

# Seeking Cover: A Path to Challenge Digital Services Taxes in Ireland

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Reprinted from *Tax Notes International*, May 13, 2024, p. 973

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In this article, the authors explain how Irish taxpayers can use the EU tax dispute resolution directive to challenge the tax treaty

compatibility of EU member states' digital services taxes.

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### Introduction

The OECD's outcome statement on the two-pillar solution<sup>1</sup> provides for an extension to the standstill on the introduction of new digital services taxes. The extension will last until December 31, 2024, with provision for a further extension to December 31, 2025, if sufficient progress is achieved on the entry into force of the multilateral convention on amount A of pillar 1 (MLC).

The trajectory of pillar 1, however, is far from certain, with many commentators casting doubt on the likelihood of the MLC ever being ratified.<sup>2</sup> As a result, taxpayers should expect to encounter DSTs (and similar unilateral tax measures) for some time to come.

The uncertainty generated by the likely proliferation of DSTs is compounded by the uncertainty on the exact status and treatment of DSTs as a matter of international tax law. In particular, the compatibility of DSTs with double taxation treaties (DTTs) is unclear.<sup>3</sup>

This article examines the potential for the EU tax dispute resolution directive<sup>4</sup> to provide an effective and efficient mechanism to challenge the imposition of DSTs (and other similar unilateral tax measures) in an intra-EU context. This article will focus on the procedural steps involved in

<sup>1</sup> OECD, "Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy" (July 11, 2023).

<sup>2</sup> See, e.g., recent commentary in this publication, including Robert Goulder, "Expectations for 2024: Pillar 1 Finds an Off-Ramp," *Tax Notes Int'l*, Dec. 18, 2023, p. 1819; and Reuven S. Avi-Yonah, "Do Not Waste Your Time Deciphering the Multilateral Tax Convention," *Tax Notes Int'l*, Oct. 16, 2023, p. 399.

<sup>3</sup> See, e.g., OECD, "Tax Challenges Arising From Digitalisation – Interim Report 2018," at chap. 6 (Mar. 16, 2018).

<sup>4</sup> Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the European Union.

obtaining a binding determination on whether those measures are compatible with the provisions of relevant Irish DTTs.

### DSTs – An Overview

DSTs are generally levied on gross income generated from digital services such as online advertising services, digital interface services, and data transmission services (irrespective of the residency status of the relevant service provider).<sup>5</sup> The exact form and application of DSTs can vary from jurisdiction to jurisdiction.

It is likely that jurisdictions that introduce DSTs will be of the view that the deliberate design of the relevant DST is such that it will not constitute a covered tax and is therefore outside the scope of a DTT. However, as noted above,<sup>6</sup> the DTT compatibility of DSTs remains uncertain and requires a case-by-case analysis of the characteristics of the relevant measure to determine whether:

1. the particular DST is a covered tax under the applicable DTT;<sup>7</sup> and
2. the imposition of the DST infringes on the nondiscrimination provision in the relevant DTT.

### Avenues for Challenging DSTs

In an international context, mutual agreement procedure is the main avenue for taxpayers to resolve instances of taxation in contravention of DTTs. The structure and process applicable to MAP depends on the legal basis for the relevant MAP.

Traditional MAP is available under article 25 of the OECD model tax convention as implemented in the relevant DTT. In addition, in an EU context, MAP is available under the EU

arbitration convention<sup>8</sup> and, more recently, the directive.<sup>9</sup>

### The Shortcomings of MAP Under DTTs

Notwithstanding the potential technical arguments in relation to the compatibility of a DST with a particular DTT, a key practical question arises: How can the binary question of whether a particular DST infringes on a specific DTT be determined by mutual agreement when the taxing jurisdiction maintains the position that the relevant DST is outside the scope of the relevant DTT?

As noted, the primary mechanism for Irish taxpayers to resolve double tax disputes under a DTT is by way of MAP. Traditionally, for EU taxpayers, the main options for initiating MAP were by way of a DTT or the arbitration convention. However, the availability of MAP under a DTT or the arbitration convention first requires competent authorities to agree that the relevant tax (for example, a DST) comes within the scope of the relevant DTT. It is in this context that the directive is particularly effective because it provides a path to appeal decisions that were denied access to MAP.

### Unlocking Stalemate: The Directive's Advantage

The EU's Economic and Financial Affairs Council adopted the directive in 2017, bringing new options for taxpayers seeking to resolve double tax disputes. The directive was designed to build on the existing arbitration convention and the DTTs by "broadening the scope and improving procedures and mechanisms in place without replacing them."<sup>10</sup>

Ireland implemented the directive for disputes on tax periods commencing on or after January 1, 2018,<sup>11</sup> to provide a framework for the

<sup>5</sup>For useful details on the nature and status of various DSTs across the EU, see Daniel Bunn and Elke Asen, "What European Countries Are Doing About Digital Services Taxes," *The Tax Foundation* (Aug. 9, 2022); Note, Sofia Balladares et al., "Digital Services Taxes," *EU Tax Observatory* (June 2023); and The National Foreign Trade Council, "International Tax" (last visited Apr. 8, 2024).

