade frictions with the United States as unilateral digital services taxes, this section explores the possibility of EU member states – or any other country – imposing withholding taxes at source even when the traditional treaty-based permanent establishment standard is not met. The approach could be pursued unilaterally or promoted via an EU withholding directive on 'special' income categories encompassing data-related payments. The first two of these payments, namely royalties and other income, are already laid out in tax treaties so the question is one of interpretation. The third, technical services, is contemplated in the UN Model but we argue could also be read into some tax treaties via dynamic contextual and purposive interpretation.

Royalties

Some types of data services income comprise location-specific rent, which are structurally similar to the proceeds from the exploitation of natural resources that are taxed under resource rent taxes.[72] As a form of economic rent that arises within the territory of the source

[69]See DJ Bederman, 'Revivalist Canons and Treaty Interpretation' 41 (1994) UCLA Law Review 953, 1030 ('Vagueness will always be with us. The trick is to deal with it.').

[70]Vázquez, supra (n 16).

[71]Ibid.

[72]See generally W Cui and N Hashimzade, 'The Digital Services Tax as a Tax on Location-Specific Rent' (29 July 2019) SSRN <https://ssrn.com/abstract=3488812> accessed 9 December 2024; J Bankman, MA Kane, and A Sykes, 'Collecting the Rent: The Global Battle to Capture MNE Profits' 72 (2019) Tax Law Review 197. When such rent is earned by quasi-monopolies that dominate the market in digital platforms and networks of users and data that are located in a jurisdiction and lack opportunity costs, the income thereby derived might be characterised as 'platform rent'. W Cui, 'The Digital Services Tax on the Verge of Implementation' 67 (2019) Canadian Tax Journal 1135; W Cui, 'The Superiority of the Digital Services Tax Over Significant Digital Presence Proposals' 72 (2019) National Tax Journal 839; W Cui, 'The Digital Services Tax: A Conceptual Defense' 73 (2019) Tax Law Review 69.

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state,[73] domestic law ought to be able to assign such earnings to treaty provisions that allow source taxation, specifically the royalties article.[74] That said, domestically classifying data fees charged by foreign-based companies as royalties only makes sense if the relevant treaty provision allows source-based withholding.

For this approach, the interpretive work to be done is in the relevant definitions. In defining royalties, tax treaties often mention 'payments of any kind received as a consideration … for information concerning industrial, commercial or scientific experience'. Data companies make profits by selling or monetising information concerning the experience of users and consumers in digital platforms that are operated and maintained by those companies. This unique attribute makes data-based income distinct from the traditional category of business profits that is characterised by productive processes carried out by an enterprise through the application of capital and labour without intense user participation.[75] Indeed, data-based firms engage in profit-seeking activities that are highly dependent on gathering, monitoring, and processing valuable information related to the active engagement of customers in digital platforms, which can be conceptually assimilated to the activity of extracting a royalty from the commercial experience of users and consumers. Domestic law could, therefore, clarify the meaning of 'commercial experience' in royalty provisions as inclusive of income from data activities.

It is likely that bringing data fees into the royalty definition will require adopting a reform to statutory law, but the conventions surrounding the treaty-based definition of royalties make room for at least some movement in applying the domestic definition. The Commentary to Article 12 in the UN Model, for instance, recognises the difficulties in distinguishing services income from royalties in the context of the expression 'information concerning industrial, commercial or scientific experience', given the broad meaning of that phrase.[76]

Where source-based withholding is preserved under a treaty, a broadly defined provision will be most amenable to interpretation that includes service fees of various kinds.[77] But even tax treaties with royalty provisions modeled after Article 12(3) of the UN Model (or the OECD Model) may encompass domestic law including data fees within the concept of 'payments of any kind received as a consideration for … the right to use industrial, commercial or scientific

[73]See RS Avi-Yonah, 'A New Corporate Tax' (2020) Tax Notes International 653 (proposing that corporate taxation targets rents from monopolies like big tech companies via progressive rates up to 80 per cent above $10 billion in profits); MP Devereux and J Vella, 'Implications of Digitalization for International Corporate Tax Reform' 46 (2018) Intertax 550, 558 (stating that digitalised multinational enterprises earn economic rent, which by definition can be taxed without affecting their activities); S Buriak, 'A New Taxing Right for the Market Jurisdiction: Where Are the Limits?' 48 (2020) Intertax 301, 315 (mentioning 'stages of wealth production for data-intensive business models that generate an economic rent'.).

[74]See RS Avi-Yonah, 'A Perspective on Supra-Nationality in Tax Law' in Y Brauner and P Pasquale (eds), *BRICS and the Emergence of International Tax Cooperation* (IBFD 2015) ('Capital gains from large participations and royalties represent income from exploiting the market and should be subject to tax at source (contrary to current OECD norm).').

[75]See E Vègèlytè, 'Deconstructing User Participation: Why in the Digital Era Advertising Income is Different from Other Business Income' 27 (2020) International Transfer Pricing Journal 180 (arguing that network effects lead to high user participation and low business participation, making the advertising income obtained by some digital companies a type of income that resembles pay-as-you-go fees).

[76]UN Model, comm. Art 12, paras 22–4.

