



Guide to the new Tax on Certain Digital Services

Tax Alert



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[Law 4/2020](#) of October 15th, 2020 on the Tax on Certain Digital Services (DST) published in the Official State Gazette last October 16th, will enter into force on January 16th, 2021

Introduction

Broadly speaking, this tax is expected to be levied on certain digital services provided by large international companies, with a specific nexus based on the presence of users in Spain.

While the passage through parliament of this new tax has taken more than 7 months since its approval by the Cabinet (for the second time¹) - the fact remains that the wording published in the Official State Gazette is all but identical to the [Draft Law](#) put before the Lower House of the Spanish Parliament in February 2020, since only minor adjustments were made at the amendments phase, namely: (i) the Preamble now specifies that the conveyance of communication signals referred to in General Telecommunications Law 9/2014 of 9 May 2014 does not fall under the scope of the DST; and (ii) DST taxpayers are no longer subject to the formal obligation to apply to the authorities for registration on the register of entities created for such purpose (formerly letter c) of article 13 of the Draft Law).

The regulatory implementation of this law was submitted for [prior public consultation](#), which ended on October 13th, 2020. Thus, details of the implementing provisions and, among other formal aspects, the procedure for filing and paying in DST self-assessments, will not emerge until Cabinet's approval, which will be foreseeable to be before or at the same time as the DST comes into force.

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

There follow our observations on the key elements of the new DST approved by Law 4/2020 of October 15th, 2020, comprising 16 articles, 1 transitional provision and 6 final provisions.

Does this tax exist elsewhere?

The tax is a **unilateral measure** set in place by Spain in anticipation of the (uncertain and in all likelihood long-awaited) results of the work in progress within the OECD-G20, which began in 2015 with the report on BEPS Action 1.

The new tax was approved four days after the OECD's announcement of its failure to secure a long-term, internationally agreed solution to the tax-related challenges posed by the digital economy, pushing the deadline for negotiations back to midway through 2021. In the OECD's own words, "the *absence of a consensus-based solution, on the other hand, could lead to a proliferation of unilateral digital services taxes and an increase in damaging tax and trade disputes, which would undermine tax certainty and investment. Under a worst-case scenario – a global trade war triggered by unilateral digital services taxes worldwide - the failure to reach agreement could reduce global GDP by more than 1% annually.*"

¹ In January 2019, the Cabinet agreed to forward the Draft Law on the Tax on Certain Digital Services ([see our tax alert](#)) to

Parliament, though the parliamentary process was cut short by the call for an early election and the dissolution of parliament that followed.

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 2018. Although rejected by countries such as Ireland, Sweden and Denmark, the draft Directive served as the inspiration for the proposed Spanish tax (albeit diverging from the proposed Directive of March 2019, which only included digital advertising).

Spain is following the lead set in Europe by France, which set in place its own DST in 2019, albeit deferring enforcement until the end of 2020 following the diplomatic pressure brought to bear by the US, which views the tax as a discriminatory measure targeting its homegrown digital companies and a threat to the core pillars of international taxation.

Within the EU, the DST is also in step with Italy, Austria and Poland, which have given the go-ahead to a new tax, entering into force in 2020, along with other Member States currently processing legislation in their respective parliaments, such as the UK or the Czech Republic.

Further afield, other countries such as India, Indonesia, Kenya and Turkey have also set in place similar levies. A digital tax is being debated in Brazil.

With this in mind, the DST 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. "Societal pressure, tax justice and the need for a sustainable tax system" are cited as reasons for the initiative.

Is the tax a direct or an indirect levy?

The DST 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, in turn, is compatible with the harmonised treatment of VAT in Europe, both of which are highly controversial, debatable matters from a technical standpoint.

While not dealt with in the law, one consequence of this status will be the treatment of the tax as a deductible expense for corporate income tax and non-resident income tax purposes, an issue that is set to spark some debate given the nexus of the

revenues for which the respective taxpayers are liable in Spain under each of these taxes.

Taxpayers

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

The main taxpayers will be companies belonging to large domestic and foreign groups (whether digital or otherwise) providing digital services in Spain over and above the threshold referred to below.

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** (meaning that the tax only applies to major multinationals, leaving SMEs and emerging companies untouched);
- (ii) **Total revenues** from the provision of digital services subject to the tax (with a significant digital footprint in Spain), once the relevant tax base calculation rules have been applied, **in excess of €3 million**. This figure is significantly lower than, for example, its French counterpart (which sets the threshold at €25 million located in France).

In order to calculate the second threshold, the Sole Transitional Provision of the Law provides that, in 2021, the total revenue from taxable digital services will be calculated as from the entry into force of the Law (January 16th, 2021) until the end of the assessment period, then annualised.

These thresholds may be modified by the General State Budget Law.

A series of **special rules are envisaged for entities forming part of a group** (understood with reference to the criteria under article 42 of the Commercial Code, albeit without regard to residence or the obligation to prepare consolidated annual accounts), whereby the amounts of the above thresholds will apply to the group as a whole. For such purposes:

- The €750 million-threshold will be calculated in line with Council Directive 2016/881 of

May 25th, 2016, which provides for country-by-country reporting, and the equivalent international standards adopted in application of Action 13 of the BEPS Project.

- The €3 million-threshold will factor in any taxable digital services rendered between entities from the same group.

Nonetheless, 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 revenue from the provision of taxable digital services.

Which digital services are to be taxed and when?

