UNIVERSITAT DE BARCELONA

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Director: Dr. José-Andrés Rozas Valdés
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Lovingly dedicated

to my mom and my dad.

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ABSTRACT

The digitalization of the economy is proving to be a challenge for policy makers as they redesign the international tax system. Activities which follow digital business models are carried out with little or no physical presence reaping benefits drawn from the value created by the data obtained from the users. Current tax systems are constructed on the idea of physical presence and were not designed to tax business models based on intangible assets and data. In Europe, to tackle the challenges of the digital economy, some countries have enacted unilateral digital services taxes that target large digital services providers. Among these countries is Spain. In this dissertation it is analyzed whether this tax, which entered into force on January 16, 2021, is contrary to law. In order to do so, an examination will be performed to determine whether this tax infringes tax treaty law, European Union law, and principles of tax law under Spanish legislation. To carry out this analysis, the research follows the procedure of an academic legal study. In this way, information is compiled from relevant academic articles, from case-law from Spanish courts, and from the Court of Justice of the European Union, and the opinions of the advocate general in different cases. This information is analyzed to draw conclusions regarding whether the arguments developed confirm or deny that the Spanish Digital Services Tax is contrary to law. As this dissertation has revealed that the Spanish Digital Services Tax does face some legality issues, it pursues to provide for recommendations that could enhance the legality of the tax. Such comprehensive research that pursues to enhance the Spanish Digital Services Tax to make it compliant with international and domestic laws does not otherwise currently exist in academic literature. Though this dissertation mainly focuses on an analysis of the Spanish Digital Services Tax, the implications are of interest to law scholars, lawmakers, and law practitioners alike from other jurisdictions which have a digital services tax in force (e.g. Austria, France, Italy, or the United Kingdom), or which might be interested in introducing one. The implications are of interest as well to those from jurisdictions whose taxpayers may become affected by such a levy as is the case of the United States where many digital services providers are headquartered; the issues raised in this dissertation are potential grounds for legal debate between the taxpayers and tax administrations in the near future. The Spanish Digital Services Tax has an unclear future due to the ongoing developments regarding the Organization for Economic Co-operation and Development Pillar One solution to address the tax challenges arising from the digitalization of the economy. As

a result, its life span may be cut short. However, this dissertation cannot be regarded as contingent to the future of this tax as it also sheds some light on the potential challenges of enacting a similar tax, for instance on pharmaceutical entities, as they operate on a business model very much like that followed by digital services providers.

RESUM

La digitalització de l'economia està donant als legisladors dificultats per redissenyar el sistema fiscal internacional. Les activitats que segueixen els models de negoci digital es duen a terme amb poca o nul·la presència física, que obtenen beneficis del valor creat per les dades dels usuaris. Els sistemes fiscals actuals es basen en la presència física i no van ser dissenyats per gravar models de negoci basats en actius intangibles i dades. A Europa, per fer front als reptes de l'economia digital, alguns països han promulgat impostos unilaterals sobre els serveis digitals dels grans proveïdors. Entre aquests països es troba Espanya. En aquesta tesi s'analitza si aquest impost, que va entrar en vigor el 16 de gener de 2021, és contrari a dret. Per fer-ho, es realitzarà un examen per determinar si aquest impost infringeix els tractats de doble imposició, el dret de la Unió Europea i els principis del dret fiscal continguts en la legislació espanyola. Per dur a terme aquest anàlisi, la investigació segueix el procediment d'un estudi jurídic acadèmic. D'aquesta manera, la informació es recopila a partir d'articles acadèmics, de la jurisprudència dels tribunals espanyols i del Tribunal de Justícia de la Unió Europea, i de les opinions de l'advocat general en diferents casos. Aquesta informació s'analitza per extreure conclusions sobre si els arguments desenvolupats confirmen o neguen que l'impost de serveis digitals espanyol sigui contrari a dret. Com que aquesta tesis ha revelat que l'impost de serveis digitals espanyol presenta alguns problemes de legalitat, persegueix proporcionar recomanacions per millorar la seva legalitat. Una recerca tan completa que pretén adaptar l'impost espanyol de serveis digitals per fer-lo compatible amb les lleis internacionals i domèstiques no existeix actualment en la literatura acadèmica. Tot i que aquesta tesi es centra principalment en un anàlisi de l'impost de serveis digitals espanyol, les implicacions són d'interès per acadèmics, legisladors i professionals del dret, tan de jurisdiccions que tenen un impost de serveis digitals en vigor (per exemple, Àustria, França, Itàlia o el Regne Unit), o que podrien estar interessats en introduir-ne un. Les implicacions són d'interès també per a aquells que procedeixen de jurisdiccions en les quals els seus contribuents poden veure's afectats per aquest impost, com és el cas dels Estats Units, on molts proveïdors de serveis digitals tenen la seva seu; les qüestions plantejades en aquesta tesis són motius potencials per al debat legal entre els contribuents i les administracions tributaries en un futur pròxim. L'impost espanyol de serveis digitals té un futur incert a causa dels desenvolupaments en seu de l'Organització per a la Cooperació i el Desenvolupament Econòmic relatius al Pilar Un per abordar els reptes

fiscals derivats de la digitalització de l'economia. Conseqüentment, la seva vigència pot ser curta. No obstant això, aquesta tesis no pot considerar-se com a subordinada al futur d'aquest impost, ja que revela els possibles reptes de promulgar un impost similar, per exemple sobre les empreses farmacèutiques, que operen en un model de negoci similar al dels proveïdors de serveis digitals.

RESUMEN

La digitalización de la economía está dando a los legisladores dificultades para rediseñar el sistema fiscal internacional. Las actividades de los modelos de negocio digital se llevan a cabo con poca o nula presencia física, que obtienen beneficios del valor creado por los datos de los usuarios. Los sistemas fiscales actuales se basan en la presencia física y no fueron diseñados para grabar modelos de negocio basados en activos intangibles y datos. En Europa, para hacer frente a los retos de la economía digital, algunos países han promulgado impuestos unilaterales sobre los servicios digitales a los grandes proveedores. Entre estos países está España. Esta tesis analiza si este impuesto, que entró en vigor el 16 de enero de 2021, es contrario a derecho. Para hacerlo, se realizará un examen para determinar si infringe los tratados de doble imposición, el derecho de la Unión Europea y los principios del derecho fiscal contenidos en la legislación española. Para llevar a cabo este análisis, la investigación sigue el procedimiento de un estudio jurídico académico. De este modo, la información se recopila a partir de artículos académicos, de la jurisprudencia de los tribunales españoles y del Tribunal de Justicia de la Unión Europea, y de las opiniones del abogado general en diferentes casos. Esta información se analiza para extraer conclusiones sobre si los argumentos desarrollados confirman o niegan que el impuesto de servicios digitales español sea contrario a derecho. Como que esta tesis ha revelado que el impuesto de servicios digitales español presenta algunos problemas de legalidad, persigue proporcionar recomendaciones para mejorarlo. Una investigación tan completa que pretende adaptar el impuesto español de servicios digitales para hacerlo compatible con las leyes internacionales y domésticas no existe actualmente en la literatura académica. A pesar de que esta tesis se centra en un análisis del impuesto de servicios digitales español, las implicaciones son de interés para académicos, legisladores y profesionales del derecho, tanto de otras jurisdicciones que tienen un impuesto de servicios digitales en vigor (por ejemplo, Austria, Francia, Italia o el Reino Unido), o que podrían estar interesados en introducir uno. Las implicaciones son de interés también para aquellos que proceden de jurisdicciones en la que sus contribuyentes pueden verse afectados por este impuesto, como es el caso de los Estados Unidos, donde muchos proveedores de servicios digitales tienen su sede; las cuestiones planteadas en esta tesis son los motivos potenciales del debate legal entre los contribuyentes y las administraciones en un futuro próximo. El impuesto español tiene un futuro incierto a causa de los desarrollos en sede de la Organización para la Cooperación

y el Desarrollo Económico en relación al Pilar Uno para abordar los retos fiscales derivados de la digitalización de la economía. Consecuentemente, su vigencia puede ser corta. Sin embargo, esta tesis no puede considerarse subordinada al futuro de este impuesto, puesto que revela los posibles retos de promulgar un impuesto similar, por ejemplo, sobre las farmacéuticas, que operan en un modelo de negocio similar al de los proveedores de servicios digitales.

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ABBREVIATIONS

AG: Attorney General

AIReF: Spanish Independent Authority of Fiscal Responsibility

BEPS: Base Erosion and Profit Shifting

CFI: Court of First Instance

CIT: Corporate Income Tax

CJEU: Court of Justice of the European Union

DAT: Digital Advertisement Tax

DST: Digital Services Tax

DST Directive Proposal: Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services

DTC: Double Tax Convention

ECHR: European Convention on Human Rights

ECOFIN: Economic and Financial Affairs Council

ECtHR: European Court of Human Rights

e.g.: for example

et seq.: and the following

EU: European Union

FAQs: Frequent Ask Questions

GC: General Court

GDP: Gross Domestic Product

HUF: Hungarian Forint

i.e.: that is / in other words

IFRS: International Financial Reporting Standards

IIVTNU: Tax on the increase in value of urban land

IP: Internet Protocol

IRC: Internal Revenue Code

ITFA: Internet Tax Freedom Act

IVPEE: Tax on the Value of Electricity Production

MAP: Mutual Agreement Procedure

Maryland DAT: Maryland Digital Advertising Gross Revenues Tax

MLC: Multilateral Convention

MNE: Multinational entity

MTC: Model Tax Convention

OECD: Organization for Economic Co-operation and Development

OECD MTC: Organization for Economic Co-operation and Development Model Tax Convention on Income and on Capital

Order HAC/590/2021: Order HAC/590/2021, of 9 June, approving form 490 on "Self-assessment of Tax on Certain Digital Services" and determining the means and procedure for its filing

Order HFP/480/2022: Order HFP/480/2022, of 23 May, amending Treasury Order/590/2021, of 9 June, approving Form 490 for “Self-assessment of the Tax on Certain Digital Services” and establishing the method and procedure for its submission

Order HFP/307/2023: Order HFP/307/2023, of 28 March, amending Treasury Order/590/2021, of 9 June, approving Form 490 for “Self-assessment of the Tax on Certain Digital Services” and establishing the method and procedure for its submission

p.: page

para.: paragraph

SME: Small and medium-sized enterprise

Spanish CIT Act: Act 27/2014, of November 27, on the Corporate Income Tax

Spanish CIT Regulation: Royal Decree 634/2015, of July 10, that approves the CIT Regulation.

Spanish DGT: Spanish Directorate General of Taxes

Spanish DGT resolution on the DST: Resolution of June 25, 2021, of the Directorate General for Taxes relating to the Tax on Certain Digital Services

Spanish DST: Spanish Tax on Certain Digital Services

Spanish DST Act: Act 4/2020, of October 15, on the Tax on Certain Digital Services

Spanish DST Regulation: Royal Decree 400/2021, of 8 June, implementing the rules for locating user devices and the formal obligations of the Tax on Certain Digital Services, and amending the General Regulation on tax management and inspection actions and procedures and implementing common rules for tax application procedures, approved by Royal Decree 1065/2007, of 27 July

Spanish GTA: Act 58/2003, of December 17, on the General Tax Act

STA: Spanish Tax Administration

STA FAQs regarding the Spanish DST: FAQs Regarding the Tax on Certain Digital Services

TEU: Treaty on the European Union

TFEU: Treaty on the Functioning of the European Union

TIN: Tax identification number

UK: United Kingdom

UN: United Nations

UN MTC: United Nations Model Double Taxation Convention between Developed and Developing Countries

US: United States of America

USTR: United States of America Trade Representative

VAT: Value Added Tax

VPN: Virtual Private Network

vs.: versus

CHAPTER 1: INTRODUCTION

1.1. Background and relevance

We are undergoing a new industrial revolution marked by the digitalization of the world economy. The consolidation of the Internet and electronic commerce in the last decade has changed the way companies conduct their business.[1] The Internet gives companies the ability to draw in revenue from across the globe by providing goods and services to clients and customers located anywhere without requiring physical presence. Consequently, the international tax system has become outdated having been assembled at the beginning of the twentieth century.[2]

The digitalization of the economy is giving policy makers a struggle to redesign the international tax system. Activities which follow digital business models are carried out with little or no physical presence reaping benefits drawn from the value created by the data obtained from the users. Current tax systems are constructed on the idea of physical presence and were not designed to tax business models based on intangible assets and data.[3]

As explained by Hoffart (2007), the second industrial revolution, which took place between the late nineteenth century and the early twentieth century, meant a radical change in the productive model of industrial countries due to the technological advances that facilitated greater development of industry and greater efficiency in transportation by such means as railroads, steamships, and the automobile allowing for a more widespread distribution of products in a shorter period of time and at a lower cost.[4] Due to all these factors, together with the governments' need of revenue

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[1] The Internet has changed the way people purchase products (e.g. Amazon), communicate (e.g. e-mail), search for information (e.g. Google), listen to music (e.g. Spotify), or watch movies or series (e.g. Netflix), among many other activities that now a days can be done online. In this dissertation the names of certain digital providers might be used, but for the sole purpose of providing examples as in this case.

[2] According to Sainz de Bujanda (1966b), for a fair tax system to exist reality must be adequately regulated by the tax system, in such a way that factual reality and legal reality coincide.

[3] In this same line of reasoning, see EU (2017a). Communication from the Commission to the European Parliament and the Council. *A Fair and Efficient Tax System in the European Union for the Digital Single Market*, (COM (2017) 547 final, September 21, 2017):

> "There are weaknesses in the international tax rules as they were originally designed for "brick and mortar" businesses and have now become outdated. The current tax rules no longer fit the modern context where businesses rely heavily on hard-to-value intangible assets, data and automation, which facilitate online trading across borders with no physical presence." (p. 2).

[4] As explained by Noah Harari (2014), until the eighteenth century, the majority of the world population lived in an agrarian economy. This was like that until the invention of the steam engine

to rebuild their economies after World War I, countries began taxing the earnings obtained from non-resident entities as a result of the economic activities carried out within their territories (Hoffart, 2007).[5]

This situation generated an international double taxation between the taxation of the state of the entity's residence and the source state of the entity's revenue. In the 1920's, negotiations within the League of Nations led to the advent of the permanent establishment concept as a means for allocating taxation rights to the source state for the profits obtained from tangible economic activities within its territory and, in turn, as an exception to the general principle of taxation by the state of residence (Garcia Prats, 1996).[6] In 1928, the League of Nations developed its first model tax treaty to prevent double taxation, being the foundation for the OECD and the UN models to come (Kobetsky, 2011). Consequently, the permanent establishment rules promulgated by the League of Nations are currently embodied in the OECD's MTC (Hoffart, 2007).

At present, the concept of permanent establishment is defined under Article 5.1 of the OECD MTC as "a fixed place of business through which the business of an enterprise is wholly or partially carried out." In addition, Article 5.2 of the OECD MTC indicates that the term "permanent establishment" includes: a) a place of management, b) a branch, c) an office, d) a factory, e) a workshop, and f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. In turn, as explained by Avi-Yonah & Clausing (2008), the notion of permanent establishment is decisive for allocating business profits for tax purposes since Article 7 of the OECD MTC establishes that business profits obtained by a non-resident entity in a foreign

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that mark the beginning of the first industrial revolution that allowed for the mass production of manufactured goods and great socioeconomics changes such a migratory movement from rural areas to urban areas were factories were being located (Noah Harari, 2014).

[5] Castro García (2021) explains that the first antecedent of the concept of permanent establishment is found in Prussian commercial law during the second half of the nineteenth century, as the term *betriebsstätte* was used to refer to the space used to carry out business activities. As indicated by the mentioned author, this concept was later incorporated into Prussian local law in order to be able to tax profits from economic activities carried out in one municipality by individuals residing in other municipalities.

[6] Castro García (2021) points out that the first international treaty that included the concept of permanent establishment was the convention signed between the Austro-Hungarian Empire and Prussia in 1899, in which it was agreed that economic transactions carried out in a fixed place of business should be taxed in that state, even if the owner of that place of business resided in another state.

jurisdiction can only be taxed in this jurisdiction if the non-resident entity has a permanent establishment there.

Thus, the concept of the permanent establishment, when it was initially contemplated, represented an adaptation of the residence-based taxation system, allowing states to tax transactions carried out within their territory by a non-resident entity subject to the condition that the entity had a physical presence in that territory. This was the way in which the international tax system was reformulated, in terms of the concept of residence as a criterion for establishing taxing rights, to adapt to the new reality of the second industrial revolution and which is still in force today. More than a century later, the so-called third and fourth industrial revolutions, jointly referred to as the digital revolution, have taken place (Schwab, 2016).

The third industrial revolution was a term first used by Rifkin (2011) to refer to the economic changes that occurred between the end of the twentieth century and the beginning of the twenty-first century in which the Internet and renewable energies became vital to create economic growth.[7] Garrell Guiu & Guilera Agüella (2019) characterized this third industrial revolution by circumstances that took place during the latter half of the twentieth century. Such circumstances include the shift from mechanical and analogue devices to digital devices, or the advent and the consequent extensive use of computers and the Internet. These are what brought relevant changes to communication technologies, among other technological advancements that have transformed business operations and production processes.

The fourth industrial revolution, a term popularized by Schwab (2016), describes the rapid technological advancement of the twenty-first century and is linked to information and communications technologies.[8] As pointed out by the mentioned author, the fourth industrial revolution is also associated with artificial intelligence, big data, biotechnology, blockchain, cloud storage, fully autonomous vehicles, robotics, the Internet of things, and 3D printing, among other new technologies.

[7] The EU Parliament adopted the term of the third industrial revolution for promoting a transition from fossil fuels to renewal energies for a greener Europe. See EU (2007). *Declaration of the European Parliament on establishing a green hydrogen economy and a third industrial revolution in Europe through a partnership with committed regions and cities, SMEs and civil society organizations*, Official Journal of the EU (C 102 E/139, May 22, 2007).

[8] Schwab (2016) admits that the fourth industrial revolution, also referred as "Industry 4.0", may simply be part of the third industrial revolution.

Prior to the twenty-first century, there was already a concern about the issues raised by the digitalization of the economy, as explained by Nocete Correa (2020). An early precedent can be found in the 1997 European e-commerce initiative, which called for examining the concepts of source, residence, and permanent establishment, and highlighted that the unequal treatment between traditional transactions and on-line transactions would create a tax-induced distortion of competition.[9] At a global level, the Ottawa OECD Ministerial Conference held in 1998 in which the issues regarding the emergence of e-commerce were addressed and the taxation principles which should apply to this new form of commerce were set out.[10] However, the issue began to be addressed more significantly as of 2013 when discussions at an OECD level began to take place to address the tax challenges raised by the digital revolution under the BEPS Project.

The aim of the BEPS Project is to mitigate mismatches or loopholes in international tax rules so that corporations cannot artificially shift profits to low or no tax jurisdictions in order to lower their tax burden. It consists of 15 actions that have been developed by the OECD to address tax avoidance and designed to be implemented under domestic legislation and through provisions set forth in DTCs.[11]

BEPS Action 1 bears the title "Address the tax challenges of the digital economy".[12] As a summary, it can be said that, on the one hand, the corporate international taxation framework is thought out for traditional "brick and mortar" enterprises as it is based on the concept of permanent establishment that requires a physical presence, but as companies have become more digitalized, the rules of this system are no longer fit for the purpose as the advent of the Internet and new technologies allow for services to be provided without the need of a physical presence. Thus, a new nexus to grant taxing rights to the source states must be established. On the other hand, the other challenge that faces the current tax system are the digital assets that are typical of the digital revolution. Digital assets (such as user's data)[13] are characterized for being intangible

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[9] EU (1997). *Report on the communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on a European Initiative in Electronic Commerce* (COM(97)0157 - C4-0297/97).

[10] OECD (1998). Ministerial Conference. *A borderless world: Realizing the potential of global electronic commerce.* Ottawa, October 7-9, 1998. SG/EC(98)9/FINAL.

[11] OECD (2013). *Action Plan on Base Erosion and Profit Shifting.* OECD Publishing.

[12] OECD (2015). *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report.* OECD/G20 Base Erosion and Profit Shifting Project. OECD Publishing.

[13] Campos Martínez (2023) considers that data is the center piece of the digital economy.

assets of difficult valuation[14] in which the added value resides in the activity performed by the user itself on the digital platform, and to a lesser extent on the work performed by the professionals on behalf of the digital service providers as opposed to the tangible assets typical of the first and second industrial revolutions (Sánchez-Archidona Hidalgo, 2021). In all, considering that the underlying principle for corporate taxation is that profits should be taxed where the value is created, it is not very clear in digital business models what that value is, how it can be measured, or even where it is created.

It is particularly relevant that in digital business models there is no need for physical presence in a certain jurisdiction to render services in that jurisdiction. Permanent establishment, which is based on physical presence, is essential to allocate taxing rights to source states, but has become outdated in the digital economy. This obsolescence is allowing digital service providers to move their physical presence to a territory with low or no taxation while still being able to provide the same services as they did before (Sánchez-Archidona Hidalgo, 2020).

