Draft Law on the Tax on Certain Digital Services

Tax Alert

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On Friday 18 January 2019, the Spanish Cabinet gave the go ahead for the **Draft Law on the Tax on Certain Digital Services** (hereinafter referred to indistinctly as the "Draft DST Law" or this "Draft Law") to be forwarded to Parliament, thereby commencing the next stage in the legislative procedure.

The Draft Law seeks to create a Tax on Certain Digital Services ("DST") in Spain that mirrors the EU Directive proposed last 21 March for the taxation of digital services.

The Draft DST Law is conceived as a transitional and unilateral measure designed to bridge the gap until the entry into force of future legislation that would transpose the above Directive into Spanish law.

It is worth noting that while the OECD and G20 have looked into the possibility of taxing the profits generated by the digitisation of the economy, a lack of consensus has so far prevented any specific measures being adopted.

In general terms, this tax is designed as a levy on **certain digital services all of which have in common that the value is created by online user interactions**, in which user data is exploited, ultimately generating revenues (user value creation), and without which such businesses and the respective revenues would not otherwise exist. It is not, therefore, a tax on profits, but on the value added to certain services rendered.

The government expects the tax to raise some **Euros 1,200 million** in yearly accrual terms.

Nature and subject matter

The DST is an **indirect tax** levied on **provisions of certain digital services** involving **users** located in **Spain**.

The fact that the tax focusses on the services rendered, without having regard to their provider, essentially explains why it has been designed as an **indirect** tax that will fall outside the scope of double taxation treaties and which is compatible with VAT.

Taxpayer

The taxpayers for DST are **legal persons and like entities** that operate globally and have a significant digital footprint in Spain.

Such entities will be taxable in all cases where the following two thresholds are exceeded on the first day of the respective assessment period in relation to the preceding calendar year:

(i) **Net turnover exceeding Euros 750 million;**

(ii) **Total revenues** from taxable provisions of digital services **exceeding Euros 3 million.**

A number of **special rules are envisaged for entities forming part of a group**, whereby the amounts of the above thresholds will apply to the group as a whole. To this end:

- The Euros 750 million threshold will be calculated per Council Directive 2016/881 of 25 May 2016, which provides for the statement regarding the country-by-country report, and the equivalent international rules adopted per Action 13 of the BEPS Project.

- The Euros 3 million threshold will be calculated without excluding taxable digital services rendered between entities of the group.

However, where the group exceeds the above thresholds, each and every one of the group's member entities will be deemed taxpayers, to the extent that they incur in the taxable event, irrespective of the individual amount of their revenues deriving from taxable digital service provisions.

Taxable revenues

The tax will be levied solely on **provisions of certain digital services** (as defined in the Draft Law) where such services are rendered by DST **taxpayers**, but only to the extent that such services are rendered in the **tax territory** (Spain), i.e. where they somehow involve users located in Spain.

The definition of "**digital services**" is therefore of the utmost importance, as it defines the type of services on which the new tax is to be levied. The above term is defined by direct reference to three concepts:

- **Online advertising services targeted at users**: which are taken to mean services consisting of the placement on an own or third-party digital interface, of advertising targeted at the users of such interface.

  To avoid possible cascading effects of taxation, the Draft Law clarifies that where the entity placing the advertising is not also the owner of the digital interface, the advertising entity and not the owner of the interface will be considered the advertising service provider.

  The Draft Law defines the concept of digital interface as any software - including a website or part thereof -, application - including mobile applications -, or other medium accessible to users that permits digital communication.

  It also defines what should be understood by targeted advertising: any form of commercial digital communication aimed at promoting a product, service or brand, and targeted at the users of a digital interface based on the data gathered by them. Lastly, the Draft Law provides for the rebuttable presumption whereby all online advertising is targeted advertising.

- **Online intermediation services**: those made available to users of a multi-sided digital interface (i.e. which permits interaction with several users simultaneously), which facilitates either the underlying supply of goods or services directly between users, or the locating of and interaction with other users.

- **Data transmission services**: transmission of data collected about users (sales, assignments, etc.) generated by the activities of users on digital interfaces. The Draft Law clarifies in this regard that the taxation of data transmission services is subject to the existence of consideration, including for these purposes both sale and assignment.

This Draft Law also regulates various **scenarios of non-taxation** which also coincide with those provided for in the EU proposed Directive. Namely:

- **Sales of goods or supplies of services online via the website of the supplier of such goods or services in which the supplier does not act as intermediary.** Digital supplies of goods or services rendered by the supplier itself (e-commerce retailers or B2C services) therefore fall outside the scope of the tax, which is restricted to services in which the supplier acts as intermediary, in the context of an online intermediation service involving underlying goods or services. In determining whether a supplier sells goods or services online for its own account or renders intermediation services, regard must be had to the legal and economic substance of the transaction.

- Underlying supplies of goods or services between users, in the context of an online intermediation service.

- Online intermediation service provisions in which, while a multi-sided digital interface is made available to users, the service is rendered by the entity with the **sole or main purpose of providing other services that constitute its actual purpose, such as the supply of digital content, or the provision of communication or payment services.**

- As regards financial institutions, **all kinds of regulated financial services rendered by**

regulated financial institutions and **transmissions of data by them** are excluded from the scope of this tax.

