
TAXATION OF DIGITAL SERVICES UNDER THE GATS FRAMEWORK: CHALLENGES AND OPPORTUNITIES IN THE GLOBAL TRADE REGIME

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ABSTRACT

With rapid digitalization, the world economy has undergone a revolutionary shift in the production, delivery, and consumption of services. More and more, cross-border trade today is increasingly made up of digital services from cloud computing and online advertising to streaming, facilitation of e-commerce, and app-based delivery of services. This shift from physical to digital means of service delivery has also brought enormous challenges to tax regimes and international trade regimes.

National governments, struggling with their tax bases being eroded and unable to tax economically absent firms, have turned to Digital Services Taxes (DSTs) as the solution. The taxes are intended to capture the value created by digitally active platforms in domestic markets. The individual actions have, however, stirred trade tensions, initiated retaliatory threats, and attracted legal scrutiny, particularly in light of the World Trade Organisation's (WTO) General Agreement on Trade in Services (GATS).

This paper discusses DSTS' conformity with GATS disciplines, considers possible breaches of WTO commitments, and examines whether DSTs are defensible under the exceptions of GATS Article XIV. It also examines current initiatives towards multilateral cooperation, especially in the OECD/G20 Inclusive Framework, and considers proposals regarding harmonisation of tax and trade discipline in an increasingly digitalised global economy.

THE RISE AND COMPOSITION OF DIGITAL SERVICES TAXES

The economic activity has followed technology in a manner that has outpaced the development of conventional tax norms. Taxation used to be on the basis of physical presence or permanent establishment. However, technology companies now follow “scale without mass” with user engagement, monetization of data, and platform-based interfaces to earn revenue. This has enabled them to extract enormous value from foreign markets without incurring corporate income taxes on such markets.

To address this challenge, countries like France, India, the United Kingdom, and Italy have enacted Digital Services Taxes. These taxes will most likely be levied on gross revenues instead of profits of specific digital services, such as targeted advertising, sales of data, and facilitation of digital marketplaces. For instance, France’s DST taxes entities with over specific global and domestic revenue thresholds 3% of the revenues received from digital services in its jurisdiction. Similarly, India’s Equalisation Levy was originally charged on online advertising and later on e-commerce operators, imposing a 2% tax on gross receipts from Indian consumers.¹

DSTs have a number of unique features relative to traditional tax arrangements. First, DSTs are levied on gross revenues, not net profits, and this can disproportionately affect, in particular, firms with thin profit margins. Second, DSTs are founded on economic presence such as user interaction and data collection instead of physical presence. Third, DSTs are selective and levied on firms with turnovers above a global or domestic threshold, with the propensity to target large foreign multinationals and exempt local firms.

Tax authorities prefer DSTs as necessary to maintaining equity in the tax system and for protecting against erosion of the base. Critics argue that the taxes are actually discriminatory and would be a breach of international trade norms, namely the WTO commitments under GATS.

THE GATS FRAMEWORK: LEGAL PROVISIONS

The General Agreement on Trade in Services (GATS) is a cornerstone of the multilateral trading system overseen by the World Trade Organization (WTO). It was the first multilateral

¹ Finance Act, s 165A.

accord to provide legally binding rules for international trade in services. GATS was created with the purpose of progressively liberalizing services trade while ensuring the rights of member states to apply regulation, all the while considering their national policy goals.

GATS covers all services except those offered in the course of government authority. It regulates the trade in services in four modes of supply:

- Mode 1 is cross-border supply, where services are supplied from the state of one member into the state of another; for example, software or digital streaming supplied over the internet.
- Mode 2: Consumption abroad - Services consumed by residents of one member in another member's territory, for example, tourism.
- Mode 3: Commercial presence - Services provided by a service provider by commercial presence within the other member's territory (e.g., setting up subsidiaries or branches).
- Mode 4: Natural person presence - Services provided by a natural person of a member country in the other member country (e.g., consultants abroad temporarily).²

Of these, Mode 1 is in the forefront of the field of taxation of digital services. It includes services delivered over the internet, such as online advertising, data analysis, and cloud computing, that are prone to being delivered electronically across a number of jurisdictions. It has emerged quite prominent in the face of digitization in economies, posing a challenge to traditional physical nexus models of tax jurisdiction.

The application of DSTs will impinge upon several of the GATS's core provisions. These are:

- **Article II: Most-Favoured-Nation (MFN) Treatment** - This article demands unconditional non-discrimination treatment between WTO members. Any advantage accorded to the service provider of a member must also be accorded to all others. A Digital Services Tax that excludes service providers from some jurisdictions or accords more favorable terms to regional partners may be in violation of this requirement.

