

## Spain releases draft bill on Digital Services Tax

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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).

If approved, the DST would be applicable as of 2019 as an indirect tax. The tax rate would be 3%, applicable to gross income derived from certain digital services in which there is an essential *user* participation in the company's value creation process. Thus, the DST should apply only to services that could not exist without user involvement.

Apart from some details, its main features (scope and DST taxable events) are mainly in line with the Directive proposal presented by the European Commission (the Commission) on 21 March 2018.<sup>1</sup>

### Detailed discussion

#### **Spanish DST within the European and international framework**

In accordance with the Draft's explanatory statement, the DST would be a first interim reaction to the challenges arising from the new global economy development, which is rapidly acquiring a digital character.

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, in view of the Spanish Government, has the same main features as those of the DST being proposed by the 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.
- ▶ In the long-term, DSTs (including the Spanish DST) are to be abolished once global solutions allowing allocation of a portion of the profits (corresponding to the value derived from the data and user contributions) to the source country of those data and users are in place. The Draft's fourth and final provision sets forth the DST's abolition upon the implementation of a future Council Directive that establishes taxation rules for companies with a significant digital presence.

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, it falls outside the scope of the tax treaties entered into by Spain.

The above is the key reason by which the tax would be implemented as an indirect tax, in accordance with Article 1 of the Draft, as in the Commission's proposal.<sup>2</sup> 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 enable 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,<sup>3</sup> of advertising targeted at users of that interface (*online advertising services*)
- (ii) Services consisting in the making available of multi-sided digital interfaces to users which allow users to find other users 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*)

**Non-subject to taxation cases**, in general, match the ones included in the 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 Draft 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.
- ▶ The most relevant discrepancy in relation to the Commission's proposal is that the Draft has not expressly excluded **intra-group transactions** from the DST scope. Consequently, the digital services described above rendered to entities within the same group will be subject to the Spanish DST. Therefore, it will be important to monitor the Draft approval procedure and future application, in order to avoid the adverse effects derived from over taxation (cascade effect).

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 Draft 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 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 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 contributed in money 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 geolocation. 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 **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.

## Next steps

The Draft DST bill will follow the approval procedure of an ordinary bill.

The first step (public comments and information procedure) has been initiated to gather the opinion of citizens holding legitimate rights and interests in relation to the Draft, whether directly or through the organizations/associations that represent them, and to obtain as many additional comments as possible from other people or entities. The deadline for the submission of comments is 15 November 2018.

In addition, once approved and after the evaluation of the observations presented in the public information, the Draft must be communicated to the European Commission in accordance with Directive (EU) 2015/1535 that sets forth a procedure for the provision of information in the field of technical regulations and of rules on Information Society services.

The Draft could be submitted for comments to the State Council. After that, the DST Law, moves to the Parliament and Senate 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 Draft, 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 Draft's approval procedure and, at the same time, the development of negotiations within the EU and the OECD.

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## Endnotes

1. See EY Global Tax Alert, [European Commission issues proposals for taxation of digitalized activity](#), dated 21 March 2018.
2. The Directive proposal is based on Article 113 of the EU treaty referred to "other forms of indirect taxation."
3. The draft 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.

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