29 January 2019

Indirect Tax Alert

Spain sends bill on Digital Services Tax to Parliament for approval

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Executive summary

On 23 October 2018, the Spanish Government released a preliminary draft bill (the Draft) introducing a Digital Services Tax (DST). On 25 January 2019, after a public consultation, the Spanish Government published a revised version, which becomes the final bill (the Bill). The Bill will be sent to the Congress and Senate (the Parliament) to be voted upon.

Its main features are similar to the DST proposed by the European Commission on 21 March 2018, with a rate of 3% imposed on gross income derived from certain digital services for which user participation is essential for creating value; namely, targeted online advertising, online intermediation services and the sale of user data. Only companies with worldwide revenues of €750 million per annum, with a total amount of taxable revenues obtained in Spain exceeding €3 million per annum, would be subject to the DST.

In contrast to the Draft, the following transactions are excluded from Spanish DST in the Bill:

- Transactions involving only entities with 100% direct or indirect ownership or common ownership.
- Regulated financial services rendered by regulated financial entities.
- Income derived from the transfer of data by regulated financial entities.

Building a better working world

It remains uncertain whether the Spanish Government has the support needed to progress the Bill. EY will provide updates on the approval status in Parliament as the Bill moves forward.

Detailed discussion

Spanish DST within the European and international framework

In accordance with the Bill's explanatory statement, the DST would be a first interim response to the challenges arising from the new global economy development.

The Spanish Government has acknowledged that the ideal approach to address these tax challenges would be to find a multilateral, international solution within the Organisation for Economic Co-operation and Development (OECD). It also points out that, in line with Spain's position expressed before the OECD, the solution may be to update the notion of a digital permanent establishment in order to allocate the profit derived from the data and the value created by user participation to the source country where those data and users are located.

Nevertheless, it also notes that, since the adoption and implementation of these agreed measures could take a long time, several countries have taken action by adopting unilateral measures in order to address this problem.

Furthermore, the DST proposed by the Spanish Government pursues the same objective and has the same main features as those of the DST being proposed by the European Commission. However, due to the ongoing discussions and the lack of practical measures, the Spanish DST precedes the European Union (EU) consensus.

As per the above, the temporary nature of the DST is two-fold, as follows:

- The Government has committed to adapt the DST to the solution adopted by the EU as soon as it becomes available.
- The Bill's preamble states that the Spanish DST is conceived as a temporary transitional measure which will apply until the Spanish rules implementing the EU Directive which addresses the same matter enter info force. This being said, the Draft's fourth and final provision, which set forth the DST's abolition upon the implementation of a future Council Directive has been deleted.

The Government's view is that the fact that the DST is focused on the services rendered, irrespective of the providers' features (among others, their economic capacity), implies that it should not be considered as a tax on income or wealth and, therefore, falls outside the scope of the double tax treaties entered into by Spain.

The above is the key reason why the tax would be implemented as an indirect tax, in accordance with Article 1 of the Bill, as in the European Commission's proposal.[1] Additionally, the Government considers that the DST would be compatible with the Value Added Tax (VAT), harmonized throughout the EU.

Spanish DST's main features

The proposed Spanish DST, if approved, will apply to services where the participation of a user in a digital activity constitutes input for the business and that enables that business to obtain revenues therefrom.

In particular, the tax is imposed on the provision of the following **digital services**:

(i) The placing on a digital interface,[2] of advertising targeted at users of that interface (*online advertising services*).

The Bill now expressly defines the notion of "targeted advertising" as any form of digital commercial communication, the purpose of which is to promote a product, service or brand, which is directed to users of a digital interface based on the data collected from them.

The Bill also includes a presumption that all advertising will be considered as "targeted advertising," unless proved otherwise.

(ii) Services consisting in the making available of multi-sided digital interfaces to users which allow users to find other uses and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users (*online intermediation services*).

(iii) The transmission of data collected about users which has been generated from such users' activities on digital interfaces (*data transfer services*).

Activities that are not subject to taxation in general match the ones outlined in the European Commission's proposal and include:

- Online sales of goods or services through the website of their supplier, in which the supplier does not act as an intermediary (e-commerce related to retail activities), are excluded. In such cases, the value creation for the retailer lies with the goods or services provided and the digital interface is simply used as a means of communication.