² GATS: General Agreement on Trade in Services, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 (Apr. 15, 1994) U.N.T.S. 183, 33 I.L.M. 1167.

- **Article XIV: General Exceptions** - This article is a safety net for policies otherwise in violation of the GATS so that deviations on public morals, health grounds, or prevention of deceptive or fraudulent practices may be permitted. In taxation, the most significant sub-provisions are Article XIV(c)(ii) and Article XIV(d), which permit certain tax measures for the purpose of the fair or effective operation of direct taxes. These exceptions are, however, construed narrowly and tested strictly by necessity, proportionality, and non-discrimination.
- **Article XVI: Market Access** - This article prohibits quantitative restrictions and restrictions on the number of service suppliers, the amount of service transactions, or the degree of operations or production. DSTs can indirectly discourage market entry or further participation by foreign services providers, particularly small and medium enterprises, as the compliance and tax burden on gross revenue can discourage them.
- **Article XVII: National Treatment** - This provision requires members to give suppliers of any other member no less favorable treatment than they give their similar suppliers. If DSTs are structured to disproportionately target foreign digital businesses, frequently by the imposition of global revenue tests, but exempt similar services of domestic businesses, a violation of this article can occur.³

Of particular note is that GATS does not have a specific provision that addresses digital trade, and at the time GATS was being negotiated in the early 1990s, the digital economy as we now understand it was not envisioned. Nevertheless, WTO jurisprudence has evolved to be mindful of the principle of technological neutrality, most recently in the WTO Work Programme on Electronic Commerce negotiation. Technological neutrality is the idea that services should be treated equally regardless of how they are delivered. An online-delivered service such as cloud hosting is thus treated under GATS on an equivalence basis with one delivered physically or face-to-face through physical server leasing or IT support.⁴

The technological neutrality implication is important. It supports the extension of GATS to digital services and enables its underlying principles to inform the assessment of digital trade barriers, such as DSTs. For example, if a member makes commitments in areas like advertising

³ *ibid.*

⁴ Noonan C and Plekhanova V, "Taxation of Digital Services under Trade Agreements" (2020) 23 *Journal of International Economic Law* 1015 <<https://doi.org/10.1093/jiel/jgaa031>>.

or computer services, digital forms of these services come within the scope of such commitments and the associated GATS obligations.

In short, although GATS was not specifically designed to create space for digital services, its general architecture and evolving interpretations by WTO institutions make it relevant for the future. As digital trade continues to grow, the interaction of GATS commitments and national tax policies, for example, Digital Services Taxes, will inevitably become more intricate and meaningful. The fundamental principles of non-discrimination, transparency, and progressive liberalization embedded in GATS should inform the handling of such new challenges.

DSTS AND POTENTIAL GATS INFRINGEMENTS

Digital Services Taxes have also posed intricate legal issues regarding their consistency with the GATS. Although presented as tax measures, DSTs can, in intent as well as impact, be inconsistent with fundamental GATS commitments, most notably the non-discrimination and market access commitments.

The primary issue is under Article XVII under which WTO members must treat foreign suppliers of services no worse than domestic suppliers. Some DST regimes, such as India's Equalisation Levy and France's GAFA tax fall only or disproportionately on non-resident businesses. These tend to exclude domestic businesses providing similar digital services or to set thresholds that in effect, exclude small local actors. Though nominally origin-neutral, the cumulative effect of such structural features creates *de facto* discrimination, potentially infringing national treatment obligations where covered service sectors are bound in a member's schedule.

DSTs can also violate Article XVI. While not explicit quantitative restrictions, DSTs can act as *de facto* barriers to entry. The administrative costs, turnover-based charges, and complexity of compliance with the taxes can discourage small and medium-sized foreign businesses from entering or remaining in targeted markets. If markets like online advertising or software services are subject to market access commitments, these inadvertent barriers can constitute functional restrictions, thereby violating GATS disciplines.

Furthermore, Article II prevents WTO members from providing advantages to the services or service providers of one trading partner in relation to another except on the basis of a legitimate

exception. Issues are created where DST regimes provide exemption or alleviated compliance burdens by way of bilateral or regional trade arrangements. The multilateral nature of the GATS framework may be compromised if such differential treatment is not allowed by GATS Article V or covered by scheduled exemptions.