[77]For example, in a case and subsequent appeal, the Federal Court of Australia declared software products and information technology services provided by an India-resident company to Australian customers to fall within the concept of royalties. The Court relied on the Australia–India tax treaty's royalty definition, specifically the expression 'payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made as consideration for … the rendering of any services (including those of technical or other personnel) which … consist of the development and transfer of a technical plan or design … ' Federal Court of Australia, Tech Mahindra Limited v Commissioner of Taxation (2015) FAC 1082 [hereinafter *Mahindra*]; Federal Court of Australia, Tech Mahindra Limited v Commissioner of Taxation (2016) FCAFC 130. See also S Jogarajan and T Voon, 'The Intersection of Treaties on Tax and Trade: A Case Study of Australia and India' in IM Valderrama et al (eds), *Redefining Global Tax Governance: A Tax, Trade and Investment Perspective in the EU and Beyond* (Springer 2025).

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equipment or for information concerning industrial, commercial or scientific experience'.[78] Here, the relevant experience could be that of the local user who provides monetisable data or the local customer who uses advertising space, in both cases by actively engaging in online search engines, social media platforms, online gaming, cloud computing, and the like.

Other income

If the tax treaty contains an 'other income' article and allows source-based withholding (as is the case in treaties that follow the UN Model rather than the OECD Model), a second option is to classify data fees charged by foreign-based, data-driven firms as falling under the category of 'other' income instead of traditional business profits. This approach, however, would likely require formal statutory law reform in order to survive judicial review.

The main difficulty with this approach lies in a conventional understanding among legal scholars that the categories of (international) income that may be subject to withholding comprise a closed list, to which new types of income cannot be simply added without re-negotiating the tax treaty-based network.[79] Yet several factors mitigate against this view.

To read the 'other' category as impervious to change is to detach the interpretation of the law from the evolving reality of business profit production. Reading the business profits articles without considering the holistic context in which they were drafted would result in an unreasonable and absurd restriction on states' power to tax cross-border transactions, counter to the good-faith intentions of treaty partners in accepting the idea of physical permanent establishments to begin with.

In 2000, for example, Brazilian federal tax authorities issued a declaratory act according to which '[r]emittances under contracts for the provision of technical assistance and technical services without the transfer of technology' were to be classified as 'other income' under Brazil's tax treaties even when the treaty did not have an Article 21. This position, as observed by Vanessa Arruda Ferreira, was based on the 'interpretative argument' that 'since the expression "business profit" is not defined by tax treaties, the meaning to be considered shall be the one under domestic law, following the interpretation rule of the treaty corresponding to Article 3(2) of the OECD Model Convention (2010).'[80] For years, Brazilian courts accepted this understanding, but after much criticism from taxpayers and some scholars, courts changed their position.[81]

In 2012, the Brazilian Superior Court of Justice decided the famous *Copesul* case, ruling that the Brazilian federal tax administration could not include technical services fees under the other income articles of the Brazil-Canada and Brazil-Germany tax treaties.[82] But in reaching this

[78]However, Art 12(1) of the OECD Model allocates the exclusive right to tax royalties to residence states, so a revised definition in domestic law will not be effective. OECD, *Model Convention on Income and on Capital* (OECD 2017) [hereinafter OECD Model], Art 12(1).

[79]See Dean, supra (n 18) (exploring the limiting doctrine of *numerus clausus* as a restriction on expanding taxation at source). Five familiar types of income appear across income tax systems, namely interest, dividends, rents, royalties, and capital gains. Being excluded from this list, other taxes imposed on a gross basis risk being viewed as excise rather than income taxes (and may thus prompt trade-based scrutiny). Eg, GC Hufbauer and Z(L) Lu, 'The European Union's Proposed Digital Services Tax: A De Facto Tariff' (June 2019) Peterson Institute for International Economics Policy Brief. In a confused pairing of ideas, Hufbauer characterises digital services taxes as *de facto* tariffs while at the same time claiming that they 'take a bite out of the US corporate [income] tax base, at the expense of the U.S. Treasury and American shareholders … hurting the U.S. Treasury and taking dividends or capital gains from American shareholders.' GC Hufbauer, 'Trump Gets It Right on Digital Taxes!' (11 July 2019) Peterson Institute for International Economics <https://www.piie.com/blogs/trade-and-investment-policy-watch/trump-gets-it-right-digital-taxes> accessed 9 December 2024.

[80]Ferreira, 'Service Income under Brazilian Tax Treaties', supra (n 58) at 429.

[81]Machado, supra (n 57) at 13.

[82]Superior Court of Justice of Brazil, REsp 1.167.467-RS (17 May 2012). See also IBFD, Brazil – Case RE 1.161.467 – RS, 17 May 2012 (Summary).

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decision, the Court seemingly accepted the Brazilian tax authority's 'interpretative argument' because the decision relied on the internal law concept of profit to determine the application of Articles 7 and 21 of Brazil-signed tax treaties.[83] Since this concept makes no reservations in respect to technical services, the Court found that technical services fees were to be classified as business profits according to domestic law, consequently attracting the application of Article 7 of tax treaties, which only allows source taxation in case of a local permanent establishment.