<sup>6</sup>See OECD/G20, *supra* note 3.

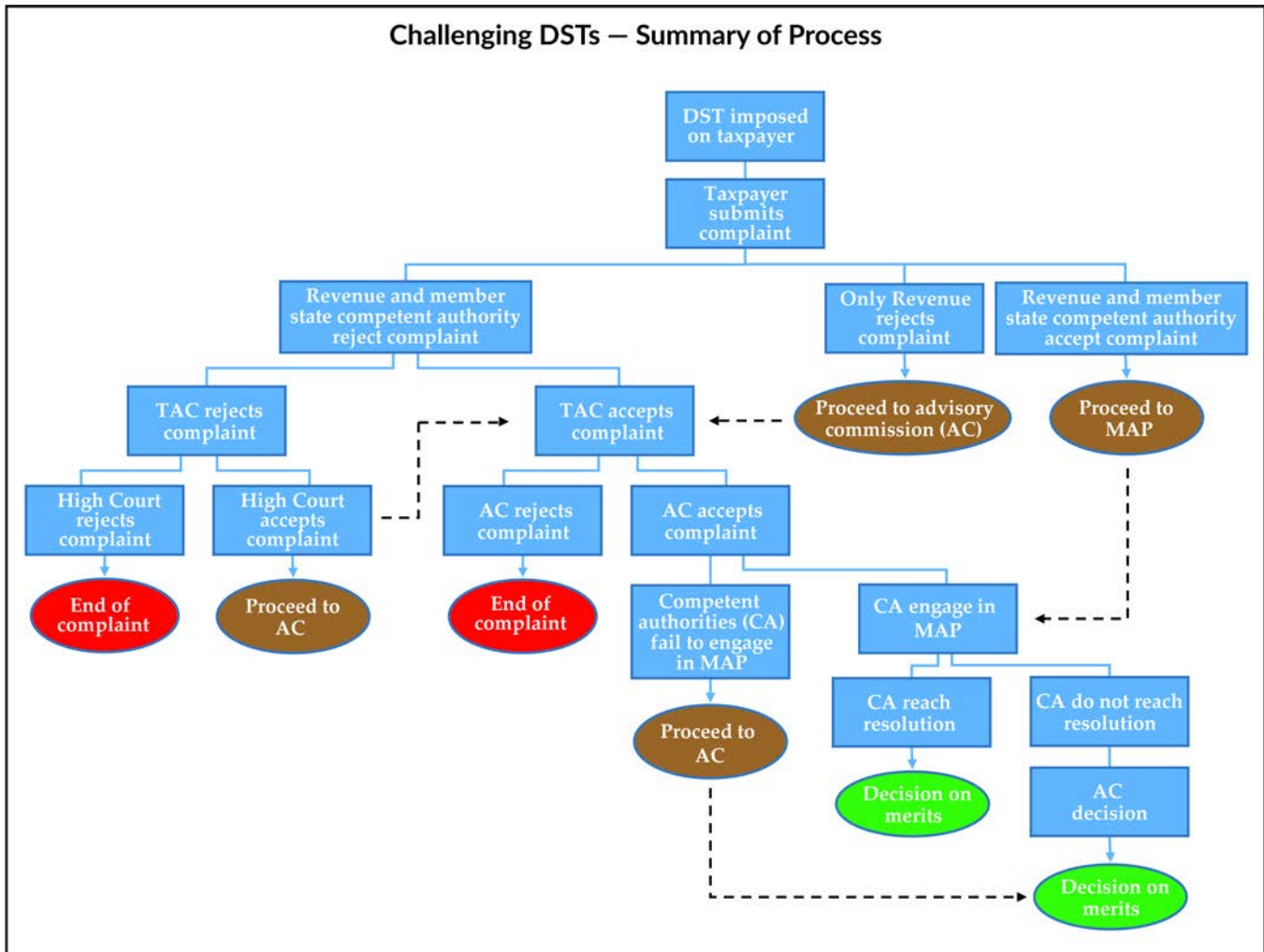
<sup>7</sup>It is worth noting in this context that many of the DTTs that Ireland has in place with other EU jurisdictions (such as France, Italy, and Spain) include language that reflects the equivalent of article 2 of the OECD model convention and in particular the reference to "substantially similar taxes."