Crucially, WTO jurisprudence affirms that even formally neutral tax laws can violate trade commitments if they are implemented in a way that leads to unfair treatment. For instance, tax benefits that disproportionately benefited domestic companies were found to be in violation of both national treatment and MFN obligations in *Brazil-Taxation*.⁵ In a similar vein, the Appellate Body in *Canada-Autos* placed more emphasis on the measure's actual impact than its declared purpose.⁶

So, DSTs must be carefully crafted to avoid breaking GATS obligations, even though they are intended to address the erosion of the tax base in the digital age. Their actual economic impact and conformity to the non-discrimination, market openness, and neutrality tenets that support the multilateral trade regime are more important factors in determining their legal defensibility than their formality.

JUSTIFICATION UNDER ARTICLE XIV: SCOPE AND LIMITS

While DSTs *prima facie* are inconsistent with GATS fundamental obligations, they are arguably justified under Article XIV as general exceptions in respect of measures that are necessary to pursue a legitimate public policy objective. Two sub-paragraphs of Article XIV are of particular relevance when addressing DSTs: Article XIV(c)(ii), inasmuch as it allows measures that are necessary to secure compliance with tax legislations and avoid fraud or tax evasion, and Article XIV(d), inasmuch as it allows measures that are aimed at ensuring equitable or effective assessment of direct taxes.

Yet, access to Article XIV is subject to a stringent three-stage test: “the measure must

- (i) be necessary to attain the specified goal,
- (ii) not amount to arbitrary or unjustifiable discrimination between nations where

⁵ WTO, *Brazil: Certain Measures Concerning Taxation and Charges* (30 August 2017) WT/DS472.

⁶ WTO, *Canada: Certain Measures Affecting the Automotive Industry* (31 May 2000) WT/DS139.

similar circumstances exist, and

- (iii) not be a disguised restriction on trade.

The WTO Appellate Body, most notably in *US - Gambling*, explained this “necessity test” by way of a formal “weighing and balancing” test, examining the seriousness of the goal, the extent of contribution of the measure, and the existence of less trade-remedial alternatives.”⁷

Applied to DSTs, this would mean that unilateral tax measures must demonstrate that no reasonable, less restrictive alternative such as participation in a multilateral initiative like the OECD/G20 Pillar One can achieve the same fiscal impact. Moreover, any discriminatory impact on foreign suppliers, particularly where domestic enterprises are exempted, could render a DST arbitrarily discriminatory.

While no WTO panel has yet ruled on a case solely on DSTs, the developing jurisprudence indicates that invoking Article XIV comes with a high threshold. With this in mind, globally harmonized solutions to digital taxation not only provide greater legal certainty but also decrease the chances of trade disputes and system fragmentation.

OECD PILLARS: A MULTILATERAL WAY FORWARD

The OECD/G20 Inclusive Framework has put forward a comprehensive two-pillar solution to address the tax challenges arising from the digital economy. Pillar One tries to reallocate taxing rights to market jurisdictions based on user interaction and revenue nexus, and Pillar Two proposes a global minimum corporate tax to prevent base erosion and profit shifting.

The Pillar One proposal is to substitute unilateral DSTs with a coordinated system aligned with modern digital business models. This would assist in tax profits being subject to tax where value is created, especially in market jurisdictions where users and consumers are based. While Pillar Two establishes a minimum level of corporate tax competition, it provides a boost to the global tax system’s integrity.

While these plans offer a possible path forward, putting them into practice has been delayed and marred by politics. To this day, as of 2025, the majority of nations have not formally

⁷ WTO, *United States: Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (7 April 2005) WT/DS285.

implemented the measures, and some still enforce or threaten to enforce DSTs. For example, the United States has objected to the imposition of DSTs by European and Asian nations and initiated Section 301 investigations, threatening retaliatory tariffs.

But international recognition of the OECD model will help to lower trade tensions, lower legal uncertainty, and restore faith in multilateralism. WTO rules must, however, adapt to accommodate such tax innovation and align trade and tax regimes with each other.⁸

TRADE EFFECTS OF DSTS AND ECONOMIC IMPLICATIONS

In addition to legal ramifications, digital services taxes have significant impacts on real-world economies. Empirical studies have shown that barriers to trade in digital services, including DSTs, appear to stifle economic growth. DSTs impose significant additional costs to transacting business; they act as fear factors in terms of entering foreign markets and they ultimately contribute to increased prices to consumers.⁹

The World Economic Forum (2020) also claim that DSTs create distortions in competition in particular industries, especially where domestic firms do not subscribe to the same tax streams. This effects not just innovation, but creates distorted and uneven playing fields. And there can be added confusion when the parameters for competitiveness can change and when compliance can change completely. The interplay of these impacts can literally deplete enthusiasm for urgently needed investment into digital infrastructure and services.¹⁰

DSTs also have implications for retaliatory actions in a variety of forms; they, in fact maybe grow into retaliatory taxes on completely disjointed goods or services and escalate into trade conflict; situations that are completely disconnected from the digital economy. The explosion of these trade distortions and retaliatory measures makes apparent the exigency for a pathway to harmonize a fair tax regime, and create trade fluidity.

