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DIGITAL SERVICES TAXES MAY VIOLATE INVESTMENT TREATY PROTECTIONS

To Our Clients and Friends:

Recent tax measures adopted, or contemplated, by States which target foreign investors may violate investment treaty obligations, including national treatment, and fair and equitable treatment obligations. These investment treaties give foreign investors the right to pursue claims directly against the State for such breaches.

The most recent example is France's Digital Services Tax ("DST").[1] The French Senate passed a bill adopting the DST on July 11, 2019, and the President of France, Emmanuel Macron, is expected to sign the bill into law in the coming days. The law, once it comes into force, will impose a 3% tax on total annual revenues generated by certain companies that provide digital services to, or targeted at, users in France. Taxable digital services include: (*i*) making available a digital interface through which users can come into contact with other users, or purchase goods and services; and (*ii*) services provided to advertisers who are able to place targeted advertisements to French users on the digital interfaces. The DST will be imposed on companies that: (*i*) earn an annual global revenue of €750 million or more from taxable digital services; and (*ii*) earn an annual revenue from French users of €25 million or more from taxable digital services. The tax will be applied retrospectively, with tax liability calculations beginning on January 1, 2019.

According to preliminary reports, the DST will impact approximately 30 companies, many of which are based in jurisdictions that are entitled to investment treaty protection.[2] These reports suggest that the DST will predominately impact companies headquartered outside of France in countries including the United States, China, Japan, and Germany. In response to the DST, on July 10, 2019, the United States Trade Representative ("USTR") announced the initiation of an investigation under Section 301 of the Trade Act of 1974. The USTR observed that, "[t]he structure of the proposed new tax as well as statements by officials suggest that France is unfairly targeting the tax at certain U.S.-based technology companies."[3]

Other States have adopted, or are considering the adoption of, similar taxation regimes. The General Court of the European Union recently upheld the validity of a similar tax placed by Hungary on advertising revenue, finding that Hungary's tax was not illegal "State aid" pursuant to Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU").[4] However, the prohibition in Article 107(1) of the TFEU is distinct from the obligations Hungary owes to foreign investors pursuant to its investment treaties. Some of these obligations are discussed in further detail below in the context of France's DST, but equally exist in Hungary's investment treaties.

France's DST, and other similar taxes, may violate investment treaty protections

The DST, and other similar taxation regimes, may violate investment treaty protections owed by these States to certain foreign investors who invest in-country, where there is an applicable investment treaty. For example, with respect to France, there are over two dozen such treaties, including treaties with China, Singapore, Mexico, and Russia. In addition, through its membership in the European Union, France is party to trade agreements with countries including Japan and South Korea.

<u>The right to national treatment</u>

Investment treaties commonly include a protection that requires the host State to treat investments of foreign investors no less favorably than it treats domestic investors in "like circumstances."[5] Arbitral tribunals considering the meaning of "like circumstances" have found that this has "a wide connotation" that requires an assessment of whether "a non-national investor complaining of less favourable treatment is in the same 'sector' as the national investor. . . . [this] includes the concepts of 'economic sector' and 'business sector.'"[6]

In the context of taxation that targets or has a disproportionate impact on foreign investors, arbitral tribunals have held, that where "the adverse effects of [a] tax were felt exclusively by [foreign] producers and suppliers . . . to the benefit of [national] producers" this is sufficient to establish that the treatment is less favorable and therefore a breach of the State's treaty obligation.[7] Arbitral tribunals have added that "[d]iscrimination does not cease to be discrimination, nor to attract the international liability stemming therefrom, because it is undertaken to achieve a laudable goal or because the achievement of that goal can be described as necessary."[8]

With respect to the DST, several French politicians, in advocating for the enactment of the DST, have stated publicly that the DST is designed to target large foreign multinational companies.[9] In addition, the DST has been structured in such a way that the adverse impact will be felt almost exclusively by foreign investors. As a consequence, it is questionable whether France is complying with its obligation to provide national treatment under various investment treaties to which it is Party.

<u>The right to fair and equitable treatment</u>

Most investment treaties also include a protection granting investors the right to fair and equitable treatment by host States. This includes a right to "protection of [a foreign investor's] legitimate expectations, protection against arbitrary and discriminatory treatment, transparency and consistency."[10]

A significant number of investment treaties require the host State to treat the investments of a foreign investor fairly and equitably.[11] Arbitral tribunals have held that this obligation prohibits host States from exercising legislative power in an "arbitrary or discriminatory manner" or from "disguis[ing] measures targeted against a protected investor under the cloak of general legislation."[12]

Given the targeted purpose and impact of taxation regimes like the DST, foreign investors who are impacted by such measures may arguably have a claim that host State has breached its fair and equitable treatment obligation by discriminating against foreign investors.

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France's new DST demonstrates just one example of where investment treaty protections might be invoked by foreign investors to pursue arbitration directly against the state in which they have invested. Investment treaties can offer important protections to foreign investors operating in markets that present significant political and legal risks.

Gibson Dunn lawyers have extensive experience advising clients on structuring their investments to take advantage of investment treaties or in disputes against States for breaches of investment treaties. If you have any questions about how your company can take advantage of such protections, or if you think your company has an investment treaty claim based on France's DST or other similar tax measures, we would be pleased to assist you.

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[1] *See* here.

[2] *See* here.

[3] *See* here.

[4] *Hungary v European Commission*, ECLI:EU:T:2019:448, Judgment of the EU General Court (27 June 2019), here.

[5] *See*, *e.g.*, China-France BIT, Article 4 ("Sans préjudice de ses dispositions légales et réglementaires, chaque Partie contractante applique sur son territoire et dans sa zone maritime aux investisseurs de l'autre Partie, en ce qui concerne leurs investissements et activités lieés à ces investissements, un traitement non moins favorable que celui qui est accordé à ses investisseurs.") ("Without prejudice to its legal and regulatory provisions, each Contracting Party shall apply in its territory and in its maritime area to investors of the other Party, in respect of their investments and activities related to such investments, treatment no less favorable than that which is granted to its investors.") (unofficial English translation).

[6] *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL, Partial Award, 13 November 2000, ¶ 250.

[7] *Corn Products International Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/1, Decision on Responsibility, 15 January 2008, ¶ 138; *Occidental Exploration and Production Company v. Republic of Ecuador*, LCIA Case No. UN3467, Final Award, 1 July 2004, ¶ 177.

[8] *Corn Products International Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/1, Decision on Responsibility, 15 January 2008, ¶ 142; *Quiborax S.A. and Non Metallic Minerals S.A. v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Award, 16 September 2015, ¶ 253.

[9] *See* here.

[10] *Crystallex International Corporation v Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award, 4 April 2016, ¶ 543.

[11] *See*, *e.g.*, Singapore-France BIT, Article 2 ("Les investissements des nationaux ou sociétés de chacune des Parties contractantes bénéficieront en tout temps d'un traitement juste et équitable et il leur sera accordé protection et sécurité sur le territoire de l'autre Partie.") ("The investments of nationals or companies of either Contracting Party shall at all times be accorded fair and equitable treatment and shall be accorded protection and security in the territory of the other Party.") (unofficial English translation).

[12] *Rusoro Mining Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/5, Award, 22 August 2016, ¶ 525.

Gibson, Dunn & Crutcher's lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's International Arbitration practice group, or the following:

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