In 2020, the Court confirmed the same understanding in respect to the Brazil-Spain tax treaty,[84] but in this case the Court also declared that business profits treaty provisions (Article 7) should not be automatically applied to all profits arising from the provision of technical services. The Court recognised that there are situations of 'hybridism' where the relevant income resembles royalties or independent personal services fees. To avoid similar challenges in respect to data-related payments, EU countries and others could consider reforming their statutory tax laws, specifically in regard to the legal concept of business profits.

Technical services

Finally, a third approach involves the definition of technical services. The concept of technical services, when present in tax treaties, is not typically defined comprehensively, but domestic law could clarify the concept to include data-related fees.

In the context of a tax treaty that includes Article 12A of the UN Model, domestic law could include data services fees within the concept of technical services fees, specifically within the defining language 'any payment in consideration for any service of managerial, technical or consultancy nature . . . '. Along these lines, Andrés Báez Moreno has argued that Article 12B of the UN Model is an unnecessary addition because that expression, which is already present in Article 12A, can be interpreted to accommodate automated digital services.[85]

Even if the relevant tax treaty contains only an Article 12 that both allows withholding taxation and mentions 'technical services' or an Article 12A of the UN Model, domestic law could define data fees charged by foreign-based companies as falling within the concept of technical services. In Brazil, for example, 28 of the 33 tax treaties contain the expression 'technical services'.[86] According to Revenue Normative Instruction 1455 of 6 March 2014, technical services are defined as 'the execution of a service that depends on specialised technical knowledge or that involves administrative assistance or consultancy, carried out by independent professionals or with an employment relationship or, even, resulting from automated structures with clear technological content . . . '.[87] Since the *Copesul* case discussed above, which denied the possibility of the tax administration using internal regulations to reclassify income differently from domestic law definitions, Brazil has opted to negotiate protocols with its treaty partners in order to amend royalty provisions to include the expression 'technical services' (often accompanied by 'technical

[83]Ferreira, 'Service Income under Brazilian Tax Treaties', supra (n 58) at 429 (explaining 'the understanding of the Superior Court of Justice in the case Copesul (2012), which decision indicated that the expression "business profit" should be interpreted rather as "operational profit" ("lucro operacional") under Brazilian domestic law.').

[84]Superior Court of Justice of Brazil, REsp 1.759.081-SP/2018 (29 March 2021). See also MJF Lopes and PVV da Rocha, 'Brazil's Superior Court of Justice Ruling on Taxation of Technical Services' (22 July 2021) International Tax Review <https://www.internationaltaxreview.com/article/2a6a9d8lm8s67f5w00m4g/brazils-superior-court-of-justice-ruling-on-taxation-of-technical-services> accessed 9 December 2024.

[85]AB Moreno, 'Because Not Always B Comes After A: Critical Reflections on the New Article 12B of the UN Model on Automated Digital Services' 13 (2021) World Tax Journal 501.

[86]The exceptions are the treaties with Austria, Finland, France, Japan, and Sweden, in respect of which tax authorities have applied Art 7 to technical services. Machado, supra (n 57) at 13.

[87]<http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=50414&visao=anotado> accessed 9 December 2024.

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assistance'). In a recent protocol to the Brazil–Argentina tax treaty, the parties even included in the royalties provision the expression 'automated structures with clear technological content'.[88]

Nevertheless, countries would do better in using internal statutory law reform instead of administrative regulations or treaty protocols to clarify the concept of technical services for treaty purposes. Statutory reform could be supported by the explicit reference to the domestic law of the treaty partners for interpreting undefined terms in Article 3(2) of both the OECD and UN Models as well as Article 2(2) of the Multilateral Instrument, respecting the purpose of such agreements in cases of undefined terms whose meanings cannot be derived from context or specific mutual agreement procedures.[89]

4. The contextual and purposive case for withholding

In considering whether and how a treaty could be viewed as covering data-related payments, we start with the premise that many treaties are built upon a vocabulary that dates to a century ago, that treaties are broadly written and slow to change, and that the categories laid out in treaties are modified and adapted by domestic and international practices in various ways to account for the advanced complexity of economic entities and transactions in the modern economy. As such, to work with a treaty is to work with categories of income that are rarely perfectly or completely defined. Reforming domestic law and correspondingly interpreting treaties to encompass data services should be understood as a reasonable reading of treaty concepts in light of the modern context in which these instruments operate.[90]

The interpretation puzzle involves investigating the source of the income, deciding whether income can be said to have alternative sources, and if so, determining what ordering rule applies. In particular, the logic enshrined in the business profits and permanent establishment threshold provisions of either the OECD or the UN Models (and in business profits articles in tax treaties around the world) is one that assumes that a firm cannot substantially participate in another country's economic life without crossing a threshold of permanence, and that the income thus produced, under assumptions of physicality, is to be classified as 'business profits'.[91] At its core, the classification and assignment

[88]Argentina–Brazil Income and Capital Tax Treaty (as amended through 2017).

[89]OECD Model, Art 3(2).