Indeed, the implication is that there is unfair tax competition since companies that provide traditional services, whose physical location necessarily coincides with the place where the services are provided, have to compete with digital services providers that are able to establish their physical location in jurisdictions with lower taxes compared to the place where the services are provided. Thus, digital entities can have lower tax costs compared to traditional entities.[15] As expressed by the European Commission, there are large disparities in regards to the effective tax rate applied in the EU between traditional business models (with an effective tax rate between 23.2% and 20.9%) and digital business models (with an effective tax rate between 10.1% and 8.5%).[16]

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[14] As explained by Rosembuj (2015), it is hard to compare data to any other existing commodity or service when analyzing its characteristics.

[15] EU (2017a). Communication from the Commission to the European Parliament and the Council. *A Fair and Efficient Tax System in the European Union for the Digital Single Market,* (COM (2017) 547 final, September 21, 2017), p. 6:

> "The EU needs a modern tax framework to seize digital opportunities, while also ensuring fair taxation. A level playing field is a pre-condition for all businesses to be able to innovate, develop and grow to support higher levels of productivity, employment and prosperity."

[16] EU (2017a). Communication from the Commission to the European Parliament and the Council. *A Fair and Efficient Tax System in the European Union for the Digital Single Market,* (COM (2017) 547 final, September 21, 2017), p. 6.

In all, it can be concluded that the corporate taxation framework is thought out for traditional “brick and mortar” enterprises, but as companies have become more digitalized, the rules of this system are no longer fit for the purpose.[17] The tax breach between traditional and digital business models, as well as the impending risk of a decrease in tax revenues accompanied by an increase of public expenditure, and the growing social demand for a fair taxation of the digital economy, have triggered discussions in the EU, at the OECD, and at the UN to solve the problems of taxing the digital economy.

Before analyzing what has been done within these organizations, it must be mentioned that there is a historical conflict over tax sovereignty to avoid international double taxation.[18] The dichotomy for taxing cross-border income is between residence states (in favor of taxing income or profits by the jurisdiction according to the entity’s residence), and source states (defenders of granting taxing rights to the jurisdiction in whose territory the economic activity is carried out). Due to the digital economy and its peculiar characteristics, what was traditionally a dispute between developed countries (residence states) and developing countries (source states) has now become, broadly speaking, a debate between mostly the US (in favor of taxation rules based on residence) and the rest of the world (inclined towards rules that favor source states).

The majority of big tech companies are American: Alphabet (Google), Amazon, Apple, Meta (Facebook), and Microsoft, also jointly referred to as the Big Five. Thus, the US, the country of residence of these large technological companies, is in favor of maintaining the taxation nexus in force in the international tax system based on physical presence, and as a result, the only taxation nexus of these digital service providers would be with the US (Brauner, 2021). However, as pointed out by Van Den

[17] EU (2017a). Communication from the Commission to the European Parliament and the Council. *A Fair and Efficient Tax System in the European Union for the Digital Single Market,* (COM (2017) 547 final, September 21, 2017), p. 2:

> “As a result, some businesses are present in some countries where they offer services to consumers and conclude contracts with them, taking full advantage of the infrastructure and rule of law institutions available while they are not considered present for tax purposes. This free rider position tilts the playing field in their favor compared to established businesses.”

[18] Martín Jiménez (2018) describes how at the beginning of the twentieth century, within the framework of the reports of the League of Nations of 1923 and 1925, which sought to lay the foundations for the approval of international conventions and the avoidance of double taxation, there was already a debate on the possibility of attributing personal taxation to the residence state of the company and impersonal taxation to the source state. However, as pointed out by the mentioned author, the US and the UK favored the taxation at the residence state, being the criterion that prevailed in the international tax order.

Hurk (2014), some large MNEs might not be paying taxes in the US from their worldwide income as their taxation could be established in low-tax jurisdictions.

At a European level and from the perspective of a source state, the European Commission released on March 21, 2018, its proposals for a fair taxation of the digital economy, also referred to as the *Digitax package*, which responded to the conclusions reached by the ECOFIN on December 5, 2017.[19] In these conclusions, the ECOFIN proposed adopting a common position by the EU to face the challenges of digital taxation to ensure that all entities pay their fair share of taxes and to guarantee a level playing field globally and in line with the work currently underway at an OECD level.[20]

The three main documents that form the *Digitax package* are: (i) the proposal for a directive on laying down rules regarding the corporate taxation of a significant digital presence;[21] (ii) the Commission recommendations relating to the corporate taxation of a significant digital presence;[22] and (iii) and the proposal for a directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services.[23]

The first two documents are seen as a long-term fix for the deficiencies of the international tax system to tax the digitalized economy, as the application of the current tax rules to the digital economy has led to a misalignment between the place where value is created and the place where business profits are taxed. This long-term fix to the existing problems advocates for adapting the current corporate tax framework to the digital economy by: (i) extending the concept of permanent establishment to cases in which there is a significant digital presence; and (ii) reforming the profit allocation rules to better capture value creation in the new business models in which the transfer pricing rules remain pivotal. These proposals

[19] The ECOFIN is composed of the economics and finance ministers of all the EU Member States.
[20] EU (2017b). Council of the EU. *Council conclusions on "Responding to the challenges of taxation of profits of the digital economy"*, document number 15175/17, December 5, 2017.
[21] EU (2018c). *Proposal for a Council Directive on laying down rules relating to the corporate taxation of a significant digital presence* (COM (2018) 147 final).
[22] EU (2018a). *Commission recommendations relating to the corporate taxation of a significant digital presence* (C (2018) 1650 final, March 21, 2018).
[23] EU (2018d). *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services* (COM (2018) 148 final). This final proposed directive is referred to as the DST Directive Proposal.

should be integrated into Members States' CIT and the Commission's Common Consolidated Corporate Tax Base proposal, and at an international level, should ultimately be in accordance with the corresponding potential changes in the OECD MTC.

The measure addressed in the third document proposes the creation of a DST within the EU as a short-term and provisional response to the taxation challenges of the digital economy. This measure was in line with the voices of certain Member States in favor of adopting transitional unilateral measures that would respond to the situation raised, among them Austria, France, Italy, Spain, and the UK.

These proposals of the Commission were debated in a context in which the OECD was working on a global response to the new tax challenges of the digital economy, though no consensus was being reached. In a situation that looked like no agreement was going to be reached, certain European countries started advocating in favor of the enactment of unilateral measures such as DSTs to provide an immediate response to this problem. That led to the publication of the Commission’s proposals for a fair taxation of the digital economy which intended to provide a common response to controversial issues at the European level to avoid uncoordinated measures taken unilaterally by Member States augmenting the risk of further fragmentation of the EU single market.[24] Likewise, the Commission contemplated its proposals as temporary measures, and expressed that the ideal approach would be to find a multilateral solution within the framework of the OECD as the problem of taxing the digital economy is of a global nature.[25] Nevertheless, these proposals were met with certain reluctance by some Member States (Denmark, Finland, Ireland, and Sweden), and as a result, the DST Directive Proposal has never been passed as Article 113 of the TFEU requires unanimity in adopting legislation concerning taxes aimed at the harmonization of the internal market (García de Pablos, 2019).

[24] Explanatory Memorandum to the DST Directive Proposal, p. 2.
[25] Explanatory Memorandum to the DST Directive Proposal, p. 2.

Under this scenario, the Commission proposed another directive in March of 2019 on a tax that was levied only on the revenues obtained from the provision of advertising services.[26] This measure also failed to gain general approval by Member States.

The DST Directive Proposal has never been enacted, but it has been used as a model for national lawmakers to create domestic DSTs. The DST Directive Proposal established three types of digital services that are subject to this tax: (i) online advertising services (consisting of the inclusion, on a digital interface, of advertising aimed at the users of that specific digital interface), (ii) online intermediary services (consisting of the provision of a digital interface that is available to users by which these are able to interact in order to facilitate the delivery of goods or to provide services, or which provides a means by which users can connect with other users to allow for mutual interaction), and (iii) data transmission (consisting of the sale or assignment of data that is gathered from the activity of the users through digital interfaces).[27]

The conception of the DST Directive Proposal was to align the taxation of the covered economic activities with the place where the underlying value is generated.[28] This proposal determined that the contribution of the user's participation by providing their data is the essential value creation element in the provision of the services that fall under the scope of this tax. It called attention to the fact that, without this tax, these revenues go untaxed in the jurisdiction in which the users are located since, in order to currently allocate taxing rights to the source state, the provider of such services must at least have a permanent establishment there, as explained.[29]

The DST Directive Proposal failed to be adopted at a EU level due to the lack of consensus among Member States although certain countries like Austria, France, Italy, Spain, and the UK, have committed themselves to act unilaterally and have introduced domestic DSTs (Garcia Prats, 2022).

There are differences between the domestic DSTs and the directive proposal concerning the covered digital services. Some include all of the three types of digital

[26] EU (2019). *Proposal for a Council Directive on the common system of a digital advertising tax on revenues resulting from the provision of digital advertising services,* Reference 6873/19, March 1, 2019.
[27] Article 3 of the DST Directive Proposal.
[28] Explanatory Memorandum to the DST Directive Proposal, p. 2.
[29] Explanatory Memorandum to the DST Directive Proposal, p. 2.

services foreseen by the DST Directive Proposal as in the case of the Spanish DST, or only digital advertising as in the case of the Austrian DST, among other possibilities. The applicable tax rate also differs between the DSTs ranging from the reduced tax rate of 2% (normal tax rate of 3%) in the case of the UK DST, to 5% as in the case of the Austrian DST (Garcia Prats, 2022). The Spanish legislature established the 3% tax rate as in the DST Directive Proposal as done likewise by French and Italian lawmakers (Garcia Prats, 2022).

That said, the principal design components of the domestic DSTs such as the use of worldwide and domestic revenue thresholds, and the taxable gross revenue streams, are common and have been inspired by the DST Directive Proposal, though the amounts of the thresholds can differ (Garcia Prats, 2022). However, despite the disparities mentioned between domestic DSTs, the DST Directive Proposal has served as a model for various countries to design their respective DSTs, including Spain where the regulation of its domestic DST is very similar to what is provided for in the directive proposal.

In all, the DSTs try to achieve fairer taxation from the perspective of the sharing of tax revenues between the residence states and the source states resulting in a new allocation of taxing rights based on the location of the users that create value, and also from the perspective of businesses as the DSTs pursue to make digital providers pay their fair share of taxes with regards to companies who operate in a traditional business model based on physical presence where revenues can be taxed in the source state under current international tax rules.

The greater interest in DSTs triggered the US to threaten to increase tariffs on goods from countries that enacted unilateral DSTs that could harm the interest of US MNEs (Kim, 2021). Due to the fear of a trade war, an agreement was reached in March 2018 between the G20 finance ministers to address the tax challenges of the digital economy.[30] The outcome of this agreement was the provisional report titled "Tax Challenges Arising from Digitalization – Interim Report 2018",[31] and in January 2019,

[30] OECD (2019). *Addressing the Tax Challenges of the Digitalization of the Economy – Policy Note*, OECD Publishing, p. 4: "taking on these challenges, together, and on a coordinated, multilateral basis could ease the growing tension within the international tax architecture with a number of countries having taken unilateral measures over recent years."

[31] OECD (2018). *Tax Challenges Arising from Digitalization – Interim Report 2018, Inclusive Framework on BEPS*. OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

a policy note was released which put forward for the first time the OECD approach of a Pillar One and a Pillar Two.[32] In October 2020, an agreement was reached that was based on this two-pillar solution. Pillar One[33] consists of two parts: Amount A which reallocates a portion of income from corporate groups with a turnover exceeding €20 billion and profitability above 10% to market jurisdictions where they operate, and Amount B which attempts to simplify transfer pricing by establishing safe harbor amounts for distribution and marketing activities.[34] Pillar Two[35] attempts to guarantee a 15% effective tax rate for corporate groups with a turnover greater than €750 million.[36] Barnes & Rosenbloom (2022), who are both skeptical of the Pillars, consider these rules to be extremely complex and that the OECD's goal of increasing source jurisdiction taxation, though laudable, can be attained through other simpler avenues.

The OECD agreement on a two-pillar solution to address the tax challenges of the digitalization of the economy seems to be moving forward and that could mean the end of the DSTs.[37] On October 21, 2021, Austria, France, Italy, Spain, the UK, and the US, issued a joint statement in which the European countries in that group undertook a compromise to withdraw their respective unilateral DSTs once the OECD Pillar One took effect.[38] In addition, in October 2023 the OECD released the draft of the "Multilateral Convention to Implement Amount A of Pillar One" which lists in its annex A specific measures that must be removed for all businesses as part of the implementation of Amount A. This includes the DSTs enacted by, among others,

[32] OECD (2019). *Addressing the Tax Challenges of the Digitalization of the Economy – Policy Note*, OECD Publishing.

[33] OECD (2020). *Tax Challenges Arising from Digitalization – Report on Pillar One Blueprint: Inclusive Framework on BEPS*. OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

[34] Kane & Kern (2021) have shown the advantages of progressive formulary apportionment, and demonstrate how it could be implemented within Pillar One by introducing amount D, a new taxing right in favor of developing countries, that would apply in addition to amounts A and B.

[35] OECD (2020). *Tax Challenges Arising from Digitalization – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*. OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

[36] Perdelwitz & Turina (2021) edited a compilation of articles on the ongoing debates surrounding the convergence towards global minimum taxation, a review of which was published by Pownall Montoya (2022).

[37] Martín Jiménez (2021) is skeptical on whether Pillar One will be accepted by the US, and with regards to Pillar Two, the mentioned author considers that its implementation could face potential challenges under EU law and jeopardize its effective implementation.

[38] OECD (2021). *Joint statement from Austria, France, Italy, Spain, the United Kingdom, and the United States regarding a compromise on a transitional approach to existing unilateral measures during the interim period before pillar 1 is in effect.*

Austria, France, Italy, Spain, and the UK.[39] The MLC provides for the withdrawal of DSTs and other similar measures, and also outlines criteria to prevent the enactment of such tax measures in the future. The MLC draft also sets the criteria to identify future DSTs and similar tax measures: First, the tax measure is applied by reference to market-based criteria such as the location of the users; second, the measure is applied solely to non-resident entities or foreign owned entities (these criteria can potentially allow the existence of DSTs); and third, the tax measure must fall out of the scope of DTCs.

Reaching a common position to solve the tax challenges of the digital economy is complicated as different interests come into play. Tax policy is developed in an environment of interdependency as explained in Dagan (2018), a review of which was published by Rozas Valdés (2020). In the book, Dagan analyzes the international tax system drawing on game theory and the well-known prisoner's dilemma, a construct which demonstrates how two individuals may have difficulty cooperating even though it could be in their interest to do so. The international tax system is described as a market which is imperfect, but in which jurisdictions must, nevertheless, interact interdependently within a globalized environment.

So, a domestic tax policy decision cannot be taken without assessing the effects it may have on the international arena, as all tax policies currently have an international dimension. Otherwise, there is a risk that the reaction of other jurisdictions will cancel out the effects of that tax policy due to this interdependency of the international tax system, according to Rozas Valdés (2022).

Pownall Montoya (2022, July 31) illustrated Dagan's (2018) thesis as it applies to the recent circumstances surrounding the DSTs. Due to the lack of a foreseeable agreement at an OECD level to tackle the taxation challenges of the digital economy in the short term, certain European countries started advocating for unilateral DSTs as a quick fix to the problem. That provoked a response from the Commission in the form of a European DST proposal to avoid uncoordinated actions. However, certain Member States opposed it which prompted unilateral decisions for implementing domestic DSTs benefitting themselves but to the detriment of the common good of all

[39] OECD (2023b). *Multilateral Convention to Implement Amount A of Pillar One.*

Member States. Those unilateral actions triggered an interest in designing a multilateral solution at an OECD level based on a two-pillar approach to undertake the challenges of the digital economy.

The concept behind the prisoner's dilemma can help in understanding the existing international tax competition that policymakers have faced while making decisions about how to tax the digital economy; the decisions made in regard seem to have fluctuated between multilateral and unilateral approaches. However, jurisdictions have shown their intent to coordinate tax policies to reach a common resolution on taxing the digital economy resulting in the two-pillar solution that is being negotiated under the umbrella of the OECD.

Despite the above, the EU has not given up in designing a harmonized European digital tax, but now as an own resource if a global solution on international digital taxation is not reached as explained in the statement of the members of the European Council of March 25, 2021.[40] Thus, contrary to the initial position of characterizing the DST as a temporary measure, in the future the EU could enact a European digital tax that will provide a new own resource, which together with the existing resources and others that might come, will support the large financial outlays that are being made by the EU to mitigate the effects caused by the COVID-19 pandemic under the *Next Generation EU* recovery instrument (Martín Rodríguez, 2022).[41] All this indicates that the apparently temporal nature of the DSTs might not be, in fact, temporary as such. As pointed out by Grau Ruiz (2020), examples can be found of taxes that are currently well consolidated within the tax system that were designed as provisional measures, such as the Spanish Wealth Tax that was enacted as a temporary tax in 1977 but is still in force.[42] Thus, it would not be unusual for a temporary measure such as the DST to take root in the legal system.

[40] EU (2018e). *Statement of the members of the European Council, 25 March 2021*, SN 18/21.
[41] As described in the EU Commission website on the EU budget for 2021-2027, new own resources will be introduced to complement Member States' contributions to the EU budget. These own new resources will align the sources of revenue to the EU budget with the EU objectives, and that means that the new taxes will help tackling climate change and ensuring fair taxation in the digital economy. See: EU (n.d.). European Commission. *The 2021-2027 EU budget – What's new?*
[42] Cox & McLure (n.d.). point out that many taxes began as temporary war measures such as the income tax that was first introduced in Great Britain in 1799, and the turnover or purchase tax that were introduced in Germany in 1918 and in Great Britain in 1940.

It might still be too early to anticipate the future of unilateral DSTs which is contingent on the outcome of the negotiations on Pillar One. If the negotiations succeed, we will have a multilateral solution. However, if there is no consensus, the DSTs will prevail. As discussed in Pownall Montoya (2022, July 31), domestic tax policies are dependent on international tax policies as they are strongly linked to each other in a tension that oscillates between competition and coordination.

In addition, it must be mentioned that in contrast to the response of the OECD MTC, which limits taxation in the source states to the requirement that the company providing the service has a permanent establishment, the UN MTC,[43] though it does not represent a radical change compared to the OECD MTC, favors a tax system in which the source states, which are traditionally the least developed, have greater sovereignty to tax business activities carried out within their territory (García Novoa, 2021). This context is essential in order to understand the response from the UN to the taxation challenges of the digital economy through Article 12B which was incorporated in April of 2021 into the UN MTC. In a nutshell, in the absence of a permanent establishment or physical presence of the service provider in the source state, this article allows for a state to tax income from "automated digital services"[44] paid to a resident of another state on a gross basis at a tax rate that was negotiated bilaterally between both states with an option for the taxpayer to pay tax on a net profit basis in the source state (Báez Moreno, 2021). In all, though Article 12B of the UN MTC can be seen as an alternative to the OECD Pillars to adapt the international tax system to the digital economy, the reality is that the UN MTC is not generally being used for drafting DTCs so it will not be discussed any further.[45]

Though it is also out of the scope of this dissertation to discuss any further the OECD two-pillar solution or other policy options and their effects from a political science point of view, the DSTs can be seen as an interesting solution for the tax challenges

[43] UN (2021). *Model Double Taxation Convention between Developed and Developing Countries*.

[44] According to paragraph of Article 12B, the term "automated digital services" refers to any service provided on the Internet or another electronic network, that requires a minimal human involvement in relation to the service provider. This term includes as specified in paragraph 6 of Article 12B: "(a) online advertising services; (b) supply of user data; (c) online search engines; (d) online intermediation platform services; (e) social media platforms; (f) digital content services".

[45] Báez Moreno (2021) strongly criticizes the existence of Article 12B of the UN MTC. On the other hand, García Novoa (2021) considers that it is easy and simple to apply and that could be appealing to developing countries, though the need to renegotiate DTCs for the correct application of this article might make it non-applicable in the short term.

of the digital economy and might be here to stay. However, they might face some legality issues which can be addressed and amended. The issues raised in this dissertation can be potential grounds for legal debate between taxpayers and tax administrations in the near future as other European countries have enacted taxes with a similar design. An in-depth study of the problem in one jurisdiction could establish a foundation for legal debates for other jurisdictions tackling similar controversies proving the importance of carrying out this research.

The choice of the dissertation topic has been motivated by the developments in methods for tackling the challenges of taxation of the digital economy. The DST Directive Proposal, the enactment of subsequent domestic DSTs as well as other proposals to taxing the digital economy have stirred a number of legal debates on the legality of these measures and on what the best tool would be to remedy the shortcomings of the current rules of the international tax system that is based on the premise of physical presence of the economic operators in the jurisdictions in which they carry out their economic activities. However, this premise no longer seems valid in a highly digitalized economy.