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

In order to tax this taxable event (user value creation), 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 (nexus) 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 DST-subject digital service has been supplied, whether or not a supplier is established in Spain, where each user resides and the place in which the supply of the underlying goods or services takes place are neither here nor there. The nexus is **where the relevant user's device permitting the service at any given moment is located**.

With this in mind, 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, such as the alternative use of geolocation methods or other potential current or future means of evidence.

It is therefore necessary to have a clear understanding of which services are taxable and which are not, and of when taxation is triggered, i.e., when such services are rendered in the tax territory (Spain) in line with specific nexuses.

Taxable digital services

The definition of **"digital services"** thus has a pivotal role to play, narrowing down the types of services affected by the new tax. They are defined with direct reference to three concepts encompassed by the term: **online advertising, online intermediation and data transfer services**.

In other words, three digital services defined in a set list constitute the taxable event of the DST, all three sharing the common feature 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.

In order to avoid cascading tax effects, it has been clarified that where the entity placing the advertising is not, in turn, the owner of the digital interface, such entity (and not the owner of the digital interface) shall be deemed to constitute the provider of the advertising service.

An understanding of what **"targeted advertising"** means is key: any form of digital commercial communication aimed at promoting a product, service or brand, targeting the users of a digital interface based on the data gathered by such users. This therefore rules out online advertising sites that do not use user profile-based search algorithms. Nonetheless, a rebuttable presumption is established whereby all advertising is targeted advertising unless proven otherwise.

Such digital services will be subject to DST **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 deemed located in Spain.

The criteria for determining the tax base is based not on the share of advertising generated by each advertiser in Spain, but rather 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 revenue obtained 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 DST **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.

Noteworthy examples include the well-known *marketplaces* allowing for the online trade of goods and services among different buyers and sellers (B2C and C2C).

The criteria for determining the tax base in such cases has no regard to the revenues from transactions specifically relating to users deemed to be located in Spain, but rather 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 revenue obtained 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 revenue 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 revenue obtained by the company from users deemed located in Spanish territory per the above criteria.

Note that such online intermediation services focus on facilitating e-commerce or contact applications and portals, and the tax will not otherwise be levied. With this in mind, the following scenarios are not DST-subject:

- **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;** Supplies of digital goods or services by a provider from its own website (online retail activities) will therefore go untaxed. In order to ascertain whether a supplier is selling goods or services online for its own account or is providing an intermediation service, regard must be had to the legal and economic substance of the transaction.
- **The provision of underlying supplies of goods and services between users within the framework of an online intermediation service.** Such non-subjection is due to the fact that e-commerce transactions between individuals are not subject to the tax.
- 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 DST **where the relevant users are located in Spanish territory**. Such circumstance will arise where the data transferred has been generated by a user via a digital interface accessed using a device located in Spain 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 revenue obtained by the company for such services.

Non-taxable digital services

The DST Law sets out several non-subjection scenarios, which may be modified by the General State Budget Law. The following scenarios (not addressed above) are worth noting:

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

Tax base and rate

The tax base is determined by direct assessment and will comprise the amount of the **revenues** earned by the taxpayer per each provision of taxable digital services excluding Value Added Tax or other equivalent levies.

To this end, certain rules have been established so as to only tax the portion of revenues corresponding to users located in the tax territory with respect to the relevant company's total users worldwide.

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

This rate may be modified by the General State Budget Law.

No tax allowances or credits are available.

With this in mind, the tax is levied not on companies' profits, but rather on a percentage of their billings, which seeks to represent the value added to the taxable digital services. Companies making a loss or with low margins may therefore find themselves subject to the tax.

Thus: **(i)** the tax is calculated on a **transaction-by-transaction** basis, albeit assessed quarterly; **(ii)** for each such transaction, the **tax base comprises 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.

A **special rule** is envisaged for cases in which digital services are provided between entities from the same group, for which their fair 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 price collection for the amounts actually received.

Management of the tax and formal obligations

The new tax is to be managed in the form of self-assessments to be filed quarterly by taxpayers, and, in principle and notwithstanding the provisions of the future regulations, the first assessments will therefore be due in the first quarter of 2021.

Nonetheless, the precise filing and payment methods and deadlines will not be known until the

implementing regulations have been approved, although this will not prevent the tax from accruing as from the date on which the Law enters into force.

In this regard, given that the deadline for the international negotiations has been pushed back and in line with the precedent set for 2020 in Final Provision Four, it will be particularly important to ascertain whether any form of deferral is arranged for assessments and payments in the first quarters of 2021.

Taxpayers are subject to certain **formal obligations** (alongside those to be approved in the relevant regulations), 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.**

While the Law has done away with the former obligation to register on the register of entities created for such purpose ("digital companies census"), taxable companies will remain subject to the relevant registry identification obligations.

This last point is key, since the calculation of the tax depends on highly complex technical information known only by the taxpayer, and which it may occasionally have to obtain from third parties. All of which may explain why the DST allows taxpayers to calculate the tax base on a provisional basis, before regularising their self-assessments within the 4-year limitation period.

In light of the observations submitted during the public consultation and information phase, it has been clarified that **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. 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.

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.

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**, an aspect deemed key to the management of the tax. 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 DST as things stand would take in the following five 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 revenue from the three digital services liable for the tax: online targeted 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 revenue 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 makes it subject to DST and which obtain revenues from digital online advertising (targeted advertising on third-party websites) 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 DST 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 DST charge would be €450,000 ($300,000,000 \times 5\% \times 3\%$).

In order to determine the DST payable for online intermediation, the worldwide revenue 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. Let's say, by way of example, that this percentage is 2%. The DST charge would be €120,000 ($200,000,000 \times 2\% \times 3\%$).

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