[90]Some authors have used the expression 'interpretative treaty override' to criticise 'tax authorities and courts [for] according treaty provisions interpretations not connected with their wording and context …'. JVG Santos, 'Interpretative Treaty Override, Breach of Confidence and the Gradual Erosion of the Importance of Tax Treaties' 69 (2015) Bulletin for International Taxation 17, 17. See also JP Le Gall, 'Handling of Judicial Override' in G Maisto (ed), *Tax Treaties and Domestic Law* (IBFD 2007); JF Bianco and RT Santos, 'The Social Contribution on Net Profits and the Substantive Scope of Brazilian Tax Treaties: Treaty Override or Legislative Interpretation?' 70 (2016) Bulletin for International Taxation; LRL Ramos, 'Treaty Override and the Proper Interpretation of Terms with Particular Reference to Mexican Tax Legislation' 64 (2010) Bulletin for International Taxation 620. However, this criticism ignores that context is not a fixed and objective idea, textual reading is not the only acceptable approach to legal interpretation, and courts often go beyond written words and even sometimes adopt 'strained interpretations'. See S Dothan, 'The Three Traditional Approaches to Treaty Interpretation: A Current Application to the European Court of Human Rights' 42 (2019) Fordham International Law Journal 765; A Perry, 'Strained Interpretations' 39 (2020) Oxford Journal of Legal Studies 316. See also JH Choi, 'An Empirical Study of Statutory Interpretation in Tax Law' 95 (2020) New York University Law Review 363, 363 (empirically demonstrating that U.S. tax courts and authorities, including the Internal Revenue Service (IRS), adopt their 'own flavor of textualism or purposivism'.). Further, as seen infra note 99, the Vienna Convention on the Law of Treaties' general rules of interpretation allow an evolutive/evolutionary approach while the OECD and United Nations have long defended an ambulatory/dynamic approach to tax treaty interpretation. For an argument that the criticism of tax treaty overrides is exaggerated because new interpretations are justified on the basis of the treaty's purpose, see RS Avi-Yonah, 'Tax Treaty Overrides: A Qualified Defense of the U.S. Practice' in G Maistro (ed), *Tax Treaties and Domestic Law* (IBFD 2006).

[91]OECD Model, comm. Arts 5(5) and 5(8). See also BJ Arnold, 'The Taxation of Income from Services under Tax Treaties: Cleaning Up the Mess – Expanded Version' 65 (2011) Bulletin for International Taxation ('In my view, the fixed-place-of-business threshold, ie PE or fixed base, that applies to the source country taxation of business profits generally is clearly insufficient for income from services. That threshold was adopted at a time when most cross-border business activity involved the

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achieved by this distributive rule presupposes brick-and-mortar businesses that require, at some point in time, to be physically present to be meaningfully involved in a country's economy.[92] Physicality was, on this view, the best available proxy for nexus in a world in which physicality was assumed to be fundamental to the production of business income in a jurisdiction.

Yet, the permanent establishment threshold is not necessarily designed to prevent source-based taxation of different business income items by drawing a rigid line between taxation and exemption. It could instead be the case that the threshold merely defines the parameters for net taxation versus gross taxation. This construction is borne out in the Australian case of *Tech Mahindra Limited v Commissioner of Taxation*, in which an Indian taxpayer received payments that could be alternatively described in both Article 7 (business profits) and Article 12 (royalties) of the Australia-India treaty.[93] The taxpayer argued that the payments were not taxable in Australia because they were business profits that were not attributable to the local permanent establishment, such that Australia could not return to Article 12 and impose gross-basis withholding instead.[94] The Federal Court of Australia rejected this argument on grounds that 'no reason or purpose is identified which would be served' by the taxpayer's proposed construction. To follow the taxpayer's logic would lead to an absurd result in that Australia would have 'no entitlement to tax the income at all'. The Court thus agreed with the Australian Tax Commissioner's construction that in the case of payments covered by Articles 7 and 12 without an effective connection to a permanent establishment, Australia is entitled by Article 12(4) 'to impose tax at the potentially more generous rates permitted under Article 7(1)'. The Court characterised this interpretation as 'manifestly … the purpose which Article 12(4) is intended to serve'.[95]

If this view is conceptually difficult to accept, we should ask ourselves why that is so. If the answer is nothing more than tradition and historical practice, we should interrogate how antiquated traditions serve as interpretation standards. The permanent establishment threshold is drawn from an age in which there was virtually no way to become established in a jurisdiction without physical presence of labour and capital.[96] That is not the world of business today.

Even if it may be clear that data services income constitutes business profits, it is also possible to view such fees as royalties, other income, or a defined category of technical services. It is a permissible act of interpretation to look for treaty wording that allows for expansion (eg, the part of the royalties article that states 'or for information concerning industrial, commercial or

manufacture or production and sale of goods. In a modern economy, cross-border services are much more important. Such services can often be performed without the need for any fixed place of business and the country in which services are performed should have the right to tax the income from those services in certain circumstances where there is no PE in the country'.).

[92]So, for example, the OECD and UN Model will provide different time spans for a foreign company to create a permanent establishment via a building site, assembly, construction or an installation project (at least twelve or six months, respectively). OECD Model, Art 5(3); UN Model, Art 5(3)(a).

[93]Mahindra 2015, supra (n 77).

[94]Ibid., (noting 'the applicant's construction that, while the Contracting States agreed that it is appropriate for the source State to tax royalties arising in its territory to a capped amount under Article 12(2), [the] State may "lose" any entitlement to tax the profits at all where there is an effective connection between the payments and the permanent establishment which does not satisfy Article 7(1)(a) or (b).').