- The Bill expressly excludes from its scope the sale of goods or services between end users within an online intermediation service (i.e., the underlying transaction, for example, a rental service price).
- Online intermediation services are also excluded when the main objective is to provide digital content to users or provide them with communication or payment services.

  Transactions involving only entities with 100% direct or indirect ownership or common ownership. The Draft did not expressly exclude **intra-group transactions** from the DST scope. During the public consultation, it was pointed out that this discrepancy in relation to the European Commission's proposal could result in adverse effects derived from over taxation (cascade effect). Given that the scope of the exclusion does not match the Commission's proposal, changes during the approval procedure of the Bill cannot be discarded; EY will carefully monitor these.
- Regulated financial services rendered by regulated financial entities.

  Regulated financial services are defined as financial services for which a regulated financial entity is authorized.

  Regulated financial entity is defined as a financial services supplier that is subject to authorization, or registry, and supervision due to any domestic law or EU-harmonized measure to regulate financial services, including those financial services suppliers subject to supervision according to any non-EU rule that, according to a legal act by the EU is considered as equivalent to EU measures.

  This broader exclusion replaces the previous ones contained in the Draft for certain online intermediation services carried on by crowdfunding platforms, or by trading venues, systematic internaliser or a regulated participatory financing service provider.
- Income derived from the transfer of data by regulated financial entities.

  This exclusion replaces the previous one contained in the Draft for data transfer services by a trading venue, a systematic internaliser or a regulated participatory financing service provider.

The **tax base** of the DST will be the gross income, excluding the VAT or other equivalent taxes (if any), obtained by the taxpayer upon the provision of the digital services covered by the DST and which are rendered within the Spanish territory.

For such purposes, the Bill establishes certain allocation keys to allow the determination of the portion over total revenues that must be taxed depending on, basically, their relation to Internet Protocol (IP) addresses located in Spain.

Certain **thresholds** are established in order to ensure that the DST is only applied to companies of a certain scale with a significant Spanish digital footprint in Spain. This is intended to protect the initial phases of highly-digitalized economic activity development, where it is usually necessary to make a substantial investment and the period to reach an earning position may be long.

Hence, the companies subject to this tax will be those with a total amount of worldwide revenues for the previous calendar year exceeding €750 million (a reference is now made to the EU Directive on Country-by-Country Reporting[3]) and with a total amount of taxable revenues obtained in Spain in the same period exceeding €3 million in Spain.

Special rules are established for entities belonging to a group. The thresholds above must be assessed at a group level in order to determine if a company exceeds the thresholds and, therefore, should be considered a taxpayer.

In line with the European Commission's proposal, the **nexus** with the Spanish territory that allows taxation in Spain is based on the location of the users (i.e., users located in Spain), regardless of whether the user has paid any consideration that contributes to the generation of revenue for the company.

For these purposes, a specific set of location rules are established for each of the digital services listed above, based on the place where the devices of these users have been used, generally located by their IP addresses.

However, proof to the contrary is accepted, in particular, other methods of geo-location. This is a protection mechanism for the tax administration and the taxpayer against potential errors, concealment or falsification of the IP address of the devices used, aimed at locating services in or out of Spanish territory.

The Bill now also sets forth that the data that can be compiled from users for the purpose of applying the provisions of the Spanish DST Law is limited to those which allow the localization of the users' devices located in Spanish territory.

The **tax rate** is set at 3% on the gross income derived from the referred services.

In contrast to the **accrual** in the EU Directive proposal, as per which the DST is calculated on the basis of the taxable revenues accrued in a given period, the accrual of the tax is immediate, taking place for each taxable digital service (or at the time of the total or partial collection of the price for the amounts actually received, whichever event takes place first). The corresponding tax return must be filed quarterly with the Spanish tax authorities.

Next steps

Now the Bill moves to the Parliament for approval. If approved, it will come into force three months after it is published in the *Spanish Official Gazette*.

Highly digitalized groups should conduct a detailed analysis of the terms of the Bill, as well as the legal and economic substance of their transactions, to consider the potential impact of this measure.

EY will monitor the development of the Bill's approval procedure and, at the same time, the development of negotiations within the EU and the OECD.

Endnotes

1. The Directive proposal is based on Article 113 of the EU treaty referred to "other forms of indirect taxation."
2. The Bill defines "digital interface" as any program, including websites or parts thereof, or application, including mobile applications, or any other means, accessible to users, that enables digital communication.
3. Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

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EYG no. 012876-18Gbl

1508-1600216 NY
ED None

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