Spanish lawmakers have taken unilateral action enacting the Spanish DST that follows closely the DST Directive Proposal in order to establish a fairer tax system. Though the goal of the lawmakers to update the current international tax system through the enactment of the Spanish DST may be laudable, it is necessary to examine the legality of this tax.[46]

1.2. Research question and hypothesis

The research question for this dissertation evolved from a comprehensive review of the relevant literature on the DSTs and DTCs, as well as current EU, and Spanish law: Is the Spanish DST contrary to law?

In order to address the research question, the investigation approaches the issues by dividing them into two blocks. The central block of the research consists of analyzing the compatibility of the Spanish DST with the non-discrimination legal framework of

[46] As expressed by Sánchez Serrano (1997) and by Aguallo Avilés (2001), a democratic and welfare state as defined under Article 1.1 of the Spanish Constitution, must be built in accordance with the rule of law.

the EU (fundamental freedoms, and State aid) and of the Spanish legal system (equality principle, the ability to pay, and the non-confiscatory principles). The secondary block regards more specific issues though of equal importance when analyzing the legality of this tax such as its compatibility with DTCs (i.e. interpretation of Article 2 OECD MTC), and its compatibility with other principles under domestic legislation (i.e. the prohibition of arbitrariness, the generality principle, as well as legal certainty and the prohibition of retroactivity).

This brief description of the situation drawn from research considered at the initial stage of the analysis forms the foundation of the hypotheses of this dissertation which are threefold: The Spanish DST infringes (i) the DTCs signed by Spain, (ii) EU law, and (iii) the principles of tax law.

The hypotheses address three independent issues. Nevertheless, the problems that arise with the Spanish DST can be included into two general groups. First, the enactment of the Spanish DST can be seen as an unusual, albeit new tool in the area of corporate taxation regarding its design. The Spanish DST creates a new nexus for allocating taxing rights based on the location of the users, thus it must be determined whether it is a tax covered by DTCs and whether it is compatible with them as these are agreements between states to allocate taxing rights. With respect to EU law, it raises the question of whether its design is compatible with the current VAT system. Finally, certain elements of the tax must be examined in accordance with the tax principles found under Spanish law since the unique design of the tax might be contrary to the ability to pay and the non-confiscatory principles (the tax is levied without considering whether the entity is profitable or not), and the equality principle (the tax only affects certain types of economic operators and a very specific economic activity).

Second, the Spanish DST might be a discriminatory tax as its burden disproportionately falls on large foreign entities which could be seen as an obstacle to free trade and free competition, and because the tax burden can be entirely different between similar entities due, as well, to its tax rate structure. The disproportionality of the tax burden between similar entities is a concern that comes up in the context of EU law, especially in light of the fundamental freedoms and State aid, but also under domestic legislation. These rules are set to protect free trade and to maintain a level playing field for competition among companies. However, the scope and internal logic of these regimes might be different making it necessary to scrutinize the compatibility of the Spanish DST within these legal systems separately.

It must be pointed out that though the OECD MTC foresees, in Article 24, the prohibition to discriminate between contracting states, this refers to direct discrimination and, as set forth in paragraph 1 of the general remarks of the commentaries on Article 24, it cannot be extended to indirect discrimination. The Spanish DST, as will be explained when analyzing its compatibility with EU legislation, might be considered as indirect discrimination as it could affect mainly foreign companies. However, in no case does the Spanish DST Act specify that it targets only non-nationals or foreign ownership, nor that it excludes domestic entities from this tax. Article 24 of the OECD MTC is only breached when a domestic provision expressly targets only non-nationals or foreign ownerships, but not when a tax might affect mainly these protected categories under such provision (Simmonds, 2019). Consequently, Article 24 of the OECD MTC concerning non-discrimination will not be analyzed in this dissertation as it is not relevant for this case.[47]

1.3. Novelty

Various authors have analyzed the DSTs, and especially the European Commission's proposal. A compilation of such articles in which both pros and cons are addressed can be found in Pistone & Weber (2019), a review of which was published by Pownall Montoya (2020).

Scholars have also studied potential reforms to address the tax challenges that have arisen from the digitalization of the economy, such as Devereux, Auerbach, Keen, Oosterhuis, Schön & Vella (2017) who proposed a destination-based cash flow tax, or Báez & Brauner (2019), who propose a withholding tax as a solution, or Lucas-Mas & Junquera-Valera (2021) who came up with the idea of the digital data tax that would subject to taxation the international supply of internet bandwidth used to access digital

[47] Santa-Bárbara Rupérez (2001) analyzes in detail the principle of non-discrimination established in EU legislation, and under Article 24 of the OCDE MTC, as well as the equality principle protected under domestic legislation.

markets through the establishment of a global internet tax agency, or Rozas Valdés & Pownall Montoya (2022) who proposed the creation of a European internet access tax.

While there is a range of literature which analyzes the European Commission's proposal, analyses of domestic DSTs remain to be carried out more extensively, as in the case of Spain, [48] and more specifically in relation to the inconsistencies regarding domestic law. However, it is not a novelty that a domestic DST or the DST Directive Proposal at a EU level is examined under the scope of DTCs, EU law, and general tax principles.[49]

This dissertation provides for a comprehensive analysis of whether the Spanish DST is compatible with DTCs, the current normative framework developed by the EU, as well as under domestic tax law principles, and pursues to provide for recommendations that could enhance the legality of the tax if applied. In all, by analyzing the relevant legal framework, this dissertation intends to contribute to potential amendments of the Spanish DST.

Such comprehensive research that pursues to enhance the Spanish DST in order to bring it into compliance with international and domestic laws does not exist in current academic literature at an international level. It was decided to focus on the Spanish DST and not on the DST Directive Proposal since it is likely that certain Member States, such as Ireland or Sweden, will be permanently opposed to a EU DST as they are home to subsidiaries of US entities that provide digital services to users based in EU Member States or are home to domestic digital services providers.[50] Under these circumstances and since tax matters are decided by unanimity in the EU, this proposal will remain blocked while the Spanish DST is already a reality and is currently being levied.

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[48] Some authors have analyzed extensively the Spanish DST such as García de Pablos (2019), Menéndez Moreno (2019), Egea Pérez-Carasa (2020), Hernández Moneo (2020), Nocete Correa (2020), Sánchez-Archidona Hidalgo (2020), Alonso Murillo (2021), Escribano (2021), Ferreiro Serret (2021), Guervós Maíllo (2021), and Pérez Merino (2023).

[49] The compatibility of the DSTs has been examined under the scope of DTCs, see: Macarro Osuna (2021), Pistone & Ullman (2021), and Sartori (2021). In relation to its compatibility under EU law, see: Haslehner (2019), Kofler & Sinnig (2019), Pinto Nogueira (2019), Mason & Parada (2020), and Moreno González (2021). In relation to its compatibility with tax law principles, see: Simmond (2019), and Belda Reig (2021).

[50] Denmark, Finland, Ireland, and Sweden opposed the enactment of a EU DST (García de Pablos, 2019).

The novelty of the dissertation also has a timing dimension that must be considered. The issues raised in this dissertation can become the legal debates between the taxpayers and the STA that could result in rulings by domestic courts in the near future. The DTC issue might generate the initiation of multiple MAPs, while the EU fundamental freedoms and State aid claims could eventually be resolved by the CJEU. In the event that the Spanish DST persists, this dissertation provides for possible amendments that the Spanish legislature could consider applying to bring the tax into compliance with the relevant legal framework. It also provides interpretation criteria for the STA to follow.

Some authors such as Haslehner (2019), Pinto Nogueira (2019), and Károlyi (2022), have analyzed the DST Directive Proposal with regards to the WTO law. However, as of today, the possibility of the US filing a complaint before the WTO seems less likely as progress is being made at an OECD level to reach an agreement to solve the challenges of the digital economy though this could ultimately depend on whether an agreement is reached on Pillar One and on the compromise of the Spanish government to withdraw this tax if an agreement is reached.

Even if there is a consensus on the OECD Pillar One proposal and the Spanish DST is derogated as a result, this dissertation could be of interest for taxpayers that could see an opportunity to challenge tax settlements paid for this tax as its legality can be questioned, and for lawmakers that could be interested in amending or enacting a tax with similar characteristics to the Spanish DST. For instance, as pointed out by Barnes & Rosenbloom (2020), pharmaceutical companies have similar characteristics to digital services providers as both sectors use consumer data; companies rely on customer input based on treatment results, intellectual property is fundamental in this industry, and the production of medicines can be seen as an example of a business in which companies do not need to have a physical presence in the jurisdictions where consumers of their products are located. Though these authors simply raise the point of whether new tax rules should also affect the pharmaceutical industry due to its similarities to digital business models, lawmakers could see an opportunity to create a new tax similar to DSTs that would be levied on pharmaceutical companies.

1.4. Methodology

In order to respond to the research question, to develop an argument regarding the hypotheses, and to propose measures to amend the tax so the Spanish DST can be made compliant with the current legal framework, the dissertation follows the procedure of an academic legal study. The research consists of the legal analysis of the relevant provisions and of the way the case-law from Spanish courts and from the CJEU as well as from the opinions of advocates general in different cases have interpreted them. In light of this analytical framework, and considering the opinions of scholars in academic articles, the information compiled is then examined to determine whether the arguments contained can confirm or deny the hypotheses of this dissertation. Although the analysis is carried out from a legal perspective, in some cases, considerations of tax policy that are directly related to the issues analyzed are also considered.

As mentioned above, the research is not limited to the analysis of the compatibility of the Spanish DST to the applicable legal framework as it also endeavors to provide for recommendations as to how to amend this tax in order to be legally compliant. To do so, the legal analysis mentioned must first be carried out and conclusions reached, and finally, the recommendations can be developed.

Furthermore, the author's work experience in a major Spanish law firm will provide a practical perspective while considering controversial real-world issues encountered by economic operators. This will allow for a dual academic and practical approach to analyzing the Spanish DST and add to the discussion of how the tax could be amended. Precisely, the objective is to conduct an academic legal study while drawing in part from the professional legal expertise of the author in the field of taxation.

For the incorporation of the bibliographical references in the text, the Anglo-Saxon system has been applied. The style of quotations and bibliographic references from general sources is based on the style of the American Psychological Association. In the case of citations and bibliographical references to legislation and case-law, the recommendations contained in Fontboté Bonilla & Ymbert Cerón (2011) have been used.

1.5. Structure

The dissertation is divided into seven different chapters. After the present introductory chapter (Chapter 1), the Spanish DST will be analyzed in-depth (Chapter 2). This chapter describes the Spanish DST in detail and critically assesses this tax highlighting the potential challenges it faces that will be covered throughout the dissertation.

After this analysis, the dissertation follows the order of the hypotheses drawn whereby one chapter is dedicated to each of the three hypotheses (Chapters 3 to 5).

Chapter 3 addresses the first hypothesis and delves into whether the Spanish DST infringes the DTCs signed by Spain. In other words, an examination is made regarding whether it could be considered as a tax covered by DTCs. This is a relevant issue as the tax would have a limited enforceability if it were to be considered to fall within the scope of the DTCs signed by Spain.

Chapter 4 addresses the second hypothesis and provides a detailed analysis of whether the Spanish DST infringes EU law. In order to do so, it is examined whether this tax is compatible with the EU fundamental freedoms, with State aid, with Article 110 of the TFEU, and finally with the VAT Directive.

Chapter 5 addresses the third hypothesis and mainly examines relevant issues that the Spanish DST faces with tax principles covered under Spanish law and proposes amendments that could be implemented so this tax could be compliant with the law.

Chapter 6 comments on the ruling of the Anne Arundel County Circuit Court judge that struck down the Maryland Digital Advertisement Tax, as certain arguments used in this case could be relevant to challenge the legality of the Spanish DST.

Chapter 7 concludes the main findings of the dissertation and puts forward the proposed measures to be enacted in order to make the Spanish DST compliant with the current legal framework.

CHAPTER 2: THE SPANISH DIGITAL SERVICES TAX

2.1. Introduction

In the previous chapter, the context in which the Spanish DST was enacted has been addressed, together with the problems of the current tax system to tax new digital businesses models due to the international tax system having been designed in a manner based on “brick and mortar” rules. Thus, the established criterion for distributing taxing powers between states to tax income is based on physical presence. This reality collides with the emergence of new digital business models that allow for the provision of services without requiring a physical presence in the territory where they provide their services. Consequently, the current tax system based on physical presence is obsolete and, as a result, source states cannot tax the economic activity provided by digital services providers within their borders.

The response adopted by some source states to face this problem in a situation in which there is a lack of international consensus to adapt the international tax system to the new reality, has been the enactment of unilateral DSTs.

This chapter aims to describe and to critically assess the Spanish DST. By doing so, the challenges that this tax presents will be indicated. It must be pointed out that the Spanish DST mimics the DST Directive Proposal. So, some of the comments made in this chapter might be extrapolated to the DST Directive Proposal and also to other DSTs in force throughout Europe that were also based on this proposal (e.g. Austria,[51] France,[52] Italy,[53] or the UK[54]). The following table summarizes the key elements of some DSTs that have been enacted in Europe:[55]

[51] For an analysis on the Austrian DST, see: Mayr (2019).
[52] For an analysis on the French DST, see: Michell (2019).
[53] For an analysis on the Italian DST, see: Sartori (2021), and Corasaniti (2022).
[54] For an analysis on the UK DST, see: Burchner (2019).
[55] The data contained in the table is based on information compiled by Garcia Prats (2022).

Country	Global revenue threshold	Domestic revenue threshold	Tax rate	Scope	Status
Austria	€750M of global revenue	€25M of digital services	5%	Online advertising	Implemented (effective from January 2020)
France	€750M of digital services	€25M of digital services	3%	Online intermediary services, and online advertising	Implemented (retroactively applicable as of January 2019)
Italy	€750M of global revenue	€5.5M of digital services	3%	Online advertising, online intermediary services, and data transmission services	Implemented (effective from January 2020)
Spain	€750M of global revenue	€3M of digital services	3%	Online advertising, online intermediary services, and data transmission services	Implemented (effective from January 2021)
United Kingdom	£500M of digital services	£25M of digital services	Reduced rate:2%; General rate: 3%	Social media platforms, internet search engines, and online marketplaces	Implemented (retroactively applicable as of April 2020)

It must be mentioned that in order to interpret the Spanish DST, the Preamble of the DST Directive Proposal will be referred to since this domestic tax is clearly inspired by such proposal. In addition, in order to interpret the Spanish DST, the Preamble of the DST Directive Proposal will be referred to since Spanish lawmakers took it into account when drafting the domestic tax. Though the proposal was never enacted, it can be seen as a relevant source for interpreting the provisions of the act that governs this tax. This is consistent with settle case-law of the CJEU that has established that a preamble can help interpret legal provisions.[56] However, the CJEU has also been consistent in considering that a preamble has no binding force and cannot be used as grounds for derogating actual provisions or for interpreting such provisions in a way that is clearly contrary to their wording.[57]

[56] CJEU judgments of June 26, 2001, C-173/99, *BECTU*, paras. 37-39; of November 20, 1997, C-244/95, *Moskof*, paras. 44-45; and of July 13, 1989, C-215/88, *Casa Fleischhandel*, para. 31.
[57] CJEU judgments of November 24, 2005, C-136/04, *Deutsches Milch-Kontor*, para. 32; of November 25, 1998, C-308/97, *Manfredi*, para. 30; of November 19, 1998, C-162/97, *Nilsson*, para. 54; and of February 9, 1995, C-412/93, *Edouard Leclerc-Siplec*, para. 47.

The Spanish DST is a unilateral tax that was introduced in order to compensate for the loss of tax revenue due to the impossibility of the current tax system to tackle the challenges of the digital economy. Essentially, the Spanish DST is a tax on the use of users' data, or more precisely, it taxes the value created by the users in participating in the services that fall under the scope of this tax. The services covered have in common that the role of the user's is key to their existence.

This chapter will provide an in-depth analysis of this tax that is necessary before diving into the examination of the issues of legality that it potentially faces in the subsequent chapters. First, the enactment of the Spanish DST will be discussed (Section 2.2). Second, all the elements that form the tax will be analyzed (Sections 2.3 to 2.17). Third, the consequences of enacting such tax will be described (Section 2.18). Finally, conclusions will be drawn (Section 2.19).

2.2. Enactment of the Spanish DST

On October 7, 2021, the Spanish Senate passed the bill which enacted the Spanish DST.[58] This tax was approved by Act 4/2020, of October 15, and was published on October 16, 2020 in the Official State Gazette. As foreseen in the Spanish DST Act, the tax went into force on January 16, 2021, three months after its publication.[59]

The Spanish DST had a long parliamentary process. The Spanish Government submitted two drafts of the bill before the Spanish Congress on two different occasions. The first draft was submitted on January 25, 2019,[60] and the second and final draft was submitted on February 28, 2020.[61]

The final version of the bill was very similar to the original bill submitted by the Spanish Government to the Spanish Congress which, in turn, was very similar to the initial European Commission proposal for a directive on a common EU DST of March 18, 2018, that was never passed by the EU Parliament.

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[58] All the amendments of the Senate were rejected and the vote was carried out with the following result: Yeses 134, Nos 101, Abstentions 28. See: Spanish Senate (October 8, 2020). *Acuerdos adoptados por el Pleno celebrado los días 06 y 07 de octubre*.
[59] Sixth final provision of the Spanish DST Act: "Entry into force. This Law shall enter into force three months after its publication in the Official State Gazette."
[60] Spanish Congress (2019, January 25). First draft of the bill on the Spanish DST.
[61] Spanish Congress (2020, February 28). Second draft of the bill on the Spanish DST.

The parliamentary processing of the original version of the bill was paralyzed due to the call for general elections that dissolved the Spanish Congress and Senate. Spain had two consecutive general elections in 2019 due to the difficulties to form a government coalition. This caused a delay in the processing of the DST bill. During this time, there were certain developments in the international arena that explain the minor differences between the original and the final bill of the Spanish DST. In essence, such minor differences between both bills are due to the following reasons.

The original and final bill are both based on the DST Directive Proposal. However, the original bill made express reference to the proposal, while the final bill does not make such reference. The reason is that the EU Commission proposed another directive in March of 2019 narrowing the services covered by the tax to only advertising services. So, the new EU directive proposal, which also failed to gain general approval by Member States, only targeted one of the three original digital services covered by the original proposal for a EU directive. Thus, the final draft of the Spanish DST could not justify the three types of digital services covered by express reference to the Commission's proposal since this one had changed.

The second main difference between both bills is that in the initial bill, the Spanish legislature linked the future of the Spanish DST to the enactment of a common EU DST. The final bill does not make any reference to the directive proposals and links the future of the Spanish DST to a forthcoming solution that should be reached at the OECD level.

It must be pointed out that it is interesting that the Spanish legislature decided to maintain the approach followed in the initial proposal for a EU directive and did not narrow the scope of the Spanish DST to tax only digital advertising services as done by the EU Commission DAT Directive Proposal of March of 2019.

The final bill of the Spanish DST was submitted to Congress in February 2020, but it was not finally passed by the Senate until October 2020. The COVID-19 pandemic and the threats of the US government to start a trade war if the tax was enacted could be factors that justify such delay (Escribano, 2021), as will be explained further along in this chapter.

The regulation of the tax was approved by Royal Decree 400/2021, of June 8,[62] which establishes the rules on the location of users' devices and regulates the formal obligations relating to this tax.[63] Finally, the form to settle the tax (form 490) was approved by Order HAC/590/2021, June 9.[64] The first payment of the Spanish DST for the first quarter of 2021 had to be performed on or before April 30, 2021. However, since the regulation of the tax as well as the tax form had not yet been approved by that date, it was established by the mentioned order that the tax returns of the first and second quarter of 2021 would need to be filed jointly in July 2021.

Finally, the Spanish DGT published its Resolution of June 25, 2021, in which it interprets and clarifies some issues regarding this tax.[65] Also, the STA published a document with FAQs regarding the Spanish DST.[66]

2.3. Main features of the Spanish DST

The Spanish DST Act consists of 16 articles and six final provisions. From the structure of the act that governs the tax and from its Preamble, it is necessary to highlight the following: (i) the Spanish legislature used the DST Directive Proposal as a reference to create the Spanish DST, and (ii) this tax is a provisional tax measure that is supposed to be in force until an international solution on how to face the challenges of the digital economy takes effect.

[62] Referred in this dissertation as "Spanish DST Regulation".
[63] The Spanish Council of State issued its Opinion of May 5, 2021, on the Spanish DST Regulations, in which it strongly criticized the said regulations for being too short. According to the Spanish Council of State a regulation is intended to complement the law and considers that it should have clarified or specified certain terms of Spanish DST Act as it acknowledges that the Spanish DST is a complex tax, and since the act that governs the tax is ambiguous, that can lead to multiple controversies. Precisely, the Opinion suggests the need for a regulatory complement to some essential aspects of the legal framework such as a better definition of the services subject to the tax, of the determination of who is a taxpayer, or the quantification of the taxable base; as well as the importance of defining more precisely certain concepts found in the Spanish DST Act, such as the term "targeted advertising". In all, though according to the Spanish Council of State, the Spanish DST Regulation is not contrary to law, the Council points out how the Regulation could have been better drafted and how certain ambiguous aspects found in the Spanish DST Act could have been clarified.
[64] Referred in this dissertation as "Order HAC/590/2021".
[65] Referred in this dissertation as "Spanish DGT resolution on the DST".
[66] Referred in this dissertation as "STA FAQs regarding the Spanish DST". The first version of this document is of June 30, 2021. For the purposes of this dissertation, it has been used the Spanish version of this document of May 27, 2023.