[95]Ibid., ('The difficulties in identifying any comprehensible purpose are illustrated by contrasting a case where a connection exists between the payments and the permanent establishment albeit outside Art 7(1)(a) or (b), on the one hand, with a case where there is no effective connection between the payments and the permanent establishment, on the other hand. On the applicant's case, the source State would have no entitlement to tax the income at all in the first scenario, but retain its entitlement to tax royalties under Art 12 in the other.').

[96]S Jogarajan, *Double Taxation and the League of Nations* (Cambridge University Press 2018) 214 (referencing a 1928 debate among League of Nations experts regarding the design of Art 5 (permanent establishment) and its relation to business profits where 'Borduge (France) queried whether their decisions were logical. In particular, he questioned the position of a company with its head office in Canada, shareholders in France, and activities in Belgium. He was unsure which principle would give Canada the right to tax the company. Clavier responded that the 1928 Experts should only examine actual cases and not hypothetical scenarios. He did not think it possible that the nationals of one country would cross the seas to establish a company in another country.').

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scientific experience') to encompass the underlying purpose of tax treaties, namely to prevent double taxation (rather than to facilitate non-taxation).[97] This is an argument for an evolutionary interpretation, which is a teleological or purposive interpretative approach.[98]

An evolutionary approach is appropriate because as a legal text, a treaty provision requires interpretation, and interpretations may change over time.[99] To read tax treaty provisions today without considering the context in which they were drafted and the evolving reality of business profit production could lead, in the words of the Vienna Convention on the Law of Treaties of 1969, to 'a result which is manifestly absurd or unreasonable'.[100] Further, the OECD and United Nations have long advocated for an ambulatory or dynamic interpretive approach to tax treaties,[101] and this view has been supported in the literature.[102] This view is also reflected in domestic U.S. tax law jurisprudence.[103]

[97]See Dothan, supra (n 90) at 790 ('A teleological reading of the treaty must seek not only the direct wishes of the parties but also more abstract goals they set for the treaty regime as a whole'.).

[98]Ibid., ('Teleological interpretation is also naturally connected to evolutionary interpretation that allows the meaning of the treaty to develop and change over time. While the text of the treaty and the will of the parties are relatively fixed, the object of the treaty, especially in high levels of abstraction, is malleable and can transform to suit new conditions. International courts have usually opted for expansive treaty interpretation instead of restrictive treaty interpretation.').

[99]Evolving modes of interpretation are wholly compatible with the Vienna Convention on the Law of Treaties, as recognised by public international law scholars and the case law of international courts. Such an approach could help establish the principle that the good-faith intention of treaty partners was never to fully suppress source-based taxation even when physical presence is no longer necessary to earn significant income from market states. As such, an evolving interpretation could be considered reasonable for respecting the idea of tax sovereignty and preserving the right of source states to tax profits with a deep connection to their territory. See, eg, PB Musgrave, 'Sovereignty, Entitlement, and Cooperation in International Taxation' 26 (2001) Brooklyn Journal of International Law 1335, 1341 ('The right of a jurisdiction to tax all income arising within its geographical borders is recognised as a fundamental entitlement.'); PB Musgrave, 'Taxing International Income: Further Thoughts' 26 (2001) Brooklyn Journal of International Law 1477, 1479 ('[T]he withholding tax is an integral part of each source country's effective tax rate and as such should play an important role in the attainment of inter-nation equity.'); PB Musgrave, 'Fiscal Coordination and Competition in an International Setting' in L Eden (ed), *Retrospectives on Public Finance* (Duke University Press 1991) 276, 294 ('[T]he jurisdiction of source or location of economic activity giving rise to the income, consumption or property, is assigned the primary right to tax whether the income accrues to its own or foreign residents.'); PB Musgrave, 'Combining Fiscal Sovereignty and Coordination: National Taxation in a Globalizing World' in I Kaul and P Conceição (eds), *The New Public Finance: Responding to Global Challenges* (Oxford University Press 2006) 172 ('[The entitlement to tax at source] permits a country to share in the gains of foreign-owned factors of production operating within its borders, gains that are generated in cooperation with its own inputs, whether they be natural resources, an educated or low-cost workforce, or proximity to a market.').

[100]Vienna Convention on the Law of Treaties of 1969 [hereinafter VCLT], Art 32(b).

[101]OECD Model, comm. Art 3(2); UN Model, comm. Art 3(2).

[102]For example, Rebecca Kysar notes that '[a]n ambulatory approach is preferable for several reasons', including that '[i]t is impractical to draft treaties anticipating future events but also to renegotiate treaties for every necessary update . . . '. Therefore, updating domestic rules might be 'necessary to fill the treaty's gaps because of the need not only to combat tax abuse but to grow with a changing global economy.' RM Kysar, 'Interpreting Tax Treaties' 101 (2015) Iowa Law Review 1387, 1426.