<sup>8</sup>Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC).

<sup>9</sup>Of course, there may also be options open to a taxpayer to challenge a DST before domestic courts.

<sup>10</sup>European Commission, Proposal for a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union, COM(2016) 686, at 3.

<sup>11</sup>European Union (Tax Dispute Resolution Mechanisms) Regulations 2019, as amended (Statutory Instrument 306/2019). The directive can be applied to an earlier tax year if the competent authorities involved agree to do so. Irish Revenue is the competent authority for Ireland.



resolution of tax disputes between Ireland and other EU member states arising from the interpretation and application of Ireland's DTTs.

Importantly, the directive is broad in scope, with the recitals to the directive specifically noting that it is intended to be wider than preexisting resolution options. Moreover, the directive covers any dispute between Ireland and any EU member state arising from the interpretation or application of DTTs. On this basis, for example, a dispute concerning whether the Italian, Spanish, or French DST falls within the definition of a covered tax for the purpose of the relevant Irish DTT and, subsequently, whether the imposition of that DST is in accordance with the relevant Irish DTT should fall within the scope of the directive.

The sections below detail the practical operation of the directive and how it can be

invoked in the context of effectively challenging DSTs. A diagram summarizing the dispute resolution process under the directive is included for ease of reference.

#### Path to Resolution: MAP Under the Directive

The process for initiating MAP under the directive, and the subsequent process of negotiation between the competent authorities to arrive at a solution for the dispute in question, shares many commonalities with a traditional MAP under a DTT. However, importantly, when the taxpayer submits the complaint to the competent authorities, any rejection of the complaint can be appealed. Although the process for progressing a complaint through MAP under the directive can vary depending on the decision of the competent authorities, the directive should

ensure that a binding decision on whether a DST is a covered tax is possible in all cases.

### Making the Complaint

Similar to traditional MAP under a DTT, MAP under the directive is initiated by the affected taxpayer submitting a complaint to Irish Revenue and the competent authority of the relevant member state(s) involved. The complaint must be submitted to Irish Revenue within three years of first notification of the action resulting in, or that will result in, the challenged taxation.

When a taxpayer submits a complaint under the directive, any ongoing MAPs regarding the same matter (for example, under a DTT) must be brought to an end; the two MAPs cannot proceed in parallel. This is designed to ensure that there is no duplication, given both the procedural and substantive overlap that would exist for the two proceedings.

### Acceptance of the Complaint

Irish Revenue must notify the taxpayer within six months as to whether the complaint is accepted.<sup>12</sup> If the complaint is accepted, the competent authorities will endeavor to resolve the matter by way of mutual agreement within a maximum of three years (that is, two years plus an optional one-year extension).<sup>13</sup> Throughout the MAP process, the competent authorities may seek additional information from the taxpayer.

After agreement is reached by the competent authorities, the outcome is subject to acceptance by the taxpayer, and the taxpayer must renounce all rights to other domestic remedies.

### Rejection: The Directive's Game Changer

Irish Revenue can refuse to accept the complaint within six months on certain limited grounds, including if, in the opinion of Irish Revenue, there is no question in dispute. Consequently, Irish Revenue could, in theory, take the position that the relevant DST does not fall

within the scope of an Irish DTT (that is, it is not a covered tax) and, on this basis, conclude that there is no dispute arising from the interpretation or application of an Irish DTT.

However, in an important improvement on existing MAP mechanisms, the rejection of a complaint by Irish Revenue or another competent authority does not mark the end of the proceedings. Instead, the taxpayer can appeal the rejection of the complaint. Notably, in most cases, as the question of acceptance will depend solely on whether the DST is a covered tax under the DTT, the resolution of this initial question should be sufficient to resolve the substance of the entire dispute.

The specific mechanism for appealing the question of acceptance will depend on whether the complaint is rejected only by Irish Revenue or whether the complaint is rejected by all competent authorities involved.

#### Rejection by All Competent Authorities

If the complaint is rejected by all the competent authorities involved, the taxpayer can appeal Irish Revenue's rejection to the Irish Tax Appeal Commission (TAC) within 30 days of the date of the notice of Irish Revenue's decision.

The TAC is an independent statutory body established to resolve tax disputes in Ireland. In general, appeals before the TAC are held in private and TAC decisions are anonymized. As a tax tribunal, the TAC operates with greater procedural flexibility than the Irish superior courts and has a strong record of resolving disputes in an efficient manner. A decision of the TAC can be appealed to the Irish High Court on a point of law.