2.4. Nature of the tax and place of taxation

Article 1 of the Spanish DST Act defines this tax as a tax of an indirect nature which taxes the provision of certain digital services in which the users involved are located in the territory of application of the tax.

Article 2.1 of the Spanish DST Act defines the territory of application of the tax as the entire Spanish territory. However, as established in Article 2.2 of the Spanish DST Act, the territory of application of the tax must be understood considering the regional tax systems in force in the three the Historical Territories of the Basque Country (Alava, Biscay, and Gipuzkoa), and in the Chartered Community of Navarre. There is an agreement that regulates the taxation and the financial relations between the Spanish Administration and the Basque Administration (Basque Economic Agreement or, in Spanish, *Concierto Económico con la Comunidad Autonómica del País Vasco*),[67] and another one with the same purposes between the Spanish Administration and the Navarre Administration (Navarre Economic Agreement or, in Spanish, *Convenio Económico entre el Estado y la Comunidad Foral de Navarra*).[68] The Basque Economic Agreement[69] and the Navarre Economic Agreement[70] were amended to allocate the taxation powers between the administrations regarding the Spanish DST. In both cases, it was agreed that: (i) the regulation of the DSTs in the different regions will be the same as the Spanish DST; (ii) the regions will be able to create their own regional DST tax forms and establish their own deadlines to submit them, but they have to be consistent with the Spanish DST regulations; and (iii) the tax will be levied to the taxpayer in proportion to the volume of digital services rendered in each territory. This proportion will be determined according to the percentage of revenue obtained by the covered services in each territory with respect to the total revenue obtained in all of the Spanish territory. The provision of services

[67] *Ley 12/2002, de 23 de mayo, por la que se aprueba el Concierto Económico con la Comunidad Autónoma del País Vasco.*
[68] *Ley 28/1990, de 26 de diciembre, por la que se aprueba el Convenio Económico entre el Estado y la Comunidad Foral de Navarra.*
[69] Act that modifies the Basque Economic Agreement for introducing the regional DSTs: *Ley 1/2022, de 8 de febrero, por la que se modifica la Ley 12/2002, de 23 de mayo, por la que se aprueba el Concierto Económico con la Comunidad Autónoma del País Vasco.*
[70] Act that modifies the Navarre Economic Agreement for introducing the regional DSTs: *Ley 22/2022, de 19 de octubre, por la que se modifica la Ley 28/1990, de 26 de diciembre, por la que se aprueba el Convenio Económico entre el Estado y la Comunidad Foral de Navarra.*
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will be understood to be carried out in these regions or in the rest of Spain depending on the location of the users. In all, the taxpayer will have to differentiate between the location of the users in each of the four regions and the rest of Spain, and pay the amount of tax due to the pertinent administration. Nevertheless, it has been necessary to adapt the original form 490 that was approved for the first time through Order HAC/590/2021, to adjust to the Basque Economic Agreement through Order HFP/480/2022, and later on to the Navarre Economic Agreement through Order HFP/307/2023. However, the modifications of form 490 are limited to the approval of a section in the form establishing the parts of the tax liability corresponding to the State and the Historical Territories of the Basque Country and Navarre. The rest remains identical to the original form 490 approved in 2021.

In any case, despite the regulation being the same, in order to simplify the compliance of the tax in Spain it would be desirable to implement an analogous system of one-stop shop foreseen by the DST Directive Proposal, so for taxpayers with DST liability in one or more jurisdictions within Spain, the DST obligations could be fulfilled together before a single administration. This administration could be the STA which should collect the information and the payment of the DST on behalf of other jurisdictions within Spain where the DST is due, and subsequently share that relevant information and the collected DST proceeds with them. Such a mechanism is without prejudice that the DST is owed by the taxpayer directly to each jurisdiction where DST is due. Consequently, each jurisdiction where the DST is due should be entitled to enforce payment of the DST directly against the taxpayer, as well as to carry out tax audits or any other control measures to examine the taxpayer's DST liability in accordance with the rules applicable in each jurisdiction where the DST is due.

Article 3 of the Spanish DST Act establishes that the provisions of such act must be understood in accordance with the international treaties that form part of Spanish legislation.

The nature of the Spanish DST as well as its compatibility with DTCs are two relevant controversial issues that will be analyzed in Chapter 3 of this dissertation since it is not clear whether the Spanish DST should be qualified as an indirect tax, and it is also doubtful that it could not fall under the scope of DTCs. Though the Preamble of the act that governs the tax specifically establishes that it does not fall under the scope of DTCs as it is not a tax on income and on wealth, this can be contested.

2.5. Scope of taxation

As described in the first paragraph of Section III of the Preamble of the Spanish DST Act, the scope of this tax is the provision of certain digital services in which the participation of the users is fundamental as it contributes to the value creation process of the company that provides these services, and through which the company obtains revenue. So, the digital services covered by this tax require the involvement of the users. The role of the customers of an offline service is entirely different compared with the role of the users of digital services as the latter requires the engagement of the users resulting in a more complex business model since the participation of the users is a key factor. In all, as stated in the Preamble of the Spanish DST Act, the digital services that are covered by this tax could not exist as we know them without the participation of the users.

2.6. Taxable event

The taxable event is regulated under Article 5 of the Spanish DST Act establishing that this tax will be levied on digital services that are carried out in the territory where this tax applies. Thus, to understand what the taxable event of this tax is, it is necessary to understand what "digital services" means for the purposes of the Spanish DST.

Article 4 of the Spanish DST Act contains relevant definitions regarding this tax. For the purpose of this tax, Article 4.5 of the Spanish DST establishes that "digital services" are exclusively online advertising services, online intermediary services, and data transmission services. These three digital services covered by the Spanish DST coincide with those covered by the DST Directive Proposal.

Following, an analysis will be provided in relation to the only three digital services covered by the Spanish DST.

2.6.1. Online advertising services

Online advertising services, defined in Article 4.6 of the Spanish DST Act, consist of the placement on a digital interface of advertising targeted to the users of that specific digital interface. Thus, it is necessary to define several terms as follows.

The concept of "digital interface" under Article 4.4 of the Spanish DST Act must be understood as any software, as well as websites or parts of websites, or applications, including mobile applications, or any other means, that are accessible to users and that make digital communication possible.

The concept of "targeted advertising" under Article 4.10 of the Spanish DST Act must be understood as any type of digital communication intended to promote a product, a service or a brand, and aimed at users of a digital interface based on the data obtained from these users. In addition, the mentioned article establishes a rebuttable presumption as it considers that all advertising is "targeted advertising" unless proven otherwise.

The concept of "user" under Article 4.9 of the Spanish DST Act must be understood as any individual or entity that uses a digital interface.

Accordingly, the placement of advertising on a digital interface that is targeted to users of that interface falls under the scope of the Spanish DST, an activity commonly carried out by large digital services providers (i.e. Facebook, Google, or YouTube). The advertising is considered as targeted to users if it is intended to promote a product, service, or brand based on the data collected from users, and is different from advertising aimed at the general population as a whole. Therefore, the aim of the DSTs is to tax revenues obtained by collecting user data through the interface and using that data to offer targeted advertising services online.

To avoid evidentiary issues, the Spanish DST Act simply presumes that all advertising is targeted unless proven otherwise, though this legal presumption is not contained in the DST Directive Proposal, nor is it contained in the norms that regulate the French and Italian DSTs as pointed out by Pérez Merino (2023). Taxpayers can face significant challenges in the event they want to rebut this presumption to not fall under the scope of the tax. This issue will be explained in more detail in Chapter 5.

The following example will illustrate how online advertising services are taxed. A user interested in travelling reverts to an online video platform (e.g. YT) which collects data from the user, who is located in Spain, according to their activity on the digital interface (YT's web page or app). Based on this data (e.g. searches), YT has information that indicates that this user might be interested in traveling. Previously, an airline had reached an agreement with YT to pay a fee to include the airline's advertising targeted to potential customers on YT's website identified as such based on the data collected by YT from its users. So, YT will include the airline's advertisement on its website so this potential customer can visualize it. Consequently, the fees paid by the airline to YT for its online advertising services targeted to Spanish users is subject to the Spanish DST.

In addition, Article 4.6 of the Spanish DST Act establishes that when the entity that places the advertising is not the owner of the digital interface, the entity that places the advertising will be considered as the provider of the advertising service, and not the owner of the digital interface. That is to say that the criterion of subjection to the Spanish DST is based on the placement of targeted advertising and not on the ownership of the digital interface. In other words, the entity responsible for making the advertising appear on a digital interface is the provider of the service.

The use of this criterion is reasoned in recital 11 of Preamble of the DST Directive Proposal. The value for an entity that places a client's advertising on a digital interface is found in the user data that is considered for placing an advertisement, and not on whether the digital interface is owned by the entity that places the advertisement nor if it is a third party who rents the digital space where the advertisement is placed.[71]

So, in the event the digital interface belongs to a third party that rents the digital space where the advertisement appears, the owner of the digital interface should not be considered as the provider of the online advertising services covered by the Spanish DST. That is to say that the transfer of the right to use the "digital space" by the interface owner is not subject to Spanish DST.

[71] This same reasoning is used by the Spanish DGT resolution on the DST under the section of online advertising services, p. 3.

As clarified in recital 11 of Preamble of the DST Directive Proposal, this is to avoid potential cascading effects and double taxation of the same revenues. The idea is that part of the revenues earned by the entity that includes a client's advertising on a digital interface will be transferred to the owner of that digital interface by means of the rent paid for the use of the digital interface.

By way of example, the owner of the digital interface (YT) is different from the entity responsible for making the advertising appear on that digital interface (e.g. YT Advertising). YT Advertising receives payments from advertisers (e.g. airlines) in order to include advertising on a digital interface owned by a third party (YT). In addition, YT Advertising pays YT for renting the digital space in its interface. As a result, the only provider of the advertising service is YT Advertising. So, the Spanish DST will tax the revenues obtained by YT Advertising for the online targeted advertising services provided. YT, as the owner of the interface, will not be considered to provide online advertising services. That is to say that the payment made for the rental of the digital space, from YT Advertising to YT, will not be subject to the Spanish DST. Otherwise, a situation of double taxation could arise as the same revenue would be taxed twice: first, for the provision of advertising service (taxing YT Advertising as the provider of the service) and second, for the rental of the digital space (taxing YT as the owner of the interface).

Finally, two different types of targeted advertising are differentiated by the Spanish DGT resolution on the DST: programmatic advertising, and individual advertising. Programmatic advertising is offered by certain platforms known as supply-side platforms that use algorithms that offer the advertiser the possibility of advertising in online media spaces in accordance with their advertising objectives in an automated and direct manner through a single contract. In individual advertising the advertiser has to formalize a contract with each of the online media spaces in which it intends to display its advertisement. Consequently, the Spanish DGT resolution on the DST establishes under the Section "Accrual and tax base" that in cases of programmatic advertising the taxable event will be determined by the joint contract of services provided to the taxpayer by each of the supply-side platforms, and in the case of individual advertising, the taxable event will be will be determined by each agreement entered into by the taxpayer.

2.6.2. Online intermediary services

Online intermediary services, as described under Article 4.7 of the Spanish DST Act, consist of providing a multi-sided digital interface that is available to users and by which these are able to interact simultaneously in order to facilitate the delivery of goods or the provision of services between users, or which allows users to connect with other users in order to interact with them.

Entities that provide certain types of multi-sided digital interfaces available to users may potentially be subject to the Spanish DST. This depends on what the digital interfaces allow users to do. The lawmakers establish two different situations that potentially fall under the scope of the tax:

(i) Interfaces that allow users to find other users and interact with them, normally by uploading and sharing digital content between them.

That would be the case of social networking platforms (e.g. Facebook, Instagram, and X, formerly known as Twitter), or professional networking platforms (e.g. LinkedIn), or platforms based on user-generated content such as reviews on hotels and restaurants (e.g. Booking, TripAdvisor), videos (e.g. YouTube), or GPS biking or hiking tracks uploaded by users for other users to download (e.g. Wikiloc). The Spanish DGT resolution on the DST under the Section “Accrual and tax base” considers that each contract concluded between the service provider and users for the purpose of opening or renewing an account that provides access to the digital interface, allowing online interaction between users without a pre-established relationship, is a taxable transaction. So, the corresponding fee to register or renew the access to multi-sided digital interfaces is subject to taxation. Relevant exclusions that can affect the above-mentioned digital content will be addressed later on in this chapter as such exclusions are justified based on the value creation principle.

(ii) Interfaces that facilitate the provision of underlying supplies of goods or services directly between users.

These are platforms that serve as a market place for their users. Digital providers connect supply and demand by making available a platform where users can buy, sell, share, or exchange goods and services. Examples may be platforms that facilitate the sale of goods (e.g. Amazon), car trips (e.g. Uber), or short-term housing rental (e.g. Airbnb). It must be pointed out that only the intermediation service (and its corresponding commission) is subject to taxation. The revenues related to the underling transaction are excluded from the tax. An example would be a digital service provider that offers a vehicle for hire platform that provides users with a digital interface (app or website) through which users (drivers and passengers) can contact each other. The revenues of this platform are based on the intermediation commission charged to the user. For instance, the intermediation commission could depend on a percentage of the price of the trip. The revenues obtained by this company for its online intermediary services are subject to the Spanish DST, but not the underlying transport services that are accorded between users.

As explained on page 7 of the Explanatory Memorandum of the DST Directive Proposal, the value in these digital interfaces is localized in the connections between users and the interaction between them. Users contribute to creating value by providing the underlying service and/or through their participation on these digital interfaces. The participation of users on these digital interfaces is based on the so-called network effects as the value of the service provided increases with the number of users that use the interface. In the case of platforms based on the interactivity between users such as social media platforms (e.g. Facebook, Instagram), the more users they draw in, the better experience the existent users get and thus the higher the value that is created. That is also the case of platforms based on user-generated content (e.g. YouTube, Wikiloc) where the value creation lies within the massive collaboration by the users that are expected to be constantly generating content for it. Finally, the platforms that are a marketplace (e.g. Amazon, Uber) for their users benefit from the network effects from the participation of the users and also based on the feedback that users are given of the products and services received as it is well known that these platforms encourage users to make reviews and post comments on products and services. This allows for gaining a competitive advantage based on a critical mass of users.

2.6.3. Data transmission services

Data transmission services, described under Article 4.8 of the Spanish DST Act, consist of the sale or assignment of data that is gathered from the activity of the users through digital interfaces (e.g. search engines, social media, web pages). The Spanish DGT resolution on the DST under the Section “Accrual and tax base” subjects to taxation each data transfer contract concluded between the interface that has obtained the data and any person acquiring such data.

The data transmission business models that are taxed by the DSTs are those by which companies obtain and collect data on user activities through digital interfaces that is then sold for a fee.

It must be pointed out that the ownership of the digital interface on which the data was collected seems to be irrelevant. Also, the term “activity” used to define this digital service should be understood in a broad sense as it is not defined in the act that governs the tax. So, a simple visit to or the navigation through a website could be considered as “activity”.

From the wording of Article 4.8 of the Spanish DST Act that defines this type of digital services, it should be understood that the Spanish DST does not tax data that is transmitted for free and it is not a tax on the collection of data that is used for purposes different from transmitting data for a price (Egea Pérez-Carasa, 2020).

In recital 17 of the Preamble of the DST Directive Proposal it is stated that the DST is not a tax on data collection, nor on the use of data collected for internal purposes, nor the sharing of collected data with other parties for no price. So, the Spanish DST should be understood as a tax that targets the revenues obtained from the transmission of data gathered from the users' activities on digital interfaces as this data is the value generated by the users.

The data transmission business models are similar to those of online advertising. However, in data transmission services business models, the data collected from users that carry out activities on the digital interface is sold to third parties whereas for online advertising services, this data is used to offer personalized advertising services to users.

By way of example, an e-commerce platform obtains data from a user from their activity on the digital interface (e.g. web page or app). A sportswear brand might pay this e-commerce platform a fee for the data generated by certain users from their activity on its platform. The type of data transmitted could be based, for example, on consumption patterns on that given e-commerce platform. The revenue obtained from the data transmission service provided by the e-commerce platform to the sportswear brand is subject to the DST.

The definition of the taxable event appears to limit its scope to the transmission of data carried out by the entity that collects it to any other party that acquires it. Consequently, successive transmissions made by the acquirers of a user's data do not seem to be subject to Spanish DST. The STA, on the other hand, has interpreted that not only the first transmission of data (original transmission) but also successive transmissions of the same data are subject to the tax.[72] In the opinion of Pérez Merino (2023), the STA has made an interpretation beyond the spirit of the Spanish DST as this tax is levied on the value created by users. As explained by the mentioned author, taxation should be limited to the first transmission, since extending taxation to successive transmissions creates a situation of double taxation on the same revenue as the user's value contribution will have already been taxed by the Spanish DST in the original transmission.

As pointed out by Escribano (2021), the following uncertainty also arises with regards to the definition given of this taxable event. According to the mentioned author, the definition definitively covers the transmission of raw data, though the question arises as to whether or not the transmission of data that has been processed should equally fall under the scope of the tax. If that is the case, the level of data processing would have to be defined for the purposes of applying this provision. The mentioned author bears in mind that the so-called big data companies do not normally sell raw data since their business is built on designing sophisticated models that come up with consumption patterns obtained by analyzing user data, and that is what they sell.

Therefore, it can be concluded that only the transfer of raw data for a price is the object of the DST since the purpose of the tax is to tax the value created by the users. Consequently, the data transferred for a price to these so-called big data companies is taxed, though not the product that big data companies sell as this product is based on the added value created by these companies in analyzing user's data.

[72] STA FAQs regarding the Spanish DST, p. 5.

Once the three covered services have been described, it must be recalled that the DST Directive Proposal included the three types of services that are regulated in the Spanish DST Act. These three types of digital services were included in the DST Directive Proposal with the idea, according to the justifying memoir of the Directive, that the users play a key role in the value creation process of these services. Accordingly, the Spanish DST is meant to mitigate the effects caused by having the revenues generated by these digital services taxed only in the jurisdiction in which the providers are tax residents, a jurisdiction that does not necessarily correspond where the value is created, assuming that the place where the users are located is the jurisdiction where value is created, and that is where it should be taxed.

2.7. Events not subject to taxation

Article 6 of the Spanish DST Act establishes the events not included in the scope of the Spanish DST. The Spanish DST Act excludes from the scope of this tax those events that make reference to situations in which the users do not carry out a relevant role in the value creation process for the provider of digital services.

Accordingly, Article 6 of the Spanish DST Act identifies the following six events that are not included in the scope of the Spanish DST:

(i) Sales of goods or services bought on the provider's website when the provider is not acting as an intermediary (Article 6.a of the Spanish DST Act)

Under Article 6.a of the Spanish DST Act, the revenue obtained from the sales of goods or services from a provider's website of its goods or services, is not subject to taxation if the provider is not acting as an intermediary.

As stated in Section IV of the Preamble of the Spanish DST Act, the reasoning for this exclusion is that the creation of value for the retailer is based on the goods or services provided while the digital interface is used only as means for communicating with the buyers. The exact same reasoning is found in recital 13 of the Preamble of the DST Directive Proposal.

For example, the sale of its own sports product by a sporting goods retailer through its website would be out of the scope of the DST as the sporting goods retailer is the supplier of its own sports products and does not act as an intermediary, and it uses its website only as means for communication with the customer.

Article 6 of the Spanish DST does not refer to any criterion to distinguish when a supplier acts as a supplier per se, or as an intermediary. In this sense, recital 13 of Preamble of the DST Directive Proposal establishes that:

> "Whether a supplier is selling goods or services online on his own account or providing intermediation services would be determined by taking into account the legal and economic substance of a transaction, as reflected in the arrangements between the relevant parties. For instance, a supplier of a digital interface where third-party goods are made available could be said to provide an intermediation service (in other words, the making available of a multi-sided digital interface) where no significant inventory risks are assumed, or where it is the third party effectively setting the price of such goods." (DST Directive Proposal, recital 13, pp. 17-18).

So, in order to determine if a supplier is acting as an intermediary or not, according to the DST Directive Proposal and to the Spanish DGT resolution on the DST,[73] it will be necessary to analyze case by case the agreements between parties as well as the real economic transactions between them. Other relevant elements to consider would be the assumption of inventory risks, and the capacity of a third party to set the price. In addition, the Spanish DGT considers as characteristics of online intermediation the existence of two subjects from the supply side of the digital service (the underlying service provider and the owner of the digital interface),[74] or that a remuneration is received as a result of the transaction by the intermediary who acts as a liaison between the users who participate in an underlying transaction through a multifaceted digital interface.[75]

These elements will be particularly relevant for cases in which companies, for example department stores, sell their own products as well as third party products through their websites. This could cause practical problems for these types of companies. It seems clear that the online selling of their own products will not fall

[73] Spanish DGT resolution on the DST, under the Section "Online intermediary services", pp. 4-5.
[74] Spanish DGT binding resolutions V2153-21, of July 28, 2021; and V2295-22, of October 31.
[75] Spanish DGT resolution on the DST, under the Section "Online intermediary services", pp. 4-5.

within the scope of the Spanish DST (as these companies act as suppliers per se and not as intermediaries), but it will require a more detailed analysis when selling third party products. As pointed out by Alonso Murillo (2021), this requires verifying the purpose of all the online intermediation services carried out, transaction by transaction, and raises a potential conflict between the taxpayers and the STA.