[103]The possibility of re-interpreting the law in light of the new reality brought on by the digital economy led the U.S. Supreme Court in 2018 to take a more expansive view regarding U.S. states' jurisdiction to impose sales taxes on out-of-state suppliers. *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018) [hereinafter *Wayfair*]. It is true that this decision concerned U.S. state-level retail sales taxes and not international corporate taxation, but the U.S. Supreme Court unmistakably adopted a contemporary reading of legal concepts, specifically tax nexus. See, eg, R Mason, 'Implications of Wayfair' 46 (2018) Intertax 810, 817 (cautioning that *Wayfair* would not help digital services taxes because these are turnover taxes that cannot be credited in other countries but, at the same time, stating that 'proponents of digital taxation have even more support from the US jurisprudence than they realise: the only question in *Wayfair* was whether sales taxes would remain an exception to the general rule that physical presence was not needed to establish tax nexus.'); RS Avi-Yonah, 'The International Implications of Wayfair' 91 (2018) Tax Notes International 161 (asserting Wayfair's relevance for the international debate on digital taxation, even though it was on sales tax and not income tax, because the direct/indirect distinction is not so meaningful and the *ratio decidendi* of the case is even more applicable to profits taxation); W Hellerstein, J Owens, and C Dimitropoulou, 'Digital Taxation Lessons from Wayfair and the U.S. States' Response' 94 (2019) Tax Notes International 241, 254 ('The fundamental message of *Wayfair* . . . is that tax rules for the digital economy, whether involving allocating taxing rights or enforcing tax obligations arising from those rights, should reflect contemporary economic reality while avoiding the imposition of undue burdens on those tasked with collection obligations.'); R Finley, 'Wayfair Decision Echoes Case for Digital PE Standard' 91

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Even a strained reading of an ambiguous provision can be acceptable in certain circumstances, so long as it meets the lawmakers' intentions.[104]

An ambulatory approach means that the treaty should follow a contemporary meaning of its terms, rather than reference only to those concepts and economic realities existing at the time of ratification. Drawing from policy learning and exogenous factors such as technological change, a dynamic interpretation of treaties could reasonably establish that treaty partners never agreed to restrict their otherwise unlimited power to tax (at source) profits that do not depend on the firm's physical presence to carry on its business.

To some extent, the Vienna Convention acts as a constraint on the ways in which authorities may interpret or apply tax treaties.[105] On the other hand it facilitates the emergence of a revised understanding over time in that the interpretive rules of Articles 31–3 accept an evolutionary or evolutive approach.[106] The analogous ambulatory approach advocated by the UN and OECD for tax treaty interpretation has been extensively discussed in the literature, particularly in relation to

(2018) Tax Notes International (quoting an official from the Finance Ministry of Estonia saying that the 'main elements of the global digital tax discussion are present in the [*Wayfair*] decision, regardless of the fact that it concerns sales tax and not the corporate income tax.'). Even the four dissenting justices agreed that tax nexus based on physical presence made sense in previous times but no longer for the digital economy. The disagreement in *Wayfair* basically rested on whether past precedent, even if bad precedent, should be upheld as a matter of stare decisis, thus leaving Congress to decide on changing the nexus rule. RLW Harris, 'Did the Supreme Court Do Congress's Dirty Work When It Killed Quill? State Sales Tax on Remote Sellers and Wayfair' 72 (2019) Tax Law 671. See also B Galle, 'Kill Quill, Keep the Dormant Commerce Clause: History's Lessons on Congressional Control of State Taxation' 70 (2018) Stanford Law Review 158, 166 (recommending overturning Quill instead of leaving the whole matter to Congress, because empirical evidence shows that 'Congress's performance when it regulates state taxes is shaped by self-serving and interest-group-driven considerations.'); EC Miller, 'Answering the Call: South Dakota v. Wayfair, Inc. and a Challenge to the Physical Presence Rule' 64 (2019) South Dakota Law Review 94, 94 (saying that previous decisions were always bad law and that *Wayfair* 'correctly determined the physical presence rule was a formalistic and anachronistic rule, which does not properly account for the expansion of technology.').

[104]Perry, supra (n 90). See also YA Wang, 'The Dynamism of Treaties' 78 (2019) Maryland Law Review 828, 845 (stating that 'practice [of some adjudicatory bodies] has even been employed to support a treaty interpretation that strains or contradicts the plain meaning of the text.').

[105]See N Bravo, 'Interpreting Tax Treaties in Light of Reservations and Opt-Ins under the Multilateral Instrument' 74 (2020) Bulletin for International Taxation 231, 234; R Danon and W Schön, 'Tax Treaty Interpretation after BEPS' 74 (2020) Bulletin for International Taxation.

