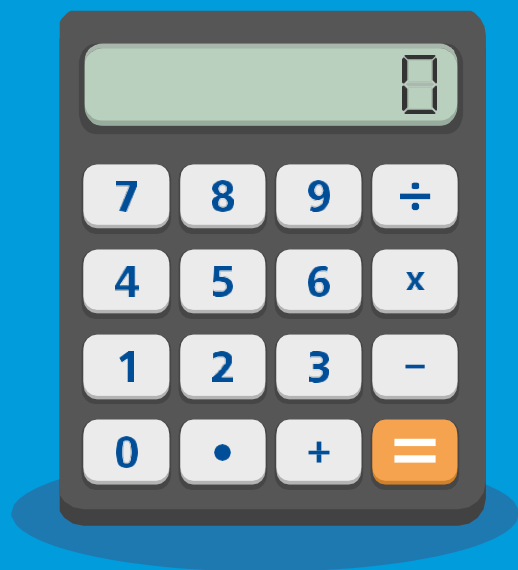




Draft Law on the Tax on Certain Digital Services

Tax Alert



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On 28 February 2020, the Presiding Panel of the Lower House of the Spanish Parliament published the **Draft Law on the Tax on Certain Digital Services**, thereby triggering the period in which to make amendments on its passage through parliament (the Draft Law).

Introduction

This Spanish government is looking to introduce a new levy into the country's tax system, the Tax on Certain Digital Services (TCDS). To this end, following an initial draft law in January 2019, which fell by the wayside when early elections were called and Parliament was dissolved, on 18 February this year the Cabinet approved a second piece of draft legislation, which differs little from the previous version.

The new tax is expected to enter into force in 2020 and will, in general terms, be levied on certain digital services provided by large international companies, with a specific connecting factor based on the presence of users in Spanish territory.

According to government estimates, the tax will raise some €968 million a year.

Does this tax exist elsewhere?

The tax is a **unilateral measure** in anticipation of the results of the work in progress within the OCDE-G20, which began in 2015 (BEPS, Action 1).

It also comes ahead of a potential agreement in the European Union, which, it is worth recalling, began work on the matter in September 2017, before unveiling a Proposal for a Council Directive in March 2017. Although rejected by countries such as Ireland, Sweden and Denmark, the draft Directive served as the inspiration for the proposed Spanish tax.

Spain is following the lead set in Europe by France, which set in place its own TCDS in 2019, albeit deferring enforcement until the end of 2020 following the diplomatic pressure brought to bear by the US.

The TCDS is also in step with Italy and Austria, which have also given the go-ahead to a new tax, entering into force in 2020, along with other states currently processing legislation in their respective parliaments, such as the UK, Belgium and the Czech Republic.

With this in mind, the TCDS has been conceived as a transitional measure until new legislation seeking to incorporate the solution adopted internationally within the Spanish legal system has been passed.

Is the tax a direct or an indirect levy?

The TCDS has been expressly defined as an **indirect tax**, as opposed to a tax on income or wealth.

This point is key since the aim is to ensure it falls outside the scope of tax treaties and is compatible with the harmonised treatment of VAT in Europe, both of which are highly controversial, debatable matters from a technical standpoint.

Taxpayers

The tax targets legal persons and like entities that operate globally and have a significant digital footprint in Spain.

To this end, the following two thresholds must be exceeded on the first day of the respective assessment period in relation to the preceding calendar:

- (i) **Net revenues in excess of €750 million in the preceding calendar year;**

- (ii) **Total global income** from digital services liable for the tax **of more than €3 million**. This figure is significantly lower than, for example, its French counterpart (€25 million located in France).

In 2020, the total income from taxable digital services will be calculated as from the entry into force of the future law until the end of the assessment period, then annualised.

A series 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. Moreover, in the event that the above thresholds are exceeded by the group, each and every one of its member companies will be deemed liable for the tax, to the extent that they incur in the taxable event, regardless of the individual amount of the income from the provision of taxable digital services.

Tax base and rate

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

The tax will be levied at a rate of **3 percent**.

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); and **(iii)** such income will be **net of any taxes** that may be levied on the taxed services, such as VAT or the like.

For cases in which digital services are provided between entities from the same group, their normal market value constitutes the tax base.

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.

Which digital services are to be taxed and when?

The TCDS seeks to tax certain digital services united by the common denominator that such services **create value by interacting with users online**, where users' data is exploited, ultimately generating income (*user value creation*), and without which such new businesses and the related earnings would not otherwise exist.

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**.

Thus, when it comes to ascertaining the place in which a digital service has been provided, the key lies in **where the device enabling the services is located at each moment**. For example, in the case of mobile phone services, the tax will be levied simply when someone accesses a website from a mobile phone located in Spain.

In this regard, a **general, rebuttable 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).

Taxable digital services

A fixed list of three digital services comprise the taxable events liable for TCDS: online advertising, online intermediation and data transfer services.

The common feature shared by all three services is that they require a **"digital interface"**, meaning any programme, including websites or parts thereof, or application, including mobile applications, or any other means accessible to users enabling digital communication.

Taxation of online “targeted advertising”

Online advertising services mean those consisting of the placing on an own or third-party digital interface of advertising targeted at users of that interface.