Another problem could be if the sale of the products is done through an application or through another device different from a website. Both the DST Directive Proposal and the Spanish DST Act only consider that it will not fall in the scope of the DST if the sale is performed specifically through a website. So, literally the sale that is done through an application would fall within the scope of the Spanish DST. However, this seems incorrect since it should not matter if a transaction is carried out through a website or through an application, as both are considered digital interfaces under Article 4.4 of the Spanish DST Act.

(ii) Delivery of goods and provision of underlying services between users regarding online intermediary services (Article 6.b of the Spanish DST Act)

As defined in Article 6.b of the Spanish DST Act, in relation to the online intermediary transactions, the transaction subject to the Spanish DST is the intermediary transaction but not the underlying transaction between the users. So, the DST would tax the intermediary commission, if applicable, obtained by the platform.

An example would be an application of a company that offers a vehicle for hire platform that charges drivers a commission for the intermediary service that consists of a service that enables them to contact passengers. The commission associated with intermediary service provided by the platform would be subject to the Spanish DST. However, the underlying transport service provided by the driver (user-supplier) to the passenger (user-customer) would be excluded from the scope of this tax.

(iii) Online intermediary services when the sole or main purpose of the provision of services is to make a digital interface available for supplying digital content or payment services or providing communication (Article 6.c of the Spanish DST Act)

Article 6.c of the Spanish DST Act is clearly inspired by the DST Directive Proposal. It is necessary to analyze separately the different online intermediary services that are included in this section due to their relevance. The supply of digital content services will be examined first, and then the payment and communication services will be examined.

a) Supply of digital content: The services consisting of the provision of digital content (such as audio, text or video) by an entity through a digital interface should be excluded from the scope of the Spanish DST, regardless of whether the digital content is owned by that entity or whether that entity has acquired its distribution rights. As the DST Directive Proposal states in recital 14 of the Preamble, the reason for this exclusion from the scope of the DST is based on the perspective of value creation as the key factor in this case, is the digital contents provided by the entity and not the role of the user whose main purpose is to receive the digital contents that the entity provides through a digital interface.

Based on the above-mentioned, it is necessary to refer to the definition of "digital content". Article 4.1 of the Spanish DST Act defines digital content as: "Data supplied in digital format, such as computer programs, applications, music, videos, texts, games, and any other computer program, other than the representative data of the digital interface itself."[76] It must be pointed out that this definition coincides with the definition of digital content contained in the DST Directive Proposal.

By way of example, the online supply service to users of movies or television series through platforms would not fall under the scope of the Spanish DST. Nevertheless, it must be pointed out that the entities that provide these services could be subject to the Spanish DST for the other two types of digital services, such as online advertising services or data transmission services.

As the DST Directive Proposal recognizes, some providers of digital content through a digital interface could allow, in certain cases, some kind of interaction between the receivers of this digital content and it could be seen that these services should fall within the scope of the DST as it could be considered an intermediary service provided

[76] See: STA (n.d.). *Law 4/2020, of 15 October on the Tax on Certain Digital Services* (Translation by the STA).

by a multi-sided digital interface. Nevertheless, as explained in recital 15 of the DST Directive Proposal, in these cases the main purpose for a user would still be to receive the digital content supplied by the entity that provides the digital interface and the interaction among users should be considered as ancillary. The DST Directive Proposal sets forward the example of an entity that provides a video game to a user through a digital interface, concluding that whether or not the user interacts with other users, that is, by playing against them, the supply of this digital content would not fall within the scope of the DST because the main or sole purpose of the user is to play the video game and not necessarily to interact with other users.

The exclusion of digital content seems unreasonable as platforms based on user-generated content (i.e. YouTube) rely heavily on their users to generate and update content constantly (i.e. uploading videos as in the case of YouTube). To this end, the mass collaboration of users is critical for the business, and volume and variety can be essential for increasing the number of users. In other words, these digital services providers should not be exempt for these services because the role of the users in creating value is as essential as in the other covered services. A reason that calls for this exclusion could be due to the fact that the companies identified by Hufbauer & Lu (2018) as market leaders that provide services that benefit from this exemption are European companies, such as the Swedish Spotify (online music streaming), the British Skrill (online payments), and the Finish Supercell (online gaming). Potentially, however, these entities fall under the scope of the tax due to the online advertising services they might carry out. In Chapter 5 this matter will be subject to further analysis.

b) Supply of communication and payment services: The digital interfaces that provide communications and payment services to users are not subject to the Spanish DST. So, instant messaging services, e-mail services, or e-payment services do not fall under the scope of the Spanish DST.

As explained in recital 12 of the Preamble of the DST Directive Proposal, the supply of communication and payment services to users is not subject to the DST because the value creation in relation to these services is based on the development and sale of support software that allows the interaction to take place. The value creation is not related to the participation of users in this case. Though services such as instant messaging, e-mail, or e-payment can be seen as tools that facilitate interaction between users through a digital interface, users cannot get in touch with each other through these services unless they have established contact through another means. Consequently, platforms such as Bizum, Microsoft Teams, PayPal, Skype, Telegram, WhatsApp, and Zoom would benefit from this exemption.

(iv) The provision of financial services by regulated financial entities (Article 6.d of the Spanish DST Act)

It must be pointed out that the DST Directive Proposal separated this event in two when explaining this exemption in recitals 19 and 20 of the Preamble:

a) Services regulated in points (1) to (9) of Section A of Annex I of Directive 2014/65/EU of the European Parliament and of the Council, of 15 May 2014, on markets in financial instruments, will not fall within the scope of the DST if these are supplied by trading venues,[77] or by systematic internalisers,[78] or by regulated crowdfunding service providers.

As described on page 9 of the DST Directive Proposal, examples of these services would be trade execution services, investment services, or investment research services provided by the above-mentioned entities.

As set out by the DST Directive Proposal in recital 19 of the Preamble, there are three reasons to exclude these services from the scope of the DST since the value in these services is created by the entity for: (i) connecting buyers and sellers of financial products, (ii) providing a secure environment for financial transactions, and (iii) promoting investments, funding and savings.

Finally, and as explained on page 9 of the DST Directive Proposal, it is important to take into account that the provision of a digital interface by these types of entities is much more than just making a means available to carry out financial transactions

[77] The definition of "trading venue" is provided in point 24 of Article 4(1) of Directive 2014/65/EU. Accordingly, "trading venue" must be understood as a regulated market, a multilateral trading facility (MTF) or an organizing trading facility (OTF).

[78] The definition of "systematic internaliser" is provided in point 20 of Article 4(1) of Directive 2014/65/EU. Accordingly, "systematic internaliser" means "an investment firm which, on an organized, frequent systematic and substantial basis, deals on own account when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system."

between the users of the digital interface, as once again, for these services the value is created by the entities and not the users.

b) The provision of online intermediary services by regulated crowdfunding service providers.

As explained in recital 20 of the DST Directive Proposal Preamble, investment and lending-based crowdfunding fall out of the scope of the DST as the providers of these digital services do not perform a mere intermediation. They play the same role as in the case of trading venues and systematic internalisers described above. Nevertheless, recital 20 goes on by saying that donation or reward-based crowdfunding platforms should be taxed by the DST as these are not investments and lending based crowdfunding platforms and are considered intermediation services.

In all, and as summed up by Pérez Merino (2023), in relation to financial entities, taxation by the Spanish DST is limited to unregulated financial entities such as FinTech, trading, or cryptocurrency entities, as well as donation or reward-based crowdfunding.

(v) Data transmission services carried out by regulated financial institutions (Article 6.e of the Spanish DST Act)

This event is closely related to the previously explained exclusion regarding regulated financial institutions. As explained in recital 21 of the DST Directive Proposal Preamble, the supply of data transmission services by regulated financial institutions should also be excluded from the scope of the DST as it is understood that it should have the same treatment as the supply of regulated financial services of online intermediary services.

(vi) Provisions of digital services between entities that are part of a group that wholly owns them, whether directly or indirectly (Article 6.f of the Spanish DST)

The Spanish DST Act hardens the provision of non-subjection with respect to the DST Directive Proposal by restricting the non-subjection of intra-group services only when the participation, direct or indirect, between the entities is 100%, while the DST

Directive Proposal excludes all intra-group transactions being irrelevant the percentage of participation between them.

The Spanish DGT resolution on the DST has provided an interpretation of the undefined expression “direct or indirect participation” used under Article 6.f of the Spanish DST Act. The mentioned resolution specifies that in this case the non-taxation extends to the rendering of services that take place between group entities, even if there is no participation between them, provided that they are directly or indirectly 100% owned by the parent company of the group.[79]

That is to say that only those intra-group transactions that take place between wholly owned entities do not fall within the scope of the Spanish DST.[80] It must be noted that the Spanish DST Act does not provide any justification on why it has followed a stricter approach regarding this non-subjection provision in relation to the DST Directive Proposal. To this end, neither the French nor the Italian DSTs establish such a strict approach (Alonso Murillo, 2021).

In all, this non-subjection provision can be considered as consistent with the unitary conception of a group of entities and the mechanisms of elimination of internal operations provided in accounting and tax regulations (Egea Pérez-Carasa, 2020), although it is surprising if compared with the 75% shareholding requirement regarding the tax consolidation scheme under the Spanish CIT law.[81] Though it is a policy option that does not appear to be unlawful as it seems consistent with the unitary conception of a group, a lower percentage of participation would clearly have been more beneficial to the taxpayers.

However, Hernández Moneo (2020) considers that this policy option can potentially generate situations of double taxation in those cases in which the user’s data is collected centrally by one group entity and subsequently transferred to other group entities for internal application, even though there has been no user contribution in the second transaction. That said, it must be taken into account that this issue pointed out by the mentioned author is only found in cases in which the data is sold between

[79] Spanish DGT resolution on the DST, under Section “General non-taxable case”, p. 6.
[80] Spanish DGT binding resolution V2535-21, of October 14, 2021.
[81] Article 58.2 of the Spanish CIT Act.

related entities for a price, as the Spanish DST does not tax data that is transmitted for free.

(vii) Conveyance of communication signals (Preamble of the Spanish DST Act)

Under Section IV of the Preamble of the Spanish DST Act it is indicated that: "In no case is the transport of communication signals referred to in Law 9/2014, of 9 May, General of Telecommunications, included."[82]

This event not subject to taxation is peculiar for the following reasons: (i) it is only mentioned in the Preamble and not in Article 6 of the Spanish DST Act that lists all the events not subject to taxation; (ii) this is an event of non-subjection that is established only by the Spanish legislature since it is not contemplated by the DST Directive Proposal; (iii) it is not specified what possible activity is being excluded from the tax; and (iv) the exclusion is not justified by any legal text, neither by the Spanish DGT, nor by the STA, and no reference can be made to the DST Directive Proposal as it does not contemplated it.

In this section, the justification for the cause of the events described not falling within the scope of the tax has been sought in the Preamble of the DST Directive Proposal as the explanations provided by the Spanish DST Act are insufficient. According to Pérez Merino (2023), this raises serious doubts regarding the equality principle on tax matters established under Article 31.1 of the Spanish Constitution since the Spanish lawmakers have not explained in detail why certain events are not covered, generating a potential unjustifiable discrimination. Though the Spanish DST Act could indeed have a more extensive preamble in which these events not subject to taxation could have been made clear as done so by the DST Directive Proposal, the exclusions contained under Article 6 of the Spanish DST Act are reasonable as they are based on the idea that the generation of value is not carried out by the users, but by the platform, and this is the central aim of the tax as explained in the Preamble of the Spanish DST. That said, it is unjustifiable the inclusion only in the Preamble of the act that governs the tax the exclusion of the conveyance of communication signals without providing any further definition of this exclusion and not listing it under Article 6 of the Spanish

[82] See: STA (n.d.). *Law 4/2020, of 15 October on the Tax on Certain Digital Services* (Translation by the STA).

DST Act. But once again, it is simply a bad legislative practice with no further consequences.

Another controversial issue regarding Article 6 of the Spanish DST Act is the following. Article 5 of the Spanish DST Act establishes in a generic way that it is the digital transactions which are the taxable event. This generic expression is specified under Article 4 of the Spanish DST Act where it establishes that “digital services” are exclusively online advertising services, online intermediary services, and data transmission services while providing a definition for each one of these services, and also under Article 6 of the Spanish DST Act which provides a list of the events not subject to taxation. Consequently, the tax will be applicable to the digital services established under Article 4 of the Spanish DST Act and that are not in turn listed as events not subject to taxation under Article 6 of the Spanish DST Act. According to Pérez Merino (2023), this can entail that the events listed under Article 6 could be deemed as exemptions instead as events not subject to taxation.

As explained by the above-mentioned author, the events not subject to taxation are those events that fall out of the scope of the tax due to the definition of the taxable event and because of the objective of the tax, while the exemptions are those events that fall under the definition of the taxable event (and thus are subject to taxation) but the legislature has expressly excluded these events from the tax, as stated under Article 22 of the Spanish GTA. As indicated by Ariza Rodríguez (2011), the events not subject to taxation fall out of the scope of the taxable event and an article that would list them simply reaffirms that there are excluded, while exemptions are events that would fall under the scope of the taxable event but which the legislature has expressly excluded from being taxed.

Pérez Merino (2023) argues that it is debatable whether the events listed under Article 6 of the Spanish DST Act are correctly classified as events not subject to taxation, except the events listed in its section a) and b) that refer to events that by their own nature would fall out of the scope of the taxable event.[83] However, the rest of the

[83] Article 6.a of the Spanish DST Act refers to the sales of goods or services contracted through the website of the provider in which the provider does not act as an intermediary; and Article 6.b of the Spanish DST Act refers to deliveries of underlying goods or services that take place between users, within the framework of an online intermediation service.

events listed under Article 6 make reference to situations that if not expressly excluded under the said article, would fall under the scope of the taxable event. Consequently, the majority of the events listed under Article 6 are exemptions rather than events not subject to taxation (Pérez Merino, 2023). This subtle difference can potentially be relevant as will be analyzed in Section 2.17 of this dissertation.

2.8. Place of taxation

Article 7 of the Spanish DST Act establishes the rules on the location of digital services taxed by the DST. Particularly, Article 7.1 describes a general rule regarding the location of the user in Spanish territory. In addition, Article 7.2 establishes more specific rules for each type of service in order to determine when a user is understood to be located within the territory of application of this tax in accordance with the Spanish DST Act. It must be pointed out that the criteria for the location of the user in the territory of application of the tax set out under Article 7 of the Spanish DST Act are analogous to the ones established under Article 5 of the DST Directive Proposal.

(i) General rule: Location of the user in Spanish territory

Article 7.1 of the Spanish DST Act describes as a general rule that the provision of digital services will be considered to be performed within the territory of application of the tax when a user is located in such territory. Therefore, the services considered to be located in Spain are those services that are provided to users located in Spain. That is to say that the location of a user in Spanish territory is the nexus to allocate a provision of a digital service in Spain, regardless of whether or not the user has carried out a payment that generates revenue related to a provision of a digital service.

This reasoning is in line with the important role of the user in the value creation process in the digital service models as stated in Section IV of the Preamble of the Spanish DST Act, and also on page 11 of the justifying memoir of the DST Directive Proposal.

(ii) Specific rules for determining the user's location for each type of service

In order to consider the location of the users within the territory of application of the tax, different rules apply based on the nature of the digital service provided.

Accordingly, and considering the nature of the digital service provided, Article 7.2 of the Spanish DST Act determines that a user is in the territory of application of the tax in the following situations:

a) Regarding online advertisement services, the user will be considered to be in the territory of application of the tax when at the time the advertisement is displayed on the user's device, this device is in the territory of application of the tax.

b) Regarding online intermediary services, it is necessary to differentiate between two scenarios:

First scenario, delivery of goods or provision of services between users: the user will be considered to be in the territory of application of the tax when the conclusion of the underlying transaction by a user is performed through a digital interface using a device that at that moment is located in the territory of application of the tax. This means that the tax is levied according to the location of the users at the time of the closing of the transaction through the digital interface: (i) the one who acquires the good or service, and (ii) the one who transmits the good or provides the service. As a result, the taxable base will be divided in half in favor of the jurisdiction in which the transmitter of the good or provider of the service is located and the other half in favor of the jurisdiction in which the acquirer of the good or service is located at the time of the conclusion of the transaction through the digital interface.

Second scenario, when the service allows users to interact and locate other users: the user will be considered to be in the territory of application of the tax when the account that allows the user to access the digital interface has been opened with a device located in the territory of application of the tax. This method establishes the location point as the location of the user the instant in which they open an account (i.e. has created an account) to be able to use it. Pérez Merino (2023) has argued that this method is not ideal as, for example, a person who resides in France might register to use a social media platform with the intention of only using it during their vacation in Spain. The taxation would be in France since it is the place where the user was located when they registered to use the platform, though according to the mentioned author the digital data that the user will benefit from actually comes from the network effect generated by the users of the platform in Spain where the service will be enjoyed.

Pérez Merino (2023) would propose that a new registration to the platform is considered for tax purposes every time the user changes jurisdictions. It must be concluded that the approach of the legislature, which is based on the assumption that the moment at which the digital interface monetizes the network effects of the interface is the moment when a new person registers to use the platform, seems reasonable and, in any case, less complex than the one proposed by Pérez Merino (2023).

c) Regarding data transmission services: the user will be considered to be in the territory of application of the tax when the data that is transmitted is generated by a user through a digital interface that has been accessed through a device located in the territory of application of the tax.

Article 7.3 of the Spanish DST Act clarifies two circumstances that will not be considered when locating digital services.

The first circumstance is regarding the underlying delivery of goods or provision of services between users of a multi-sided digital interface establishing that the location where the underlying transaction takes place will not be considered for locating the digital service. This rule could cause a controversy when the user contracts a delivery of goods or a provision of services by using mobile devices while traveling. For example, a user who is flying from one country to another might, before traveling, concludes a vehicle transport service at their destination airport so that when they arrive there from abroad, they have a way to get to their hotel. So, in this case, the jurisdiction in which the underlying service is concluded is different from the jurisdiction where the underlying service is provided. The legislature seems to give priority to the location of where the underlying service is concluded as the location of where the underlying service is performed is irrelevant for the purposes of the DST.

The second circumstance that will not be considered when locating digital services is the location from which any payment related to a digital service is carried out.

Though these two rules might be controversial since they might present some practical difficulties for the taxpayers, they are in line with Article 5.4 of the DST Directive Proposal. These are consistent with the idea that what matters is the location of the user when using the digital service since that is when value is created by the user, and not when the underlying service is performed nor when the payment is carried out.

(iii) Device location

Article 7.4 of the Spanish DST Act establishes that a user's device will presumably be located at the place determined by the device's IP address.

However, it must be pointed out that Article 7.4 establishes a rebuttable presumption as the location of the IP address will presumably determine the location of the user's device unless it can be concluded that this place is a different one through the use of other legally admissible means of evidence, in particular the use of any other method of geolocation.[84]

Article 1 of the Spanish DST Regulation establishes in accordance with Article 7 of the Spanish DST Act that the user is located in the territory of application of the tax when the device through which the digital service is provided is located in that territory. For the purposes of locating that device, it indicates that: (i) the location of the device will be given by geolocation technology used to analyze information from the device, or from the Internet network in which the device is connected, or from a combination of both; and (ii) the device shall be presumed to be at the location determined by its IP address, unless proven otherwise through other means of geolocation technology such as: a) network identification (such as Wi-Fi, Ethernet, or others), or b) physical geolocation by satellite (such as the Global Positioning System, GLONASS, Galileo, or BeiDou), or through information provided by wireless terrestrial communications systems (such as the Global System for Mobile Communications, or the Lower Power Wide Area Networks), or also by beacons (such as Wi-Fi, or Bluetooth), or c) a combination of current or future technologies for locating the users devices.

[84] The Spanish DST Act regulates this issue in the same terms as Article 5.5 of the DST Directive Proposal. Specifically, on page 12 of the DST Directive Proposal considers the IP address to be a simple and effective proxy to determine a user location. The possibility is also given to the taxpayer to prove that the user is not located in a given Member State by other means of geolocation.

It must be pointed out that the use of different techniques to localize a user might lead to different results increasing the complexity of complying with the obligations of this tax.

Given the importance of the use of the IP address, Article 4.2 of the Spanish DST Act provides a definition of this term.[85] Accordingly, an "Internet Protocol (IP) address" is a code assigned to interconnected devices to facilitate their communication over the Internet.