⁸ OECD, 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy' (8 October 2021) < <https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf> >.

⁹ Jangam BP, "do barriers to digital services trade hamper economic growth? Evidence from a cross- country analysis" (2023) 26 Bulletin of Monetary Economics and Banking 111 <<https://doi.org/10.59091/1410-8046.2059>>.

¹⁰ World Economic Forum, 'Digital Trade in Services and Taxation' (2021) <https://www3.weforum.org/docs/WEF_Digital_Trade_in_Services_and_Taxation_2021.pdf>.

TOWARDS A BALANCED TRADE-TAX INTERFACE: POLICY SUGGESTIONS

There needs to be a more coordinated and integrated policy approach in the light of the increasingly complex relationship between tax law and international trade, especially with regard to digital services. Unilateral DSTs, to the extent that they are driven by domestic budgetary imperatives, can destabilize multilateral norms of trade and create systemically risks of legal uncertainty. In finding a balance between these competing forces, a series of systematic policy steps must be undertaken to bridge the gap between WTO trade obligations and emerging norms of international tax cooperation.

Firstly, the WTO would be able to provide clearer guidance on the implementation of GATS provisions to include digital taxation. This might take the form of authoritative interpretative direction, or the Council for Trade in Services reports setting out how DSTs intersect with Articles II, XVI, and XVII and upon what terms Article XIV exceptions may be invoked lawfully. This would make for greater predictability and help clarify the scope of the national taxing which can be tolerated within the multilateral order.

Second, WTO members may make specific commitments to include digital taxation measures in their GATS schedules of specific commitments. In doing so, members may reserve regulatory space for DSTs or other measures with the recognition of the commitments in place. This is innovative, yet it may be used as a device for avoiding conflict, expressing policy intention with the preservation of legal flexibility

Third, the WTO could encourage plurilateral negotiation of a code of conduct or guidelines on digital taxation as a template for the application of reference papers to areas such as telecommunications and financial services. Such soft law instruments, consented to by a critical mass of members, would establish best practice on transparency, non-discrimination, and proportionality in designing and implementing DSTs.

Fourth, to enhance confidence and reduce controversy, members should institutionalize the consultation and transparency process regarding digital tax policies. Advance notification of planned DSTs, peer review of the implementation process, and official channels of consultation can help problems resolve before they become trade disputes.

Finally, WTO members ought to make best efforts to align trade disciplines with international

tax cooperation efforts, particularly those emanating from the OECD/G20 Inclusive Framework. Phasing out DSTs unilaterally after the effective application of Pillar One would reduce fragmentation of international tax policy and reestablish coherence of the multilateral trading system.

Together, these proposals offer a guide to balancing tax sovereignty and trade liberalisation to the point that taxing digital services evolves in a manner that is legally acceptable, economically sensible, and internationally coordinated.

CONCLUSION

Digital Services Taxes are at the crossroads of two of the world's largest regulatory frameworks: international trade and taxation. Although they respond to legitimate issues of tax justice and fiscal sustainability in the digital economy, their unilateral imposition poses huge legal and economic risks under the WTO framework. GATS commitments, especially on market access and non-discrimination, can be violated when DSTs are disproportionately imposed on foreign service providers.

Although GATS Article XIV offers possible rationales, these are subject to stringent tests, many existing DSTs would not survive. The OECD/G20 Inclusive Framework offers a possible multilateral solution, but implementation delays and varying national interests have stalled progress. In the meantime, trade tensions simmer.

A balance as much in trade as in tax rules through reform of the WTO, increased transparency, and better multilateral coordination is needed to achieve fairness without compromising predictability. As trade in digital commerce keeps expanding, the stakes in aligning fiscal and trade policies have never been higher. The future prospects of cross-border digital services trade will depend not only on innovation and connectivity but also on the regulatory framework enabling fair and efficient markets.