[106]E Bjorge, *The Evolutionary Interpretation of Treaties* (Oxford University Press 2014) (stating that there is nothing exceptional about an evolutionary interpretation, which is a consistent approach that derives from the Vienna Convention's general rules of interpretation in the search for what treaty partners objectively *intended*); C Djeffal, *Static and Evolutive Treaty Interpretation: A Functional Reconstruction* (Cambridge University Press 2016) (arguing that the Vienna Convention is intertemporally open, serving more as 'a guide for the interpreters to extrapolate their agreed reading of the treaty', thus empowering interpreters and enhancing international legal discourse). See also MPV Alstine, 'Dynamic Treaty Interpretation' 146 (1998) University of Pennsylvania Law Review 687; M Fitzmaurice, 'Dynamic (Evolutive) Interpretation of Treaties' 21 (2008) Hague Yearbook of International Law 101; U Linderfalk, 'Doing the Right Thing for the Right Reason: Why Dynamic or Static Approaches Should Be Taken in the Interpretation of Treaties' 10 (2008) International Community Law Review 109; J Arato, 'Subsequent Practice and Evolutive Interpretation: Techniques of Treaty Interpretation over Time and Their Diverse Consequences' 9 (2010) The Law and Practice of International Courts and Tribunals 443; P-M Dupuy, 'Evolutionary Interpretation of Treaties: Between Memory and Prophecy' in E Cannizzaro (ed), *The Law of Treaties Beyond the Vienna Convention* (Oxford University Press 2011); P Merkouris, '(Inter)Temporal Considerations in the Interpretative Process of the VCLT: Do Treaties Endure, Perdure or Exdure?' in M Ambrus and RA Wessel (eds), *Netherlands Yearbook of International Law* 121 (Springer 2014); D McKeever, 'Evolving Interpretation of Multilateral Treaties: 'Acts Contrary to the Purposes and Principles of the United Nations' in the Refugee Convention' 64 (2015) International and Comparative Law Quarterly 405; EE Triantafilou, 'Contemporaneity and Evolutive Interpretation under the Vienna Convention on the Law of Treaties' 32 (2017) ICSID Review 138; OI Roos and A Mackay, 'The Evolutionary Interpretation of Treaties and the Right to Marry: Why Article 23(2) of the ICCPR Should Be Reinterpreted to Encompass Same-Sex Marriage' 49 (2017) George Washington International Law Review 879; G Marceau, 'Evolutive Interpretation by the WTO Adjudicator' 21 (2018) Journal of International Economic Law 791; D Moeckli and ND White, 'Treaties as "Living Instruments"' in M Bowman and D Kritsiotis (eds), *Conceptual and Contextual Perspectives on the Modern Law of Treaties* (Cambridge University Press 2018); G Abi-Saab et al (eds), *Evolutionary Interpretation and International Law* (Hart Publishing 2019); D Liakapoulos, 'Evolutionary, Dynamic or Contemporary Interpretation in WTO System?' 5 (2019) The Chinese Journal of Global Governance 21; M Jimoh, 'The

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updated OECD commentaries to its model convention.[107] Even though the appropriateness of this doctrine has raised disagreement amongst legal scholars,[108] a dynamic approach is in line with the general rules set forth in the Vienna Convention that require that a treaty be interpreted 'in good faith' and 'in light of its objects and purpose' so as to avoid 'a result which is manifestly absurd or unreasonable'.[109]

Reading tax treaties in a contextual and purposive manner is a core interpretive requirement, and doing so should assist lawmakers seeking to defend the expansion of withholding taxes at source against a categorical rejection on doctrinal grounds. The goal is to preserve taxing rights that would never have been surrendered had the rise of digitalisation been anticipated. The underlying rationale is that relevant conceptions have changed in such a way that to continue to adhere to conventional definitions or to rely on plain meaning readings of treaties would be contrary to the broader good-faith intentions of the parties as well as the object and purpose of designing different categories of income and physical presence thresholds in the first place.

Accordingly, an interpretation of treaty terms that validates a legal characterisation of data service fees as royalty, other income, or technical services (grounded on Article 3(2) of tax treaties in combination with Articles 31 and 32 of the Vienna Convention) need not be viewed as permissive of treaty override. Rather, such an approach may be viewed as accounting for an evolving consensus surrounding new economic realities in order to realise the treaty's broader mandates.

5. Conclusions

When policymakers consider the choice between adopting a standalone tax on data service-related transfers or working with the existing corporate income tax regime, bilateral and multilateral tax, trade, and investment agreements are ever-present factors. Using income taxes instead of a standalone digital services tax will not immunise the European Union and countries elsewhere against U.S. resistance, but it would likely circumvent the immediate trade retaliation that seems sure to arise.

In 2015, the OECD first acknowledged a gross-basis final withholding tax as a possible measure to capture the profits created by highly digitalised firms, 'provided they respect existing treaty obligations or [adopt changes] in their bilateral tax treaties."[110] It cautioned that countries and firms might raise international trade law and EU law challenges in response yet recognised that the different agreements carry distinct implications for tax measures. In particular, the OECD noted

Evolutive Interpretation of the African Charter of Human and Peoples' Rights' 10 (2023) Indonesian Journal of International and Comparative Law 43.

[107]Eg, PJ Wattel and O Marres, 'The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties' 43 (2003) European Taxation 222; PJ Wattel and O Marres, 'Characterization of Fictitious Income under OECD-Patterned Tax Treaties' 43 (2003) European Taxation.