The use of IP addresses seems to be an acceptable method to ascertain the location of a device, and by extension the user of the device (Svantesson, 2007). Back in the year 2000, the OECD suggested the use of IP addresses as a suitable proxy for identifying a customer's jurisdiction although this possibility has not been explored any further (Escribano, 2021). The EU Commission has also used IP addresses to locate the users in Article 5.5 of the DST Directive Proposal and in Article 4.6 of the proposal for a directive on laying down rules regarding the corporate taxation of a significant digital presence.

The use of IP as a nexus is simple and straightforward, though it has some risks (Escribano, 2021). A risk that must be contemplated is that IP addresses might not be that reliable due to the possible use of anonymizers or VPNs. The use of this software by Internet users allows for the possibility to hide their real IP address, physical location, and online activity, from the administrators of the visited websites as well as from third parties. This software also allows users to select an IP address of a specific location.[86] That said and considering its risks, the use of the IP address is commonly used to locate devices and its users and it can be presumed that the vast majority of users do not use software to hide their real IP address and location.

(iv) Collecting and processing personal data

Article 7.5 of the Spanish DST Act establishes that in order to comply with data protection regulations, the data that may be collected from users for the purpose of

[85] Article 2.6 of the DST Directive Proposal provides the same definition.
[86] For a more detailed explanation on how this software works and how it can jeopardize the use of the IP as a proxy, see Greil & Wargowske (2019).

applying this tax is limited to the data that allows for the location of the users' devices in the territory of application of the tax.

The IP address of users' devices is considered as personal data for the purposes of data protection according to domestic[87] and EU law.[88] However, since the IP address of a device is data that is collected and processed by a taxpayer in order to comply with a legal obligation set by the Spanish DST, it is considered lawful under Article 6 of the Regulation (EU) 2016/679 and Article 8 of the Spanish Data Protection Act with no need to request consent to do so from the user.

In addition, it must be pointed out that under Article 95.1 of the Spanish GTA, the data obtained by the STA is confidential and, except for the limited number of exceptions provided in this article, it may only be used for tax purposes, and cannot not be transferred or communicated to third parties.[89]

Consequently, no issues have been found regarding the Spanish DST with data protection regulations. Be as it may, the taxpayers are imposed with the obligation to track the IP addresses of their users and that might cause them to incur significant compliant costs as well as to require them to keep records on the data regarding the location of the users together with the supporting documentation. In addition to these potential technical difficulties that the taxpayers have to face to comply with this tax, the act that governs the tax foresees significant fines if these obligations are not met as will be explained further along in this chapter. Also, the ability of the STA to cross-check the information on the location of the users that could be provided by the taxpayer is limited. Overall, it seems that the STA will have to act in faith that the taxpayers are providing the correct data.

[87] Act 3/2018, of December 5, Spanish Data Protection Act (in Spanish, *Ley Orgánica 3/2018, de 5 de diciembre, de Protección de Datos Personales y garantía de los derechos digitales*). It must be pointed out that the report number 327/2003 of the Spanish Data Protection Agency considered that IP address as personal data.

[88] Regulation (EU) 2016/679 of the European Parliament and of the Council of April 27, 2016, on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, also considers IP address to be personal data.

[89] Under Article 95 of the Spanish GTA includes the possibility to transfer data collected in cases when a court or a prosecutor request it to fight against crimes, and in general, in limited cases when it is necessary for the administration to carry out their obligations.

2.9. Accrual

Before moving into a description of who is considered to be a taxpayer (Article 8 of the Spanish DST Act), it is necessary to define first when the tax is accrued (Article 9 of the Spanish DST Act).

In accordance with Article 9 of the Spanish DST Act, the tax is accrued when the taxable transactions are rendered, executed, or carried out. That is to say that the tax will accrue at the time the taxable digital services are performed.

However, regarding the taxable digital services that originate advance payments before they are fulfilled, the Spanish DST will accrue at the time of total or partial obtention of the payment for the amounts actually received as expressly stated under Article 9; which is different compared to the DST Directive Proposal, which in Article 4.5, sets that taxable revenues shall be considered as obtained when they fall due, being irrelevant whether the amounts have been paid.

As explained in the Spanish DGT resolution on the DST under the title "Accrual and tax base", the tax is accrued for each digital service carried out subject to taxation (transaction by transaction) regardless of the fact that the self-assessment is not filed for each individual transaction, as a quarterly self-assessment is filed for all taxable transactions carried out within the settlement period as established under Article 14 of the Spanish DST Act. This mechanism makes it similar to the VAT being able to consider them as instantaneous taxes as both are levied when a transaction is carried out, and a self-assessment has to be filed for all the taxable transactions performed within a settlement period, which in the case of the VAT is also normally done on a quarterly basis (Pérez Merino, 2023).

The accrual moment of the tax chosen by the Spanish legislature is in line with Sainz de Bujanda's (1966a) approach on this issue taking into account that in practical terms the object of taxation of DSTs is the conclusion of contracts of online targeted advertising, online intermediation, and data transmission. The mentioned author considers that when a rule establishes the conclusion of a contract as a taxable event, this will be considered as an instantaneous taxable event, while the timeframe to perform what is stipulated in the contract is irrelevant since its conclusion is what generates the tax liability. Consequently, in accordance with this statement from Sainz de Bujanda (1966a), the Spanish DST can be labeled as an instantaneous tax, though filed on a quarterly basis. Moreover, calling it an instantaneous tax is an argument in favor of characterizing the Spanish DST as an indirect tax, which will be discussed in Chapter 3.[90]

As explained, Article 9 of the Spanish DST Act establishes that the tax will accrue at the time the taxable digital service is performed, but the question is in what given moment in time does that happen. The Spanish DGT resolution on the DST under the title “Accrual and tax base” expresses that it is up to the taxpayer to prove when such accrual has occurred by any means of evidence admissible by law. After stating this general criterion, the said resolution goes on by specifying that it can be considered that the transaction has been rendered on the date of issuance of the invoice or the equivalent document.

2.10. Taxpayer

Article 8 of the Spanish DST Act establishes the criteria for identifying whether or not an entity can be considered as a taxpayer.

This article establishes that the taxpayers of the Spanish DST are the legal entities and entities referred to in Article 35.4 of the Spanish GTA[91] that provide digital services which fall within the scope of the Spanish DST and, regardless of their tax residence, on the first day of the settlement period, meet two thresholds: (i) The net turnover must have been of over €750 million during the previous calendar year;[92] and (ii) the total revenue from the provision of the services that are subject to the Spanish DST, once the rules for determining the taxable base under Article 10 of the Spanish DST

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[90] In this sense, the Spanish DGT resolution on the DST under the title “Accrual and tax base”, it is defended that since the tax is calculated transaction by transaction it is an indirect tax as it does not consider the characteristics of the providers of the services.

[91] Article 34.5 of the Spanish GTA establishes the kinds of entities that could also be considered as taxpayers and these are: “estates of a deceased person, community of assets and other entities which, without a legal personality, constitute a separate economic unit or a separate group of assets liable to taxation” (translated by the author). Entities such as trusts, partnerships, or any other figures that do not have legal personality that are common in other jurisdictions but are not contemplated under Spanish law would fall under the scope of this article.

[92] Article 8 of the Spanish DST Act uses the term in Spanish *importe neto de la cifra de negocios* that can be translated into English as “net turnover”. Standard 11 of the Spanish General Accounting Plan establishes that the *importe neto de la cifra de negocios* consists of the: “revenue from sales of goods and the provision of services or other revenue generated by the company’s ordinary activities, minus any discounts (volume rebates and other sales reductions), the VAT, and other directly related taxes that must be passed on to customers.” (Translated by the author).

Act have been applied, must have been of over €3 million during the previous calendar year. For entities that form part of a group, the mentioned amounts that make up these thresholds are the global figures of the group.

Article 4.3 of the Spanish DST Act defines what should be understood by the term *group* by making reference to Article 42 of the Spanish Commercial Code that establishes the criteria to define what should be understood as a group of entities under Spanish law, being irrelevant the residence of the entities or their obligation to file consolidated financial statements. Basically, Article 42 of the Spanish Commercial Code establishes that a group of companies is a situation in which a company, either directly or indirectly, exercises control over its subsidiaries. In brief, control will be presumed when a company (the controlling company) meets one of the following requirements in relation to another company (the subsidiary): (i) it holds the majority of voting powers of the subsidiary, and (ii) it is able to appoint or dismiss the majority of the members of the administrative body of the subsidiary.

Once the requirements to be a taxpayer of the Spanish DST are established, it is necessary to analyze the thresholds used. It must be pointed out that the DST Directive Proposal also uses the €750 million worldwide revenue threshold.[93] However, with regards to the second threshold, it establishes a €50 million revenue threshold of covered services obtained by the entity in the EU.

The Spanish DST Act establishes thresholds based on turnover to determine whether a digital service provider is subject to the tax, regardless of their tax residence and of their physical presence in Spain. As stated in the Section V of the Preamble of the Spanish DST Act, the first threshold (€750 million threshold) limits the application of this tax to large companies, while the second threshold (€3 million threshold) limits the application of this tax to situations in which there is a significant digital footprint of the taxpayer in Spain in relation to the digital services taxed.

The first threshold refers to the total turnover obtained by the taxpayer (or the group that it forms part of) worldwide and does not refer only to that obtained from the provision of digital services. The Preamble of the Spanish DST Act establishes the

[93] The DST Directive Proposal uses the term “worldwide revenues” while the Spanish DST Act uses the term “net turnover” (in Spanish, *importe neto de su cifra de negocios*). From a practical standpoint, both terms can be deemed as synonyms as it will be seen further along.

clear intention of the legislature to tax only very large companies. Considering that most very large companies are foreign or foreign-parented could lead to potential discrimination issues under EU as will be examined in Chapter 4 of this dissertation. The Preamble justifies this threshold by saying that it is the same as the one established in the Country-by-Country Report[94] which should provide legal certainty since both the STA as well as corporations will be able to determine more easily whether a company is subject to the tax or not. The Preamble also adds that, due to this threshold, SMEs as well as startups, will be excluded from this tax since for this type of companies, the compliance cost associated with the Spanish DST could have a disproportionate effect on them. The idea is that the Spanish DST targets only very large companies but excludes SMEs in order to avoid hindering innovation and digital transformation carried out by these types of companies.

In addition, and in order to calculate this first threshold, the question arises concerning what method should be used to calculate the net turnover. For stand-alone entities, it seems reasonable, under Article 8.1 of the Spanish DST Act, that the rules set out in the Spanish General Accounting Plan would apply.[95] Regarding group entities, Article 8.3 of Spanish DST Act establishes the criteria to follow, but that will be discussed further along.

The second threshold limits the application of the DST to situations in which there is a significant digital presence in the territory of application of this tax. It must be pointed out that the amount of revenue considered for this threshold only refers to the types of digital services that are taxed by the DST. These services are, online advertising services, online intermediary services, and data transmission services. Excluded are those services that are expressly exempt by Article 6 of the Spanish DST. So, the digital services that do not fall within the scope of the DST will not be considered for calculating this threshold.

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[94] Council Directive 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

[95] As noted by López Pombo & Bastida Peydro (2021), if a non-resident entity applies the accounting criteria established by IFRS 15 on Revenue from Contracts with Customers (that is the closest concept to the *importe neto de la cifra de negocios*, in English, net turnover) it may be necessary to make some adjustments to find the *importe neto de la cifra de negocios* under the Spanish General Accounting Plan.

The amount of this threshold (€3 million) is similar to the Italian DST revenue threshold (€5.5 million), but much lower than the ones established by the Austrian and French DSTs (€25 million) or the UK's DST (£25 million), as noted by Garcia Prats (2022). Due to this comparatively low revenue threshold, it could happen that entities that form part of a large group of companies whose main activity is not that of a digital services provider might be affected by this tax. For example, it's reasonable that revenue perceived by a large airline company from digital advertising of hotels or car rentals contained on its website falls under the scope of this tax. Another example could be a newspaper that forms part of a large media group that also receives relevant revenues from online advertising inserted in its website. These would be examples of companies whose main economic activity is not providing digital services but due to the low threshold to determine a digital presence might make them taxpayers of this tax, a situation that the legislature might not have considered. In order to avoid this scenario, this threshold should be increased as will be discussed in Chapter 5 of this dissertation.

In relation to these thresholds, the following specifics regarding the concept of taxpayer of the Spanish DST must be considered.

First, the Spanish DST Act establishes that legal entities and entities included under Article 35.4 of the Spanish GTA can be taxpayers of this tax. Therefore, legal entities and certain entities without legal personality can be taxpayers of the Spanish DST. The Spanish DST Act excludes natural persons from the scope of the tax. This circumstance seems irrelevant in practice since it is rare for an individual to have an annual turnover exceeding €750 million, and to provide covered digital services to users located in Spain for an amount exceeding €3 million per year, which are the two thresholds required to be subject to the Spanish DST.

Second, in the definition of the taxpayer of the Spanish DST, there is no reference to the residence of the legal persons and entities subject to this tax. In this sense, the objective of the Spanish DST is to tax all types of entities regardless of their residence. Accordingly, the Spanish DST seeks to tax those digital business models in which there is a disconnection between the tax residence of the digital service provider and the place where revenues are obtained and where value is created. As emphasized by Alonso Murillo (2021), the condition of taxpayer of the Spanish DST is entirely unrelated to residence in Spanish territory, because all entities that provide digital services subject to this tax and exceed the two thresholds will be taxpayers, regardless of their residence. Therefore, the traditional nexus of taxation based on residence, establishment, or presence in Spain are not relevant to determine if an entity falls under the scope of this tax.

Third, Article 8.1 of the Spanish DST Act specifies that in the event the activity was started in the immediately preceding year, for the purposes of the thresholds, the amounts obtained during the period in which the activity began will be used to estimate the revenue which would potentially have been obtainable over a one-year period. That means that not the real amount of revenue will be considered, rather the amount that it could have potentially obtained in one year.

In this same sense, though Article 8.1.b of the Spanish DST Act establishes that for calculating the €3 million threshold (i.e. the significant digital footprint) regarding the revenues of digital services covered, the revenues of the preceding year (i.e. from January 1 to December 31) will be taken into account. The sole transitory provision of the Spanish DST provides an exception according to which for fiscal year 2022 (i.e. the second year in which the tax is levied) this threshold was calculated from January 16, 2021 (i.e. the day the tax went into force) until December 31, 2021, and estimate the revenue which would potentially have been obtainable over a one-year period.[96] In addition, for year 2021, as there was no preceding year in which the tax was in force, to calculate whether an entity met the significant digital footprint threshold, the STA established that the revenues of covered digital services were considered from the beginning of each of the four quarterly settlement periods (the first quarterly period beginning on January 16) until the end of each, though these quarterly amounts were estimated over a one-year period to determine whether the €3 million threshold was met or not with regards to each quarter.[97]

Fourth, Article 8.2 of the Spanish DST Act establishes that when the amounts regarding the thresholds are calculated in a currency other than the euro, they will

[96] Nothing is said with regards to the €750 million threshold established under Article 8.1.a of the Spanish DST Act. The legislature set the €750 million threshold for all years with no exceptions probably for simplification purposes, though it could have established the same rules as for the €3 million threshold.

[97] STA FAQs regarding the Spanish DST, version of June 30, 2021, pp. 7-8.

have to be converted into euros by applying the exchange rate that is published in the latest Official Journal of the EU available for the calendar year of reference. The question does arise in regard to what exchange rate should be used for the transactions done in currencies other than euros. To this effect, as the act that governs the tax does not provide an answer to this question, reference must be made to Article 21.1 of the Spanish GTA. This article establishes that the accrual of the tax determines the relevant circumstances to consider for establishing the tax liability. Thus, it seems reasonable to say that the exchange rate that should be considered is that of the day on which the accrual of the tax takes place. Consequently, and being coherent with Article 8.2 of the Spanish DST Act, the exchange rate published in the Official Journal of the EU regarding the date of accrual of the tax should be used.

Fifth, Article 8.3 of the Spanish DST Act establishes special rules for calculating the thresholds in case of entities that form part of a group.

In relation to the first threshold (€750 million), Article 8.3 of the Spanish DST Act establishes that in these cases the provisions of Council Directive 2016/881 of May 25, 2016, meaning the country-by-country reporting obligations, shall be complied with, as well as the equivalent international standards adopted in application of Action 13 of the BEPS project regarding the documentation on transfer pricing and country-by-country reports.

The country-by-country reporting obligations directive refers to "consolidated group revenue" that the Spanish internal transposition regulation, that is Article 14 of the Spanish CIT Regulation, refers to it as the *importe neto de la cifra de negocios* (in English, net turnover). On the other hand, as pointed out by López Pombo & Bastida Peydro (2021), Action 13 refers in some cases to the domestic accounting regulations of the head company or the IFRS, and consequently, a different result can be reached depending on the accounting rules used. It would therefore be desirable that the Spanish DGT would expressly clarify which accounting standard should apply to groups for determining this first threshold. A possible solution would be to use as a standard the definition of the *importe neto de la cifra de negocios* under Spanish law, as done in the transposition regulation of the country-by-country reporting obligations directive.

In relation to the second threshold (€3 million), the provision of digital services between entities with a direct or indirect participation of 100% are not considered for the purposes of calculating this threshold as it falls under one of the cases of non-subjection. However, intra-group services between entities with a participation of less than 100% are considered for the purposes of calculating this threshold. This criterion does not follow the DST Directive Proposal since, as indicated in its recital 26, the revenues obtained by an entity from supplies to other entities belonging to the same group are excluded from the scope of the tax.

Finally, as indicated in Article 8.3 of the Spanish DST Act, if the group jointly exceeds these thresholds, each of the entities of the group will be considered a taxpayer of the Spanish DST if they obtain revenues of covered digital services from users located in Spain. This is in line with Article 9.1 of the DST Directive Proposal, though its second paragraph contains a rule not foreseen in the Spanish DST Act. Article 9.2 of the DST Directive Proposal includes the possibility for groups of companies in which various entities are deemed to be taxpayers to be permitted to nominate one entity within the group for paying the tax and fulfilling the obligations regarding this tax on behalf of each of the taxpayers in that group that are liable to the DST. As mentioned, the Spanish DST Act does not contemplate such a possibility.

So, in a group that jointly exceeds these thresholds, if an entity of such a group renders a covered digital service, it will be obliged to pay the tax being irrelevant the amount of the transaction. On the other hand, if another entity of the group does not provide any covered digital services, it will not be considered as a taxpayer. However, Article 3.3 of the Order HAC/590/2021 indicates that if any of the entities of the group sporadically renders covered digital services, such entity will have to file the Spanish DST tax forms for all periods (although with a zero-tax liability in those periods in which it does not provide covered digital services) and not only in the periods in which covered digital services are provided. This measure might be seen as particularly burdensome as certain thresholds could be introduced so entities that do not carry out relevant covered services would not be considered taxpayers. This can be justified as a means to avoid a possible practice of splitting digital services among group entities that would prevent non-taxation.

As mentioned above, the thresholds are determined on the basis of the previous year's figures. This is relevant for the purpose of considering the entities that make up a group as taxpayers or those that do not when there are changes in the entities that make up a group.

The situation in which an entity of a group that exceeded the thresholds joins a group that also exceeds the thresholds is not problematic since it generates no doubts that the entity joining the group remains subject to the tax. Likewise, in the case where an entity that met the thresholds on its own separates from the group of which it was a part that also met the thresholds; it is clear that the entity remains subject to the tax. However, there are cases that are less clear, two for which the STA has provided a solution in the STA FAQs regarding the Spanish DST.[98]

The first situation refers to an entity that did not exceed the thresholds and joins a group that did exceed the thresholds; according to the STA, the entity is not considered as a taxpayer of the Spanish DST for the tax year in which it joins the group. The second situation refers to an entity that by itself did not meet the thresholds but was considered to be a taxpayer because it was part of a group that met the thresholds. In the event that such an entity separates from that group, according to the STA, since the entity started the year as a taxpayer, it will maintain this consideration until the end of the calendar year.

There are other potential scenarios that though they are plausible, remain unsolved. One such situation is that in which an entity, by itself, meets the thresholds and joins a group that does not meet the thresholds. In this case, it seems reasonable that the entity would be a taxpayer, individually, of the Spanish DST, but not the rest of the entities of the group since the group did not meet the thresholds in the preceding year. Another unresolved situation would be that of an entity that by itself met the criteria for being subject to the tax and which separates from a group that would not have exceeded those thresholds without it. It seems coherent that both the entity and the other group entities should maintain their condition of taxpayers until the calendar year ends based on the STA’s criterion that the entity (and by analogy the rest of the

[98] STA FAQs regarding the Spanish DST, p. 7.

entities that form part of the group) that starts the year as a taxpayer will maintain this consideration until the end of the calendar year.

A resolution from the Spanish DGT would be interesting in order to clarify the controversial situations referred to.[99] In the absence of such a resolution, in general terms, it can be concluded as done so by Pérez Merino (2023) that the condition of being a taxpayer or not will not be altered during the calendar year in which the change takes place.