Such digital services will be subject to TCDS **where the relevant users are located in Spanish territory**. Such circumstance will arise where, in the moment in which the advertising appears on a user’s device, the device is in Spain.

The criteria for determining the **tax base** is based on the percentage represented by the number of times the advertising appears on devices in Spanish territory out of the total devices worldwide, applied to the global income earned by the company for such services.

Taxation of online intermediation services

Online intermediation services refer to the making available of multi-sided digital interfaces to users, which allow users to interact with other users regularly, facilitating the provision of underlying supplies of goods or services directly between such users, or enabling them to locate other users and interact with them.

Such digital services will be subject to TCDS **where the relevant users are located in Spanish territory**.

This will apply 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 Spanish territory in the moment of such conclusion.

The criteria for determining **the tax base** in such cases consists of applying the percentage represented by the number of users deemed located in Spanish territory out of the total users of the service, regardless of where they are located, to the global income earned by the company from such intermediation services (as opposed to the total amount of the transaction where the price paid to the provider is included, and where it may be worth analysing whether or not logistics-related income concerning storage or transportation is included).

In the case of the **other online intermediation services not based on the provision of underlying supplies of goods or services directly between users, but rather on locating and interacting with other users** (e.g., contact websites charging a fee), users will be deemed located in Spanish territory where the account enabling the user to access the digital interface has been opened using a device located in Spanish territory at such time. In such case, the tax base will consist of the total income earned by the company from users deemed located in Spanish territory per the above criteria.

The tax is not levied in the following scenarios:

- **Sales of goods or services contracted online via the website of the supplier of such goods or services, in which the supplier does not act as an intermediary;**
- **The provision of underlying supplies of goods and services between users within the framework of an online intermediation service.**
- The provision of online intermediation services in which, while a multi-sided digital platform is effectively made available to users, the service is provided by the relevant entity for the **sole or main purpose of facilitating other services constituting its actual aim, such as the supply of digital content (computer programmes, apps, music, videos, text, games, etc.), communication services or payment services**. In such scenarios, the user is understood not to have a pivotal to play in the creation of value for the entity making the digital interface available.

Taxation of data transfer services

Data transfer services comprise the transfer of data gathered concerning users that has been generated by activities pursued by such users on digital interfaces, provided consideration is involved, for such purposes including both sales and transfers.

Such digital services will be subject to TCDS **where the relevant users are located in Spanish territory**, i.e., 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.

The **criteria for determining the tax base** in such cases is based on applying the percentage represented by the number of users generating such data and deemed located in Spanish territory out of the total users generating such data, wherever they may be located, to the global income earned by the company for such services.

Non-taxable digital services

The Draft Law provides for various scenarios not subject to the tax. Namely:

- **All types of regulated financial services provided by regulated financial institutions**, as well as **data transfers by such institutions**. The Draft Law includes definitions of such regulated financial services and institutions.
- Digital service provided between entities forming part of a **group and which are one hundred percent directly or indirectly owned by such group**.

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**.

In principle, self-assessments in respect of 2020, for the relevant quarters per the date on which the law regulating the tax enters into force (expected to take place three months after publication in the Official State Gazette), must be filed and settled by no later than 20 December this year.

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 from a non-EU third country; **(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**.

The **data that can be gathered** from users with a view to enforcing this Law are restricted to **those enabling users' devices to be located** in the relevant tax territory.

Infringements and penalties

The applicable disciplinary framework is the common regime under the General Taxation Law.

Moreover, 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.

Practical tips for companies

The steps to be taken by companies looking to assess the potential impact of the TCDS as things stand, as the Draft Law is currently worded, would take in the following four consecutive phases of analysis:

- 1) **Ascertaining whether or not they are classed as taxpayers**, which will depend on the relevant group's revenues from the taxable services worldwide and in Spain.
- 2) Calculating their **worldwide income** from the three digital services liable for the tax: online advertising, online intermediation and data transfers.
- 3) Setting in place the systems, mechanisms or arrangements enabling users' devices to be **located** in Spanish territory.
- 4) **Determining the tax base**, identifying the relevant portion of worldwide income based on the users located in Spanish territory and the specific rules governing each taxable service, which focus on the location of mobile devices (IP addresses in the absence of other criteria).
- 5) **Calculating the tax charge** simply by applying 3 percent to the tax base, before assessing whether it may be deducted from the corporate or non-resident income tax levied in Spain.

Practical example

There follows an example of all of the above, based on a multinational whose turnover make it subject to TCDS and which earns income from digital online advertising and intermediation services (an e-business website). The former account for €300 million, while the latter bring in €200 million, calculated on a worldwide basis.

In order to determine the TCDS payable for online advertising, the number of times the advertising appears on devices in Spanish territory must be calculated (in principle, based on IP addresses), before calculating the relevant percentage in respect of the total number of such appearances worldwide. Say, by way of example, that this percentage is 5%. The TCDS charge would be €450,000 ($300,000,000 \times 5\% \times 3\%$).

In order to determine the TCDS payable for online intermediation, the worldwide income from such

services in each self-assessment period must be divided by the proportion between the number of users with mobile devices located in Spanish territory in the moment in which the business transactions are concluded (in principle, based on IP addresses) out of the total users of the service, regardless of where they are located. Say, by way of example, that this percentage is 2%. The TCDS charge would be €120,000 ($200,000,000 \times 2\% \times 3\%$).

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