If the taxpayer is unsuccessful in overturning Irish Revenue's rejection of the complaint through the TAC process, the proceedings under the directive are at an end.<sup>14</sup> However, the mandatory appeal process prescribed under the directive ensures that the taxpayer can advance the matter beyond the discretion of the competent authorities and obtain a binding ruling from an independent decision-making body on the

<sup>12</sup>This time limit can be extended in circumstances in which Irish Revenue requests additional information from the taxpayer.

<sup>13</sup>In the same way as under traditional MAP, the competent authorities can first seek to resolve the matter on a unilateral basis. However, when unilateral resolution is not possible, the competent authorities then engage in negotiation to reach an agreed solution.

<sup>14</sup>It is possible to appeal a determination of the TAC to the Irish High Court.

compatibility of the relevant DST with the relevant DTT.

### Rejection by One Competent Authority

If a complaint is rejected by only one of the competent authorities involved in the matter, there is no domestic appeal process. Instead, the directive prescribes a self-contained review mechanism: the advisory commission.<sup>15</sup> As outlined below, the commission is established under the directive, and like mandatory binding arbitration, it is designed to provide for mandatory binding resolution of the relevant question in dispute.

In these circumstances, the taxpayer requests the competent authorities to establish an advisory commission to rule on the acceptance of the complaint. The commission must be established within 120 days of the request and must make its determination on the acceptance of the complaint within six months of its establishment.

If the advisory commission determines that a complaint should be accepted, this decision is binding on the competent authorities. As such, the complaint is conclusively determined to be within the scope of MAP under the directive, and the matter should proceed to MAP between the competent authorities. To the extent that the competent authorities refuse or fail to engage in MAP within 60 days of the commission's decision, then the commission will proceed to resolve the complaint under its arbitration procedures.

Consequently, the directive provides a clear path to taxpayers to ensure that the competent authorities engage with the complaint, resolving one of the shortcomings inherent in traditional MAP. Importantly, as noted, when the question of acceptance of the complaint depends on whether the DST is a covered tax under the relevant treaty, the resolution of the issue of admissibility should go to determining the broader complaint as a whole, given its binary nature.

<sup>15</sup> Equally, when the TAC overturns the decision of the Irish competent authority to reject a complaint, the question of the acceptance of the complaint will then proceed to the advisory commission for a final ruling on the question of acceptance.

### Mandatory Binding MAP Resolution

Once the complaint enters into MAP, the competent authorities are obliged to endeavor to resolve the dispute by mutual agreement. To the extent that the competent authorities do not reach agreement in MAP, the directive provides for the binding resolution of the complaint by the advisory commission or the alternative dispute resolution commission (ADRC).

### Establishing an Advisory Commission

If the competent authorities fail to resolve MAP within two years,<sup>16</sup> the taxpayer can request that the competent authorities establish an advisory commission to determine the substance of the complaint. The commission should be established within 120 days of the taxpayer's request and should issue a determination on the complaint within six months of its establishment.

As an alternative to setting up an advisory commission, the competent authorities can instead elect to establish an ADRC. The main difference between an ADRC and an advisory commission is the availability of different mechanisms for dispute resolution available to an ADRC. The commission can only issue a decision by way of an independent opinion, whereas the ADRC can use alternative methods (for example, last best offer) to resolve the dispute.

### Commission Decision

As noted, the advisory commission (or the ADRC, as relevant) has six months to deliver a decision on the substance of the complaint. Although the competent authorities are not bound by the decision, if they fail to reach an alternative resolution within six months of the decision, it becomes binding on the competent authorities (subject to taxpayer consent).

In light of the nature of DSTs and the potential reticence of national competent authorities to determine the DTT compatibility of a DST, it seems more likely that a decision of the advisory commission or ADRC would be required to determine the matter. The mandatory nature of

<sup>16</sup> This timeline can be extended to three years in certain circumstances.

the directive's mechanics ensures that such a determination is achievable in an efficient manner.

### Determination on DSTs

When the European Commission proposed the directive, the commission noted that new dispute resolution mechanisms were necessary because the existing options led to many complaints getting stuck in the relevant process or remaining unresolved.<sup>17</sup> Consequently, the directive has a strong focus on prescribing definitive timelines for progressing the matter and ensuring that key determinations (for

example, the admission of complaints) are forced to resolution.

This is of particular importance for a potential challenge to the imposition of DSTs or similar unilateral tax measures for which the compatibility of the relevant tax with the relevant DTT is likely to be contentious. In those cases, the initial acceptance of the complaint into MAP will be crucial, and the directive ensures that this step can be determined by an independent binding determination, when necessary.

Because DSTs and similar unilateral measures are more likely to proliferate in than disappear from the international tax landscape in the medium term, at least, the pathway provided by the directive to Irish resident taxpayers to challenge those measures could be particularly important over the coming years. ■

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<sup>17</sup> COM(2016) 686.