2.11. Tax base

Article 10 of the Spanish DST Act provides the following parts: (i) a general rule to determine the tax base, (ii) specific rules to determine the tax base for each type of digital service subject to this tax, and (iii) a rule for the provisional determination of the tax base, as well as the corresponding mechanisms for regularizing and rectifying the tax base.

(i) General rule to determine the Spanish DST tax base

Article 10.1 of the Spanish DST Act, based on the DST Directive Proposal, defines the general rule by establishing that the taxable base is constituted by the amount of revenue obtained by the taxpayer for each of the digital services subject to this tax carried out in the territory of application of the tax, excluding, when applicable, VAT as well as other equivalent taxes.[100] This direct method to calculate the tax base would be the method preferred by Sainz de Bujanda (1966a) who argues that this method should prevail when designing a tax because it is in line with the idea of tax justice since it aims to provide certainty; compared to alternative methods based on estimations that only intend to simplify its calculation.

It is deemed necessary to make the following observations of this general rule established under Article 10.1 of the Spanish DST Act.

[99] As established under Article 12.3 of the Spanish GTA, the effects of a Spanish DGT resolution are limited to the STA, as long as the legislation or case-law does not modify it.

[100] As pointed out by Pérez Merino (2023), the expression "other equivalent taxes" used in Article 10.1 of the Spanish DST Act possibly refers to the Canary Islands General Indirect Tax (analogous to the VAT in the Canary Islands), and the Tax on Production, Services and Imports (equivalent to the VAT in the autonomous cities of Ceuta and Melilla), as well as to other similar indirect taxes that may exist outside Spain, such as other sales taxes similar to the VAT.

First, the taxpayer of the Spanish DST cannot deduct any expenses since it is a tax on gross revenue and not a tax on profits. Consequently, the tax base will always be a positive number regardless of the profits obtained and it will be levied even in case of losses. This is a controversial aspect of this tax that will be analyzed in more detail in Chapter 5 of this dissertation.

Second, Article 10.1 refers to the fact that the Spanish DST will be levied on the revenues obtained by the taxpayer for each of the digital services that falls under the scope of the tax. The obtained revenue must be understood under Article 9 of the Spanish DST Act as revenue accrued in a given tax period. As explained in Section 2.9 of this dissertation, revenue is accrued when the taxable transactions are rendered, executed, or carried out.

Third, Article 10.1 establishes that for the provision of digital services between entities of the same group, that is the provision of digital services between entities with a participation of less than 100% (since the provision of digital services between entities with a direct or indirect participation of 100% are not subject to taxation in accordance with Article 6 of the Spanish DST Act), the tax base will be its normal market value. On the other hand, in the case of transactions between independent parties, in the absence of a criterion in the law for the quantification of the taxable base, the amount of revenue obtained by the taxpayer from the taxable digital services must be considered. The definition of the revenue from digital services covered has been specified in the Spanish DGT resolution on the DST:

a) In online advertising services, the revenue is the total amount received for including online advertising.

b) In online intermediary services without an underlying transaction, the revenue is the subscription or registration fee to be able to use the digital interface; while in online intermediary services with an underlying transaction, the revenue is the amount received for the intermediation service (i.e. the commission).

c) In data transmission transactions, the revenue is the amount of the transaction carried out.

According to a literal interpretation of Article 10.1 of the Spanish DST Act, it can be concluded that in the event that there is no compensation for the digital service provided, the transaction would be excluded from taxation. This is in line with the objective of the tax which seeks to tax the monetization of users' data by companies; so, if there is no compensation, there is no monetization to be taxed (Pérez Merino, 2023).

(ii) Specific rules for each type of digital services covered to determine the Spanish DST tax base

When users of a given taxable service are located in different jurisdictions, the taxable revenues obtained from that service ought to be allocated to Spain in a proportional way on the basis of certain specific allocation keys. Consequently, Article 10.2 of the Spanish DST Act establishes specific allocation keys for each type of digital service to calculate the tax base.

So, the allocation keys that will be analyzed are applied exclusively to cross-border transactions in order to determine the part of the revenue obtained in Spain. If the transaction had been carried out entirely in Spanish territory (i.e. the users are all located in Spain), these rules do not apply and the tax base will be composed of the entire amount of taxable revenue as foreseen in Article 10.1 of the Spanish DST Act.

As will be seen, most of these rules have in common that a percentage is applied to the gross revenue obtained worldwide by the taxpayer of each type of service (online advertising services, online intermediary services, and data transmission services) in order to obtain the tax base. The percentage is the result of dividing, for example, the number of users or the number of devices in the territory of application of the tax by the total number of registered users or devices worldwide.

For the purposes of locating the users for allocating the tax base between jurisdictions, as discussed in Section 2.8 of this dissertation, the device shall be presumed to be at the location determined by its IP address, unless proven otherwise through other means of geolocation technology, in accordance with Article 7.4 of the Spanish DST Act and Article 1 of the Spanish DST Regulation.

These rules are based on Article 5.3 of the DST Directive Proposal under which allocation keys are established in order to distribute the taxable revenues among Member States. The allocation keys also vary depending on the type of service taxed.

The specific rules under the Spanish DST Act are the following in relation to each type of service covered:

a) Online advertising services

In relation to online advertising services, the proportion will be calculated by dividing the number of times advertising appears on devices that are located in the territory of application of the tax by the number of times advertising appears on devices that are located worldwide. The proportion is then multiplied by the revenues of digital advertising obtained worldwide. In this case, the key element is the location of the device when the advertisement appears.

That is to say, if a given online targeted advertisement has been displayed on 100 electronic devices around the world, of which at the time the advertisement was displayed, 25 devices were located in Spain and 75 elsewhere; the Spanish DST tax base will be formed by 25/100 parts of the revenue obtained for this specific advertisement by the taxpayer.

This calculation method can pose a significant challenge for the taxpayers as technically they should monitor the number of times an advertisement pops up on a device located in Spain and elsewhere. It is unknown if the taxpayers would be able to effectively monitor this data, and the question also arises on how the STA will verify the information provided by the taxpayer.

b) Online intermediary services

In relation to online intermediary services in which there is an underlying transaction of goods or services directly between users, the proportion will be calculated by dividing the number of users located in the territory of application of the tax by the total number of users that participate in that service elsewhere. The proportion is then multiplied by the revenues of that specific online intermediary service in which there is an underlying transaction of goods or services directly between users.

Though the provision does not clarify at what moment it should be understood that the users are located in a given territory, it seems reasonable to consider the location of the user at the time of the closing of the underlying transaction through a digital interface in accordance with Article 7 of the Spanish DST Act that regulates the place of taxation. In this sense, recital 35 of the DST Directive Proposal establishes that the revenues of the entity that provides the digital interface must be allocated to Member States where the users concluding underlying transactions through a digital interface are located.

Thus, in the case of a platform like Amazon that has facilitated a specific transaction in which a user who at the time of its conclusion was located in Spain and another user who was located elsewhere, the Spanish DST tax base will be formed by 1/2 parts of the revenue obtained by Amazon for this specific online intermediation service.

In relation to intermediary services in which there is not an underlying transaction, the tax base will be obtained by the direct payments performed by users to obtain access to the digital platform insofar as they were located in Spanish territory the first time they signed up for the service. In this case no proportion applies since the tax base is formed of the amount of revenues derived directly from users located in the territory of application of the tax. The key element is the location of the device used to sign up for the account to access the digital interface.

The calculation method established by the Spanish DST Act is different from the DST Directive Proposal which is based on an estimation, as revenues had to be allocated to each Member State in proportion to the number of local users that held an account for the platform in relation to the total registered number of users worldwide in the given tax period,[101] not taking into account the overall volume of fees paid by the users in each Member State.

The method used under the Spanish DST Act brings more legal certainty than the one used in the DST Directive Proposal as the latter is based on an estimation, as well as in the case of the other digital services. The method under the Spanish DST Act is straightforward as it taxes the fees paid by users to the services providers.

[101] Article 5.3.b.ii of the DST Directive Proposal.

c) Data transmission services

In relation to data transmission services, the proportion will be calculated by dividing the number of users who have generated data and are located in the territory of application of the tax by the number of users worldwide that have created data. The proportion is then multiplied by the revenues of data transmission services obtained worldwide. In this case, the key element is the location of the device when the data of the users is generated. For instance, if the data transmitted has been obtained from 100 worldwide users, of which 10 were located in Spain; the Spanish DST tax base will be formed by 10/100 parts of the revenue obtained by the taxpayer for this specific data transmission. As expressed in Article 10.2 of the Spanish DST Act, the time at which the data transmitted was collected is irrelevant.

Pérez Merino (2023) would consider it appropriate to use the amount of data transferred (calculated in kilobytes) instead of using the number of users in each given jurisdiction as the Spanish DST pursues to tax the user's data. However, from a practical perspective, it seems that it would be less challenging for companies to control the number of users from whom they obtained data than the amount of data collected from them in each given jurisdiction as the mentioned author suggests. That said, the use of the amount of data transferred would seem more in line with the objective of the tax, but might complicate the calculation of the tax base even more. In all, the criterion used by the legislature seems reasonable.

These rules present some controversial issues since the information needed to calculate the tax base could be difficult for the taxpayer to obtain and challenging for the STA to verify. Bahía Almansa (2020), Hernández Moneo (2020), Belda Reig (2021), and Guervós Maíllo (2021), point out the technical difficulties for the STA to verify whether the tax bases declared by the taxpayers are correct, especially in relation to the Spanish non-resident taxpayers, as noted by Hernández Moneo (2020), since the STA will need to verify information on digital transactions carried out in Spain and elsewhere, and as mentioned by Bahía Almansa (2020), certain jurisdictions are reluctant to exchange information, especially in the case of indirect taxes. According to Belda Reig (2021), in regards to online advertising services, it is nearly impossible to determine the number of users in a given jurisdiction and worldwide that will see a given advertisement, as well as the number of times an advertisement will appear on digital interfaces. The said author believes that these numbers can be easily manipulated. It cannot be ignored, as indicated by Hernández Moneo (2020), that the compliance cost for the taxpayers will be very high as they will have to manage a vast amount of data. Consequently, Guervós Maíllo (2021) considers that it will be difficult to enforce the tax correctly. In all, the calculation of the tax base is left to the good will of the taxpayer to use the correct numbers (Belda Reig, 2021).

(iii) Rules for the provisional determination of the tax base, as well as the corresponding mechanisms for regularizing and rectifying the tax base

Due to the complexity and volume of information required to determine the tax base, the lawmakers established the following two mechanisms for rectifying the tax base depending on whether it was not known at the time of declaration and therefore established provisionally (Article 10.3 of the Spanish DST Act), or, being known, it had been declared incorrectly (Article 10.4 of the Spanish DST Act).

a) Provisional self-assessments

Under Article 10.3 of the Spanish DST Act it is established that if taxpayers do not know the amount of the tax base during the settlement period for reasons beyond their control, they will have to provisionally estimate the tax base by using well-founded criteria that would take into account the revenue delivered from these digital services over the relevant period. The provision indicates that when the amounts become known, the taxpayer will have to carry out a regularization in the self-assessment corresponding to the DST settlement period during which the amount became known. This must be done within a period of up to four years.[102]

This situation of not having sufficient information to calculate the tax base could be frequent due to the peculiar characteristics of this tax. For instance, and as pointed out by Macarro Osuna (2020), in online advertising the accrual of the tax may occur before all the contracted views are fulfilled. Despite the services being contracted on a specific date, the advertisement will be displayed on users' devices in different jurisdictions. Until the term of the contract ends or until a specific number of views

[102] The four-year period coincides with the statute of limitations period established under Article 66 of the Spanish GTA.

has been reached, it will not be possible to determine the portion of tax liability that corresponds to each jurisdiction in accordance with the allocation rules.

b) Rectifying incorrectly determined tax bases

Article 10.4 of the Spanish DST Act establishes that if a tax base is incorrectly determined, the taxpayer will have to rectify it in accordance with the Spanish GTA. So, if, as a result of the incorrectly determined tax base, the taxpayer should have paid more, they will have to file a complementary self-assessment as regulated under Article 122 of the Spanish GTA. On the other hand, if the taxpayer should have paid less, they should file a request for undue revenue asking for the reimbursement of the amount paid in excess plus the accrued interest from the STA as regulated under Article 120.3 of the Spanish GTA.

The Spanish DGT resolution on the DST states that Article 10.3 establishes a special regularization procedure. It justifies the existence in the law of this special procedure for those cases in which it is not possible to determine the tax base at the time the tax settlement has to be filed. Consequently, Article 10.3 allows for the tax base to be provisionally settled, and once the definitive amount of the transaction can be determined, a subsequent regularization of the tax is carried out through a self-assessment during the settlement period in which the definitive amount of the tax base is known and within a maximum period of four years following the accrual date of the tax corresponding to the relevant transaction. On the other hand, the Spanish DGT indicates that Article 10.4 establishes an entirely different procedure from Article 10.3. According to the Spanish DGT, the procedure in Article 10.4 would be limited to cases in which the tax base had been known (or could have been known) but was declared incorrectly (and not provisionally).

Regarding Article 10.3, the Spanish Ministry of Finance provides a further interpretation of this article in the Order HAC/590/2021.[103] Unlike the Spanish DGT resolution on the DST, the effects of which are binding only to the Administration and

[103] Pérez Merino (2023) points out that the Spanish DGT does not seem to consider as a self-assessment the declaration that is made without full knowledge of the definitive amount of the tax base; this is because the Spanish DGT only uses in its interpretation the term self-assessment once the definitive amount of the tax base is known. The question arises of what this provisional declaration could be classified as, since the Spanish DGT does not provide an answer to this question. That said, the Ministerial Order does refer to both declarations, the provisional and the definitive (or regularized) as self-assessments.

provided that there is no legislative modification or case-law that modifies the DGT's interpretation,[104] the ministerial order, which is a regulation that is binding to both the Administration and the taxpayers, has the purpose of specifying the content of the law.

The Order HAC/590/2021 interprets Article 10.3 as a special regularization procedure (as also stated by the Spanish DGT) for cases in which the taxable revenue is not known at the time of filing the self-assessment, the taxable base will be provisionally declared and a regularization will take place.[105] However, the ministerial order establishes an exception: in the event that at the time of the regularization the entity has lost the condition of taxpayer of the tax, the regularization of the self-assessments filed with provisional amounts of the taxable base will not be carried out following the procedure of Article 10.3, but in accordance with the procedures established in the Spanish GTA, thus following the same proceedings as in the case foreseen under Article 10.4 for incorrectly declared tax bases explained above.

Though nothing is said in Article 10 of the Spanish DST Act about the consequences of regularization in regards to surcharges and late payment interest, it is reasonable to believe that the regularization carried out under Article 10.3 of the Spanish DST Act for not knowing the exact amount of the tax base during the filing should not entail surcharges, nor late payment interest as it could be understood that the legislature has provided a mechanism to the taxpayer in order to regularize a situation that may very well happen due to the complexity of calculating the tax base. That said, the Spanish DGT resolution on the DST has provided its own criteria.

Regarding the surcharges, the Spanish DGT, after providing a brief description of the Spanish Constitutional case-law on the application of surcharges, rules out, due to the coercive, dissuasive, and stimulative nature of the surcharge, that such surcharge is applicable to the regularization of provisional tax bases carried out under Article 10.3 for not knowing the definitive amount of the tax base at the time of filing the self-assessment. This is so insofar as it is justified that the reason for the subsequent regularization is not a decision of the free will of the taxpayer, but is due to a diligent

[104] Article 12.3 of the Spanish GTA.

[105] Within the Spanish DST self-assessment (form 490) specific sections to regularize provisional tax bases from previous periods are included in accordance with Article 10.3 of the Spanish DST. Though the tax is levied on a transaction-by-transaction basis, it contains the total aggregated amount of tax base for the quarterly period, having to declare the aggregate tax base for each type of service subject to taxation. Thus, a self-assessment can contain provisional, definitive, or regularized tax bases.

lack of knowledge of the true amount of the tax base; provided that the regularization is performed within the tax period in which the amount becomes known. Consequently, the taxpayer shall not be subject to the surcharge with the regularization of the provisional self-assessments filed provided that the following conditions are met: (i) the amount of the taxable base was not known with certainty; (ii) for the determination of the provisional taxable base, well-founded criteria have been applied as required by the Spanish DST; and (iii) the regularization is carried out within the settlement period in which the final amount of the taxable base is known. Thus, if the three conditions are met, the surcharge should not be applied to the regularization of the provisional self-assessment, due to force majeure, since the taxpayer will have acted with diligence.[106] In other words, the conduct of the taxpayer is not reproachable. Nevertheless, if any of the three conditions are not met, a surcharge will be applied.

In relation late payment interest, the Spanish DGT resolution on the DST determines that late payment interest must be accrued with the adjustment of the provisional tax base, justifying its compensatory nature in accordance with the Spanish Constitutional Court ruling of April 26, 1990 (judgment 76/1990), which is partially quoted in the resolution. However, this criterion of the Spanish DGT can be contested for the following reasons.

First, interest on late payment has a compensatory nature, but also has a dissuasive function,[107] since Article 26.6 of the Spanish GTA defines it as the legal interest on money plus an increase of 25%, unless modified by the General State Budget Act.[108] Thus, if the only purpose of the late payment interest was to compensate the time difference between the accrual of the tax and the payment of the tax liability in favor of the Treasury (or the refund in favor of the taxpayer), it would be more appropriate that the compensation for the late payment of the tax be set in accordance with the legal interest (and not in accordance with the late payment interest) as established

[106] According to the Spanish DGT resolution on the DST, if the three conditions are met, the non-application of the surcharge is justified due to force majeure reasons as the true amount of the tax base could not be known.

[107] This dual purpose (compensatory and dissuasive) of late payment interest is recognized in the Spanish Constitutional Court ruling of April 26, 1990 (judgment 76/1990), which the Spanish DGT partially quotes in order to justify its reasoning.

[108] In addition, Article 26.6 of the Spanish GTA establishes some exceptions in which the increase of 25% is not applied, but among these regularizations are not included.

under Article 1,108 of the Spanish Civil Code as compensation for delays in the payment of monetary amounts (Pérez Merino, 2023). The General State Budget Act for 2023 set the legal interest rate at 3.25%, and the late payment interest rate at 4.0625%.[109] As a result, if the late payment interest rate is applied instead of the legal interest rate, the regularization of the self-assessment in the year 2023 would be taxed at 0.8125% more than what corresponds to the taxpayer for the temporary delay. This is clearly a coercive and dissuasive measure. Consequently, it seems illogical that the Spanish DGT considers the surcharges not applicable for being of a coercive and dissuasive nature, but it separates from this criterion in the case of late payment interest that is seen as having both a compensatory and a dissuasive purpose. In all, the Spanish DGT has not provided a convincing justification on why it only focuses on the compensatory purpose of the late payment interest.

Second, and in agreement with Pérez Merino (2023), provided that the regularization is carried out in the tax period in which the amount becomes known by the taxpayer, no compensation should be established in favor of the Treasury, not even on the basis of the legal interest rate.

The purpose of the compensation is to remunerate for the fact that the taxpayer has disposed of an amount of money during a period of time that did not correspond to them (i.e. an unjust enrichment), but this reality does not occur in the regulation of the tax. In the case of the regularization foreseen in Article 10.3, a correction of the revenue received by the taxpayer is performed through a second self-assessment to adjust it to the new reality. That is to say, once the taxpayer receives revenue higher than that provisionally declared, it pays the Treasury. The taxpayer does not possess this monetary amount during the period of time that elapses from the provisional declaration of the amount until the regularization is performed, being therefore impossible for the taxpayer to capitalize this amount, so there is no enrichment. Thus, there is no reason to establish any compensation in favor of the Treasury for the regularizations carried out under Article 10.3 that involve an increase in the tax liability since there is no unjust enrichment on behalf of the taxpayer.

[109] Forty-second additional provision of the Act 31/2022, of December 23, of the State Budget Act for year 2023.

On the other hand, a different situation is if the taxpayer declares as a provisional amount a higher amount than what it finally perceives. In this case, the taxpayer should be compensated with the legal interest rate (and not with the late payment interest rate) because the Treasury will have an amount higher than the due amount during the period from the provisional self-assessment and the regularization, causing unjust enrichment on behalf of the Treasury (Pérez Merino, 2023).

However, if the regularization is performed under Article 10.4 of the Spanish DST Act for having incorrectly determine the tax base, late payment interest should apply (López Pombo & Bastida Peydro, 2021; Pérez Merino 2023): In favor of the Treasury if the result is an amount to be paid (i.e. initially less was paid by the taxpayer than was owed), or in favor of the taxpayer if the result is an amount to be refunded (i.e. initially more was paid by the taxpayer than was owed).

Penalties are excluded under any of the regularizations carried out under both sections of Article 10 for non-payment of the tax debt since it would be a voluntary regularization with no prior requirement of the STA.

2.12. Tax rate and tax liability

Article 11 of the Spanish DST Act establishes that the tax will be levied at a rate of 3%,[110] and Article 12 indicates that the tax liability will be the result of applying the tax rate to the tax base.