- Digital service provisions between entities forming part of a **group and which are one hundred percent directly or indirectly owned by the parent of such group.**

Place of supply of digital services

A general rule has been set in place whereby a provision of digital services **will be deemed to have taken place in the tax territory where any of its users is located in such territory**, regardless of whether or not the user has paid any consideration contributing to the generation of the revenues deriving from the service.

The term **user** is defined in broad terms, as **any person or entity using a digital interface**.

It is then necessary to specify when **a user will be deemed located in the tax territory**, with various rules applying to each of the four potential scenarios that may arise, all of which have in common the fact that the key lies in the place in which the device enabling the services (e.g., a mobile phone) is located at each moment:

- In the case of **online advertising services**, where, in the moment in which the **advertising** appears on the device of such user, **the device is in the relevant territory**.

- In the case of **online intermediation services** in which the provision of underlying supplies of goods or services directly between such users is facilitated, where the underlying transaction is concluded by the user via the digital interface of a device **located inside the territory in the moment of such conclusion**.

- In the case of **other online intermediation services**, where the account allowing a user to access the digital interface has been opened using a device **located within the above territory in the moment of such opening**.

- In the case of **data transmission services**, where the data transferred has been generated by a user via a digital interface accessed using a device **located in such territory in the moment in which such data is generated**.

Elsewhere, the Draft Law goes on to add that, when it comes to ascertaining the place in which a digital service has been supplied, **(i)** the place in which the supply of the underlying goods or services takes place, and **(ii)** the place in which any digital service-related payment is made, **will have no relevance whatsoever**.

Moreover, a **general assumption** is envisaged whereby **a particular device of a user will, in principle, be deemed located in the place determined based on its Internet Protocol (IP) address** (the code assigned to interconnected devices in order to enable online communication), and the IP will in most cases therefore be required in order to ascertain the physical place in which the devices used by users are located. Nonetheless, **evidence to the contrary**, locating the relevant operations elsewhere, is also admitted.

The data that can be gathered from users with a view to enforcing this tax are restricted to **those enabling** users' devices **to be located** in the relevant tax territory. Any personal data processing carried out within the context of this tax must be in line with the EU General Data Protection Regulation and the Organic Law for the Protection of Personal Data and Digital Rights.

Tax base

The tax base will comprise **the amount of the revenues earned by the taxpayer for each provision of taxable digital services**.

Thus: **(i)** The tax will be calculated on a **transaction-by-transaction** basis, albeit assessed quarterly; **(ii)** for each such transaction, the **tax base will comprise the amount of the revenues earned by the taxpayer**, meaning that no tax will be levied where the transactions generate no revenue (e.g., where they are free of charge); **(iii)** such income will be **net of any taxes** that may be levied on the taxed services, such as VAT or the like; **(iv)** the taxable portion of the revenues in respect of the transactions performed by the taxpayer includes only **the portion earned in the tax territory**, which, in turn, depends on the existence of users in such territory.

A **special rule** is then envisaged for cases in which digital services are provided between entities from the same group, whereby their normal market value constitutes the tax base.

The Draft Law set out the **rules enabling an issue** crucial to the tax's viability **to be determined**, namely, **the portion of revenues to be taxed in each transaction**, which will for the most part depend on the proportion of worldwide users located in Spain.

However, the rule is different in the case of online intermediation services with no underlying supply (services only enabling users to contact or connect with one another), where the key lies in determining the place in which the device with which the account used was opened is located.

Chargeability

The tax will become chargeable **when the taxed transactions are provided, executed or performed**. Nonetheless, in taxable transactions giving rise to payments in advance of the performance of the taxable event, the tax will become chargeable on the date of full or partial collection of the price for the amounts actually received.

Tax rate

The tax will be levied at a rate of **3 percent**, in line with the European Commission proposal.

Management of the tax and formal obligations

The new tax will be assessed in the form of **self-assessments filed by taxpayers** on a **quarterly basis**.

Taxpayers will be subject to certain **formal obligations**, noteworthy examples including: **(i) reporting, periodically** or at the request of the authorities, of the information concerning their digital services; **(ii)** appointment of a **representative** in order to meet the relevant obligations in the case of taxpayers not established in the EU; **(iii)** conservation of any **means of proof** enabling the place in which the taxed digital service was supplied to be identified; **(iv) translation** into Spanish (or any other official language) of any **supporting documentation** in respect of digital services deemed to have been supplied in the tax territory; **(v) the obligation to set in place the systems, mechanisms or arrangements enabling users' devices to be located in the tax territory.**

Infringements and penalties

With respect to the applicable DST-related infringements and penalties regime, the applicable disciplinary framework is the common regime under the General Taxation Law.

Nonetheless, a **new tax infringement** has been added (classed as **serious** in nature), consisting of the failure on the part of taxpayers to meet their **obligation to set in place systems enabling the place of supply to be determined**. The penalty will take the form of a fine of 0.5% of the net revenues in the preceding calendar year, with a minimum of €15,000 and a maximum of €400,000 a year.

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