Spain Has Approved the Digital Service Tax: The Controversy Is Served

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Patricia Lampreave (IEB)

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The Spanish government approved, on 18 February 2020, a bill for a digital service tax (DST) for discussion by the parliament[1]. The current government has a majority consensus on the new tax with the rest of the political parties, and it is, therefore, very likely to pass the bill.

Background: EU Proposal

The Spanish Digital Service Tax is based on the Proposal for a Council Directive on a common system for a digital services tax on revenues resulting from certain digital services COM/2018/0148 final – 2018/073 (21 March, 2018[2]).

The proposal for a DST was presented by the EU Commission as a short-term remedy for the under-taxation of digital platforms, before a new consensus on multilateral tax reform can be reached within the OECD during 2020.

Due to the reticence of several member states, in March 2019[3] another proposal was presented which significantly narrowed the scope to target only revenues from digital advertising. Despite the changes of 2019, Ireland, Sweden and Denmark maintained their opposition to the EU's digital tax, forcing the EU to put on hold the European solution and focus instead on the OECD's ongoing work on tax challenges arisen in the digital economy.

As a result of the lack of consensus mentioned, there are several individual countries, including in the EU, that plan to move ahead with their own, separate Digital Service Tax proposals.

Spain's digital service tax[4]

- **Why now?**

The question is indeed why now Spain has decided to enact this tax. We have to remember that France enacted the "*Taxe GAFA*," in July 2019 but after the US took trade actions against France and its DST, France decided to suspend it until the end of 2020. US could now take legitimate actions against Spain.

The reason for this decision is that Spain needs to increase revenues to fund the increase of public spending already adopted by the government for 2020.

But, just after making public the approval of the tax, the Spanish Ministry of Economy underlined that the bill states that the collection of the tax is delayed until the end of the year. Therefore, Spain will not immediately collect the tax on a quarterly basis, as mentioned in the initial proposal. "It´s not a suspension of the tax, just an end-of-the-year collection[5]". In 2019, the government estimated that these new levies would bring the state around EUR 2 billion in revenues. The Spanish Independent Fiscal Authority already underlined that the sum was overestimated.

Could it be possible that Spain would never collect the DST? If the OECD reaches a deal by the end of 2020, then Spain´s unilateral tax would not be collected at all. This creates a legal uncertainty to the potential companies affected. They will not know until the end of the year if they will have to pay this tax; therefore, they will have to withhold part of their revenues derived from the service affected by the tax for a potential payment at the end of the year.

Then, could it not have been better to wait until the end of 2020 to decide to incorporate the DST?

- **Nature of the DST:**

As the EU DST, the Spanish DST is presented as an indirect tax, compatible with VAT.

The proposed digital service tax has been criticised[6] (and I agree with the criticism) as this turnover tax is a hybrid tax between a direct and an indirect tax.

A tax like the DST is less efficient than a VAT. Not only the final consumer will be affected, like the VAT, but unlike the VAT, this kind of tax could affect the production (if the cost of production is higher, the final cost is also higher). At a moment when the economy is in process of digitalizing, this tax measure will be negative for the economy. We also have to consider that, as it´s a unilateral measure, the digital companies could decide not to operate in our territory, and this could affect the Spanish economic growth.

Another consequence of the DST is the increase of tax litigations for double taxation. If a company is already subject to corporate income tax in Spain (25%) and is now obliged to pay this new tax, the same services are taxed twice and if a company operates in Spain without a permanent establishment (therefore, it´s a tax resident in another country) and it´s obliged to pay this tax, this paying could also generate a double taxation.

The DST is outside the scope of Double Tax Conventions signed by Spain and as a consequence, the DST will likely generate double taxation issues that Spain's tax treaties cannot resolve and as a consequence there will be an increase of tax litigations.

- **Scope of the DST:**

Like the EU proposal, the revenues subject to Spain's digital services tax are those from three main types of services[7]:

1. *Selling online advertising space*: Online advertising would be subject to the Spanish DST when the user´s device on which the advertising appears is located in Spain.

The taxable base would be computed by reference to the proportional number of times the advertising is shown on Spanish located devices to the number of times the advertising appears on all devices regardless of the location.

In line with the EU proposal, the bill establishes that a digital interface means any software, including a website or a part thereof and applications, including mobile applications, that is accessible by users. Also, in line with the proposal, where the entity placing the advertising does not own the digital interface, that entity, and not the owner of the interface, shall be the one providing a service falling in scope.

2. *Selling online intermediation activities*: Online intermediation would be regarded as occurring in Spain and therefore subject to the Spanish DST when: either the underlying transaction takes place through a digital interface using a device located in Spain; or the user's account is opened with a device located in Spain

Digital intermediary activities subject to Spain's digital services tax are those that allow recurrent interaction between users (B2B and B2C) with the purpose of a direct delivery of underlying goods or services between those users.

The taxable base would be computed by reference to the proportion of Spanish users to the total number of users and the proportion of income resulting from users' accounts opened in Spain to the income from the total number of accounts opened**.**

In the case of online intermediation, it is irrelevant from a nexus point of view where payments are made and where the underlying transaction takes place. Relevant is whether the transaction was conducted using a device located in Spain.

3. *Selling data transfer*: Data transfer would be subject to the Spanish DST when the data transferred is generated by a user through a digital interface using a device located in Spain.

The taxable base would be computed by reference to the proportion of Spanish users generating the transmitted data to the total number of users regardless of the place where it is located and regardless of the moment at which the data were collected.