[108]U Linderfalk and M Hilling, 'The Use of OECD Commentaries as Interpretative Aids: The Static/Ambulatory–Approaches Debate Considered from the Perspective of International Law' (2015) Nordic Tax Journal 34 (surveying the literature). See also LA Steenkamp, 'The Use of the OECD Model Tax Convention as an Interpretative Aid: The Static vs Ambulatory Approach Debate Considered from a South African Perspective' 10 (2017) Journal of Economic and Financial Sciences 195; EJ Rensburg, 'The Application and Interpretation by South African Courts of General Renvoi Clauses in South African Double Taxation Agreements' 22 (2019) Potchefstroom Electronic Law Journal 1; MS Kirsch, 'The Limits of Administrative Guidance in the Interpretation of Tax Treaties' 87 (2009) Texas Law Review 1064; K Vogel, 'The Influence of the OECD Commentaries on Tax Treaty Interpretation' 54 (2000) Bulletin for International Taxation 612; JFA Jones, 'The Effect of Changes in the OECD Commentaries after a Treaty is Concluded' 56 (2002) Bulletin for International Taxation 102; D Ward, 'The Role of Commentaries on the OECD Model in the Tax Treaty Interpretation Process' 60 (2006) Bulletin for International Taxation 97.

[109]VCLT, Arts 31(1) and 32(b).

[110]OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1– 2015 Final Report* (2015) [hereinafter Action 1 Final Report] at 113.

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that the GATS provides broad exceptions in situations involving tax treaties and for the imposition of direct tax provisions aimed at ensuring the equitable or effective imposition of direct taxes, while the GATT prohibits parties from subjecting imported products to taxes in excess of those that would apply to similar products produced domestically.[111] Regardless of these distinctions, it seems clear that the OECD's overall preference is to sidestep trade and investment entanglements in favor of forging a coordinated multilateral solution, even if doing so requires renegotiation of existing income tax treaties.[112] But a coordinated multilateral solution is by no means the only possible approach involving income taxes; unilateral and EU-level tools exist and in many circumstances are a more feasible option.

To the extent that there are concerns about violating treaties, it is useful to recall that disputes about the reach, scope, and meaning of treaties are very often resolved through a diplomatic process that involves designated officials whose discretion to resolve matters with treaty partners is broad according to the terms of the treaty. Thus, in the OECD Model, the designated treaty dispute resolution personnel – the so-called 'competent authorities' of the respective treaty partners – are authorised not only to endeavor to resolve 'any difficulties or doubts arising as to the interpretation or application of the Convention . . . ', but they 'may also consult together for the elimination of double taxation in cases not provided for in the Convention'.[113] This is an expansive delegation of authority that in effect empowers the treaty partners to achieve ends not necessarily laid out in the treaty. The scope of competent authority powers should accordingly inform lawmakers who are considering how to bring data-based payments within scope of the taxing power.

In sum, digital services taxes and similar measures are meant to offset income tax revenue losses that market states face in an increasingly digitised world. But imposed as stand-alone excise taxes, these measures have attracted retaliatory trade-based action from the United States which cannot currently be effectively challenged before the WTO. Bringing digital services taxes into the income tax system would reduce some of this retaliation risk. A dynamic approach to interpreting existing tax treaty concepts may thus provide a more reliable way of achieving the objectives of digital services taxes, with less friction.

[111]Ibid., at 115 ('Both agreements generally require foreign suppliers of goods (in the case of GATT) and services (in the case of GATS) to be taxed no less favourably than domestic suppliers.'). While the GATT is not explicit about the possibility of withholding taxes on income from the cross-border sale of products, one of the GATS general exceptions to restrictions on cross-border services include measures 'aimed at ensuring the equitable or effective imposition or collection of direct taxes' (Article XIV(d)). Footnote 6 to the cited article specifies to nonresident service suppliers in order to ensure the source state can collect taxes, prevent avoidance or evasion, and protect its tax base by determining, allocating or apportioning income, profits, gains, losses, deductions, and credits of resident entities and its related parties. As such, withholding taxes, even if contrary to the national-treatment principle (which generally requires that foreigners be treated no less favourably than nationals), are allowed under the GATS so long as they 'are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services . . . ' (Article XIV). Furthermore, if these taxes are fully credited in the residence state, they can also apply differently among taxpayers from each trading partner without resulting in discrimination that would be prohibited by the most-favoured-nation principle. The assumption here is that gross-basis withholding taxes matched by foreign tax credits ensure that the overall liability is not less favourable than a purely net-basis income assessment. See JE Farrell, 'The Effects of Global and Regional Trade Agreements on Domestic Tax Law and Bilateral Tax Conventions: Proceedings of a Seminar held at the 60th International Fiscal Association' 35 (2007) Intertax 286, 288; RS Avi-Yonah, 'Treating Tax Issues Through Trade Regimes' 26 (2001) Brooklyn Journal of International Law 1683, 1684–5 (n 4). But see Daly, supra (n 55) at 543–4 (suggesting that a Bangladesh withholding tax of 3% on imports that is creditable against the corporate tax is 'tantamount to an import charge' when 'the importer is in a non-tax-paying position', such as when the importer operates at a loss or enjoys tax incentives).

[112]According to the OECD, a coordinated solution would be preferable in order to capture any business with a digital or automated platform that has a 'purposeful and sustained interaction' with the local economy. Pertinent factors to determine whether such interaction is present included the amount of revenues generated through a digital platform; the level of sustained local user interaction; the use of local marketing and promotion; the integration of local forms of payment into purchasing platforms (that is, prices reflecting local currency); the number of monthly active users that visit the digital platform; and the amount of digital data collected by the business. Industries likely to be affected include those providing streaming services, search engines, as well as transportation and accommodation services that operate on a digital platform. Action 1 Final Report.

[113]OECD Model, Art 25.

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