A controversial aspect of the Spanish DST is that it establishes a legal presumption that the location of any digital device corresponds to an IP address. In other words, if the IP address is located in Spain, it is assumed the digital service is provided from Spain.

It is relevant to underline that, unlike the EU proposal, inter-company transactions, cross-border transactions, and domestic transactions are subject to tax.

The tax rate applied will be 3% of gross revenues (without deduction of any expenses) from digital services.

- **Out of the scope of the tax:**

In line with the EU proposal, Spain's digital services tax lists a series of cases out of the scope of the digital services tax and are therefore not subject to tax.

Spain excludes tax on sales of goods or services between users, sales of goods or services made on the supplier´s website when the provider does not act as an intermediary, and certain financial services by a regulated crowdfunding provider or a service consisting in the facilitation of the granting of loans.

- **Taxpayers of the DST:**

The tax applies to both resident and non-resident companies, inside and outside the EU, whose revenues exceed certain thresholds.

In order to protect small and medium-sized businesses and start-ups, taxpayers that are subject to Spain's digital services tax are limited to those that have more than EUR 750 million of total annual worldwide revenue and EUR 3 million of total annual revenue (instead of the 50 million threshold of the EU proposal) from digital activities in Spain during the relevant financial year.

The thresholds are considered at the level of the group. If a group exceeds the thresholds, all companies within the group are affected by this tax, to the extent that they render these kinds of mentioned services.

- **Compliance obligation:**

The bill establishes compliance obligations. Among others, companies must file periodic returns of information requested by the tax authorities relating to the computation of the digital service tax or must maintain all documents to support service transactions carried out in Spain. If the company is operating without being established in Spain, it must appoint a tax representative to pay the DST in its place.

These compliance obligations will clearly require an investment by the companies affected. But also, the tax authorities will require more resources for controlling the submission of the information requested and for collecting the tax.

- **Penalties**:

The bill also establishes penalties for non-compliance. To fake or hide the place of realization of the digital service or the IP address will have a penalty of 0.5% of the company's previous year gross income, with a minimum of EUR 15,000 and a maximum of EUR 400,000.

- **DST and State Aid:**

It has been argued that the fact that smaller companies will not pay the digital services tax may be regarded as having received an unlawful aid.

The Commission issued several decisions (i.e *Hungarian cases* (SA.39235)) considering that progressive tax rates which differentiate between undertakings with high advertisement revenues (and thus larger undertakings) and undertakings with low advertisement revenues (and thus smaller undertakings), granted a selective advantage to the latter based on their size. The Commission rejected the argument of Hungary that the size of undertakings reflected their ability to pay and therefore to contribute to the cost of public policies. On 27 June 2019, the EU General Court[8] annulled an EU Commission decision[9].

The purpose of the present article is not to examine digital service tax under State aid regulation. But from my point of view, companies could not challenge a DST on State aid ground. The companies subject to the DST are not in a comparable factual and legal situation than the rest of the companies under the Spanish tax system. The potential selectivity of this tax measure could be justified by the logic of the system.

Conclusions

There is broad agreement among EU member states and in other parts of the world that something should change in international tax policy to address the challenges of taxation in the digital economy.

In a global debate on how to tax the digital economy, unilateral measures, like Spain's digital service tax, are the simplest for a county to adopt, as they do not require the agreement of other countries. However, in general, such protectionist measures are not particularly effective and likely to draw legitimate retaliation from third countries.

A unilateral digital services tax could result in an increase of tax disputes for reason of double taxation, particularly when charged on revenues which are already subject to corporate income tax in a particular jurisdiction.

The proposed digital services tax has been designed with large and highly profitable companies in mind, but in practice, the tax burden would be passed on to consumers. Therefore, the tax will not meet the aim for which it was created.

The political reason for this announcement is understandable. Nevertheless, if the tax collection is delayed until the end of the year, the new tax will be a "fake" revenue for the Spanish budgetary plan of 2020. Maybe it would have been more effective if Spain would wait until the EU reach a consensus on a coordinate action after examining the result of the OECD work at the end of 2020.

[1] This article is based on a previous article written by the author and published in MNETax , "Spanish government approves digital services tax targeting large multinationals" which can be found at https://mnetax.com/spain-targets-large-multinationals-with-new-digital-services-tax-37756

[2] https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf

[3] https://data.consilium.europa.eu/doc/document/ST-6873-2019-INIT/en/pdf

[4] http://www.congreso.es/public_oficiales/L12/CONG/BOCG/A/BOCG-12-A-40-1.PDF

[5] https://www.lamoncloa.gob.es/consejodeministros/Paginas/enlaces/180220enlace_impuestos_d.aspx

[6] http://kluwertaxblog.com/2018/03/16/eu-digital-services-tax-populist-flawed-proposal/; https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/2/462/1539953034/181019-dst-report.pdf

[7] Article 10, http://www.congreso.es/public_oficiales/L12/CONG/BOCG/A/BOCG-12-A-40-1.PDF

[8] https://mnetax.com/eu-court-addresses-legality-of-progressive-turnover-taxes-34589

[9] It is not an isolated case, see also **EC decisión –** SA.44351 – (30 June 2017). *P. Lampreave, "Harmful Tax Competition and Fiscal State Aid, two sides of the same coin". European Taxation (Volume 59), No 5 (2019)* Edited by *Journal IBFD.*