The Third Final Regulation of the Spanish DST Act establishes that the tax rate can be modified through the yearly State Budget Act. In the event that an international agreement is reached to eliminate the Spanish DST, the tax rate could be lowered to zero. So, in practice there would be no need to file this tax and it would not be necessary to derogate the act that governs it. By not derogating the law, the autonomous regions would not be able to enact a similar tax and the Spanish legislature would be able to reintroduce it if deemed necessary (López Pombo & Bastida Peydro, 2021).

[110] The 3% tax rate was also the tax rate established under Article 8 the DST Directive Proposal. The French and Italian DSTs also applied a 3% tax rate (Garcia Prats, 2022).

To this extent, among the proposed amendments that were not passed by the Senate, one included the possibility of establishing a tax rate of 2%, and a safe harbor with a tax exemption for entities with losses as well as lower tax rates for entities with a low profit margin.[111]

Nevertheless, 3% is a low tax rate as it is taxing gross revenues. Though it could be reduced to benefit taxpayers, it is a policy option that seems coherent and does not pose any potential infringements (Belda Reig, 2021). It also must be pointed out that Article 8 of the DST Directive Proposal also establishes a 3% tax rate. That being said, in Chapter 5 the possibility of introducing a tax exemption for entities with losses will be examined.

Finally, it is appropriate to mention that the Spanish DST Act remains silent on whether it could be deductible from the Spanish CIT, contrary to what the DST Directive Proposal suggests.[112] In this regard, recital 27 of the DST Directive Proposal Preamble establishes that:

> “In order to alleviate possible cases of double taxation where the same revenues are subject to the corporate income tax and DST, it is expected that Member States will allow businesses to deduct the DST paid as a cost from the corporate income tax base in their territory, irrespective of whether both taxes are paid in the same Member State or in different ones.”

In Spain, all expenses related to business activity are effectively deductible unless the Spanish CIT Act states otherwise. Considering that the Spanish DST does not fall under any of the excluded expenses listed in Article 15 of the Spanish CIT Act, it is safe to say that its tax liability is deductible under the Spanish CIT. Though it seems clear, a Spanish DGT binding resolution on this relevant issue would definitely provide legal certainty.

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[111] Proposed amendments to the Spanish DST, see: Spanish Congress (2020, May 13). *Enmiendas e índice de enmiendas al articulado. 121/000001 Proyecto de Ley del Impuesto sobre Determinados Servicios Digitales.*

[112] This is done to avoid providing further arguments to classify the DST as a direct tax. Macarro Osuna (2020) considers that if the legislature would have included such deduction on the tax liability of the CIT, it would implicitly be accepting that it is a direct tax as it creates a double taxation situation with the CIT (a direct tax) as double taxation can only occur between taxes of the same nature, and consequently, there would be no further discussion on whether the DST is a direct or an indirect tax. The nature of the tax will be examined in Chapter 3.

Finally, although it is a statement without legal effect, the Commission calls for the responsible behavior of companies not to pass on the economic effects of the DST to consumers.[113] However, as will be discussed further along, this indeed does not happen.[114]

2.13. Formal obligations

Article 13 of the Spanish DST Act defines the formal obligations that must be carried out by the taxpayers of this tax, in addition to the main obligation of filing the tax form and paying the tax debt of the Spanish DST.

These obligations can be divided into two types of formal obligations: (i) those that refer to the identification of the taxpayer, and (ii) those that refer to the documentation that must be kept by the taxpayer.

(i) In relation to the formal obligation that refers to the identification of the taxpayer

First, taxpayers must report all information regarding the start, modification, and cessation of the business activities carried out by the taxpayer in accordance with Article 13.1.a, and request the STA for the registration of the taxpayer in the registry of entities created for the purposes of this tax. As indicated by the Spanish DST Regulation this will be done through form 036, being irrelevant whether the tax residency is in Spain or not. Also, gain or loss of the condition of being a taxpayer of the Spanish DST will have to be communicated as well.

Second, taxpayers ought to request a TIN from the STA in the event that they do not have one in accordance with Article 13.1.b. The request of a Spanish TIN is of great importance as it allows the STA to identify the taxpayer and enables it to carry out transactions with tax consequences in Spain.

[113] EU Commission (2018, March 21). *Questions and Answers on a Fair and Efficient Tax System in the EU for the Digital Single Market.*
[114] Macarro Osuna (2020) qualifies this statement of the Commission as “naïve”.

Third, taxpayers have to appoint a representative for the purposes of compliance with the obligations of the Spanish DST when the taxpayers are not from a EU Member State in accordance with Article 13.1.e.[115]

(ii) In relation to the formal obligation regarding documents that must be kept by the taxpayers

Article 13.1.c indicates that taxpayers must keep the records mentioned under Article 2 of the Spanish DST Regulation that establishes that, for each self-settlement filed, the taxpayers are obliged to keep records for each transaction as well as a descriptive report. In addition, as established under the said Article 2, taxpayers ought to be able to provide this documentation periodically (quarterly) or at the request of the STA. There is no predetermined format for complying with these obligations, although the Spanish DST Regulation establishes the minimum content for the records and the descriptive report.

The records for each transaction refer to all the information needed for calculating the taxable base for each of the covered services as established under Article 3 of the Spanish DST Regulation. In summary, the taxpayer must register the following information for each transaction carried out: (i) the total revenue derived from the covered digital services, including the identification of the customer;[116] and (ii) the number of times the advertising appears on devices (for online advertisement), the number of users that participate in the conclusion of the underlying transaction (for online intermediary services with an underlying transaction), the number of accounts opened during the settlement period in Spain (for online intermediary services without an underlying transaction), or the number of users who have generated transmitted data (data transmission), and depending the type of service, it will be necessary to provide this information for Spain as well as worldwide. In addition, as established

[115] Under Article 13 of the Spanish DST, the taxpayer, or its representative, will have to inform the STA about this appointment.

[116] As pointed out by Pérez Merino (2023) the term “customer” refers to the beneficiary of the digital service, that is who pays for the service; while the user, in accordance with Article 4.9 of the Spanish DST Act is who uses the digital interface (and as a result generates data). Under Article 3.2 of the Spanish DST Regulation, customers will be identified by name and surname, or by company name and, if available, with the identification number for VAT purposes or the domestic TIN. That said, according to the Opinion of the Spanish Council of State of May 5, 2021 on the Spanish DST Regulation, the said regulation should have clarified the difference between “user” and “customer”.

under Article 3.3 of the Spanish DST Regulation, all this information must be registered before the deadline to file the self-assessment of the relevant period.

The purpose of this registry is to provide to the STA with information on the tax amount that has to be allocated in Spain, for the purpose of possible administrative verifications as to whether the calculation of the taxable base in the case of cross-border digital transactions has been carried out by the taxpayer in accordance with Article 10.2 of the Spanish DST Act or not.

The descriptive report, regulated under Article 4 of the Spanish DST Regulation, must contain a detailed description of the methods, algorithms, technologies, and procedures used in order to determine: (i) what services are covered and which ones are exempt, (ii) the localization of each service provided in the territory of application of the tax, (iii) the calculation of the amount of revenue obtained from the covered services, and (iv) what programs, applications, and files have been used to carry out the analysis for each settlement period. In all, the descriptive report must explain the manner in which the information provided in the records of each transaction has been obtained. This will allow the STA to know in the event of a possible verification, whether the data in the register has been obtained using an appropriate technology and, ultimately, know the reliability of the data used to calculate the tax base.

Furthermore, under Article 13.1.f taxpayers are required to keep up to four years[117] the supporting documents of the transactions covered by the tax, and in particular, those means of proof that allow them to identify the place where the taxed digital services were provided.

Likewise, under Article 13.1.g taxpayers need to translate all supporting documents corresponding to the provision of digital services that are provided in the territory of application of the tax into Spanish or into any other official language in Spain when required by the STA.[118]

[117] The four-year period is in accordance with the statute of limitations (Article 66 of the Spanish GTA), though this period could be interrupted under Article 68 of the Spanish GTA.
[118] The other official languages that Article 13.1.g refers to are: Aranese, Basque, Catalan, Galician, and Valencian, since these languages are official in certain regions in accordance with the Spanish Ministry of Territorial Policy, see: Spanish Ministry of Territorial Policy (n.d.). *Lenguas cooficiales en España.*

Finally, one of the greatest challenges faced by the Spanish DST is the difficulty of locating the place where the taxed transactions are carried out since a main characteristic of the digital economy is the absence of physical presence in the provision of the service. As explained in Section 2.8 of this dissertation, the criterion chosen by the legislature to determine the place where the digital service is provided is the location of the device. Thus, the location of the devices is a key element. Consequently, under Article 13.1.h of the Spanish DST Act, together with Article 5.1 of the Spanish DST Regulation, taxpayers must set up the systems, mechanisms, or arrangements necessary to enable the location of user devices in the territory of application of the tax.[119] That said, Article 5.2 of the Spanish DST Regulation establishes the possibility that taxpayers can delegate this obligation to a third party, in which this third party will be the one responsible for providing the user's device location.

Article 7.4 of the Spanish DST Act establishes that it will be assumed that a user's device is located in the place determined by its IP address, unless it can be established that the real location is different by using other means of evidence. Thus, Article 5.3 of the Spanish DST Regulation establishes that the location systems and mechanisms that taxpayers ought to set up should record the IP address of the device, and when other additional data is used, the systems or mechanisms installed must also record all data applied to locate the user's devices. Lastly, Article 5.4 of the Spanish DST Regulation indicates that taxpayers have to keep the information obtained to locate the user's devices for four years, in accordance with the statute of limitations.

In all, the burden imposed on the Spanish DST taxpayers to comply with the obligations of this tax is very high and taxpayers must dedicate a relevant amount of time and resources to comply with them (Hernández Moneo, 2020).[120]

[119] The opinion issued by the Spanish Council of State on the Spanish DST Regulation advises for the provision of more detail on the scope of the obligation contained under Article 13.1.h of the Spanish DST Act considering that the non-compliance of such obligations constitutes a serious infringement, as will be explained further along.

[120] In the opinion issued by the Spanish Council of State on the Spanish DST Regulation, it is stated that this institution has analyzed each one of the formal obligations regarding the Spanish DST and has concluded that all of them are lawful and are not disproportionate in accordance with the purpose they pursue and in view of the characteristics of the tax.

2.14. Tax compliance

Article 14 of the Spanish DST Act establishes that the self-assessments will have to be filed on a quarterly basis in accordance with the Spanish DST Order. This order indicates that the taxpayer must file the corresponding self-assessments through form 490.[121] This form must be filed and the tax debt paid during the month following the corresponding quarterly period of the calendar year. Thus, for the first quarter of the calendar year (January to March) the payment is performed in April; for the second quarter of the calendar year (April to June) the payment is performed in July; for the third quarter of the calendar year (July to September) the payment is performed in October; and for the fourth and final quarter of the calendar year (October to December) the payment is performed in January of the following calendar year.

Moreover, the self-assessment will have to be filed even in those periods in which the taxpayer has not provided any covered digital services as established under Article 3.3 of the Order HAC/590/2021. To this effect, form 490 includes the possibility to check a box named "Negative return (no amount payable)" for those periods in which a taxpayer has not rendered any covered digital services. Not filing form 490, even if no amount is due, could be penalized under Article 198 of the Spanish GTA. Also, Article 4 of the Order HAC/590/2021 establishes that the DST self-assessment must be filed online.

It must be pointed out that the first self-assessment of the Spanish DST had to be filed between July 1, and August 2, 2021, regarding the first and second quarter of 2021 as established by the Order HAC/590/2021[122] since, even though the tax entered into force in January 16, 2021,[123] the tax regulations were not approved until June 8, 2021, and the form to settle the tax was approved a day later, on June 9, 2021. So, even though

[121] Form 490 was approved for the first time through the Order HAC/590/2021. However, as a consequence of the incorporation of the DST to the Basque Economic Agreement, a modification to the form had to be approved in order to adjust it to this agreement. In this sense, as from the second quarter of 2022, the self-assessments had to be filed in accordance with Order HFP/480/2022. Likewise, as a consequence of the incorporation of the DST to the Navarre Economic Agreement, another modification to the form had to be approved in order to adjust it to the agreement. In this sense, as from the third quarter of 2023, the tax settlements must be made in accordance with Order HFP/307/2023. However, the modifications are limited to the approval of a section in the form establishing the parts of the tax liability corresponding to the State and the Historical Territories of the Basque Country and Navarre. The rest remains identical to the initial Order HAC/590/2021.

[122] Sole transitional provision of the Order HAC/590/2021.

[123] Sixth and final provision of the Spanish DST.

the tax was in force, it could not be filed by the taxpayer until the regulation and form 490 were approved.

In addition, it is relevant to point out that though in accordance with the Spanish DST Act the tax entered into force on January 16, 2021, and the first settlement period of the tax started in 2021 in accordance with the Order HAC/590/2021, the Fourth Final Provision of the Spanish DST Act indicates that:

> "During the year 2020, the submission of the self-assessments corresponding to the settlement periods of the second and third quarter, as well as the deposit of the respective tax owed, will not be required, in any case, before 20 December." [Translation by the STA].[124]

The question arises on whether the Spanish DST should have been applicable in 2020, that is, whether it would be applied retroactively to the covered transactions carried out during 2020. Though the legality of this retroactive effect would be questionable,[125] it seems reasonable the explanation provided by Alonso Murillo (2021) who considers that it has no legal effect as the legislature simply forgot to eliminate this provision as there is no doubt that the act that governs this tax finally entered into force in 2021. Possibly when the draft of the act was prepared, it was intended to be in force in 2020. It is also clear that not updating the final draft before its publication in the Spanish State Official Gazette is a mistake since neither the Order HAC/590/2021, nor the Spanish DGT resolution on the DST, nor the STA FAQ has made any reference to the retroactive application of the tax for the year 2020.

Finally, as already mentioned under the Section 2.10 of this dissertation, a difference between the Spanish DST Act and the DST Directive Proposal is that the latter contains under its Article 9.2 the possibility for groups of companies in which various entities are deemed to be taxpayers, to nominate one entity within the group for paying the tax and fulfilling the obligations regarding this tax on behalf of each of the taxpayers in that group that are liable to the DST. Though the Spanish DST Act does

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[124] See: STA (n.d.). *Law 4/2020, of 15 October on the Tax on Certain Digital Services* (Translation by the STA).

[125] Article 10.2 of the Spanish GTA establishes that tax norms will not have a retroactive effect, unless indicated otherwise, and that taxes without a tax period will be levied when the norms that regulate them enter into force.

not contemplate such a possibility, it would have been an interesting option to include as will be argued further along.

2.15. Tax penalties

Regarding the penalty regime, Article 15 of the Spanish DST Act refers to the general regime provided under the Spanish GTA. So, for any infringements that may arise regarding the Spanish DST, for example failure to pay the tax, the applicable penalties will be governed by the provisions of the Spanish GTA.

A specific penalty is provided for the failure to comply with the formal obligation of putting in place the systems, mechanisms, or arrangements to determine the location of the users' devices in the territory of application of the tax. Article 15.2 of the Spanish DST Act indicates that the penalty will consist of a monetary fine of 0.5% of the net turnover of the previous calendar year that the infringement took place with a minimum of €15,000 and a maximum of €400,000 for each year in which the taxpayer failed to comply with this specific formal obligation.

The localization of the user's devices is a key element to determine the tax base. So, it is reasonable that the legislature imposes such a high penalty to ensure that taxpayers effectively put in place the relevant mechanism to be able to localize the user's devices. However, in agreement with López Pombo & Bastida Peydro (2021), it might have been more of a proportional penalty if the legislature had decided to impose the penalty on the revenues rendered from digital services of each non-compliant period rather than on the net turnover of the previous calendar year, since then the penalty would be related only to revenues obtained from digital services.

In addition, the legislature has not specified whether the net turnover refers only to that of the taxpayer or to the net turnover of the whole group. It could be interpreted that since Article 15.2 of the Spanish DST Act refers to Article 8 on taxpayers, the group turnover would be used to calculate the penalty. However, in agreement with López Pombo & Bastida Peydro (2021), since the non-compliance refers only to the taxpayer as it is the taxpayer who has to set up the said mechanisms and systems to comply with its tax obligations, and not the group as a whole, it should be understood that the penalty has to be calculated only on the net turnover of the taxpayer. Though the legislature should have specified this aspect, it should be understood that the proposed interpretation would be the only one consistent with the proportionality principle contained under Article 178 of the Spanish GTA that must inspire the penalty system.

Finally, it must be pointed out that, from a literal interpretation of Article 15.2 of the Spanish DST Act, it is reasonable to understand that the penalty would only be applicable if the taxpayer has not implemented any systems, mechanisms, or arrangements in order to locate the user's devices, as also defended by López Pombo & Bastida Peydro (2021), and Pérez Merino (2023). This would be the only valid interpretation under the legal certainty principle.

2.16. Jurisdiction

Article 16 of the Spanish DST establishes that the contentious-administrative jurisdiction will be the only competent authority to settle disputes that this tax might raise between the taxpayer and the STA once the economic-administrative route has been exhausted.

Though not mentioned in the Spanish DST Act, if there are issues raised between the Spanish DST Act and DTCs, there could be the possibility to initiate a MAP. Also, if issues regarding the EU law or Constitutional law were to be raised, such cases could reach the CJEU or the Spanish Constitutional Court.

2.17. Amendments

The Third Final Regulation of the Spanish DST Act establishes that the State Budget Act can modify certain elements of the tax without the need to expressly modify the act that governs the tax. This has the advantage that, in theory, any amendments would be processed quickly as they would follow the same process as the yearly budget law. That said, the State Budget Act may: (i) Modify the quantitative thresholds that determine the definition of taxpayer; (ii) modify the tax rate; (iii) introduce and modify the regulations to fulfill the obligations derived from EU law; and (iv) modify the events not subject to taxation.

As explained,[126] to delimit the taxable event of the tax, of great relevance are the events not subject to taxation listed under Article 6 of the Spanish DST Act.[127] However, as analyzed, the majority of the events listed under the mentioned article are exemptions rather than events not subject to taxation. The events not subject to taxation refer to events that are already excluded from the definition of taxable event, though the majority of the events listed under Article 6 fall under the definition of the taxable event but are expressly excluded by the legislature from the scope of the tax, thus being exemptions.[128]

In turn, under the Spanish DST Act, the events not subject to taxation can be modified by the State Budget Act. Consequently, and considering the fact that most of the events not subject to taxation established under Article 6 of the Spanish DST Act are indeed exemptions, this implies that the State Budget Act can modify the taxable event. Alonso Murillo (2021) points out that Article 134.7 of the Spanish Constitution, which establishes that the State Budget Act may not create new taxes, could be infringed though the State Budget Act can modify them whenever a tax law allows it.

According to Falcón y Tella (1982), Article 134.7 of the Spanish Constitution has two objectives. On the one hand, it allows the government to adapt the tax regulations to a new reality by means of the budget law for reasons of economic policy, requiring for such modification prior authorization by a law. On the other hand, it prevents the government from creating new taxes through the State Budget Act as it has its own particularities (i.e. among others, a greater role of the executive branch before the legislative branch if compared with the procedure for approval of ordinary laws, the limitation of the right of amendment of the parliamentarians, or the preferential processing). Consequently, a relevant modification of a tax should always be done in accordance with the proceedings for enacting an ordinary law in order to ensure an adequate parliamentary debate on the amendments to the tax (Falcón y Tella, 1982).

[126] See Section 2.7 of this dissertation.
[127] The events listed under Article 6 of the Spanish DST Act abide by the idea that the value creation is not provided by the user, but by the platform.
[128] Articles 6.a and 6.b of the Spanish DST Act that refer to online sales and the underlying transactions of online intermediary services, respectively, could be considered events not subject to taxation as they are excluded from the definition of taxable event. However, the other events listed under Article 6, if they were not expressly excluded by this article, could be reasonable considered to fall under the scope of the tax.

According to Falcón y Tella (1982), Article 134.7 of the Spanish Constitution must be interpreted in a broad sense as it only explicitly prohibits the creation of new taxes by the State Budget Act. As a result, the mentioned author considers that the State Budget Act can modify a tax if enabled to do so, and that modification can be so substantial that could entail the abolition of the tax.[129] In the opinion of Falcón y Tella (1982), Article 134.7 of the Spanish Constitution only prohibits the creation of new taxes, or such substantial modifications that are equivalent to the creation of a new tax, as would be the case of a modification that entails the expansion of the taxable event to new situations, or a modification that results in an extension of the scope of the taxpayers. In this same line of reasoning, Alonso Murillo (2021) considers that if, as a result of an amendment introduced by a State Budget Act, a situation that was initially out of the scope of the tax becomes taxable, it would be contrary to Article 134.7 of the Spanish Constitution, as it could be considered that the modification has in a way entailed the creation of a tax for those new situations that are subject to taxation.

Therefore, a future modification of the Spanish DST Act through a budget law reducing the cases of non-taxable events listed under Article 6 could be deemed unconstitutional to the extent that the taxable event would be expanded, but that would only occur in the case that the modification affects one of the cases that is listed as a non-taxable event though in is in fact an exemption. By contrast, an increase of the events not subject to taxation (or an increase of exemptions) would not infringe Article 134.7 of the Spanish Constitution as the taxable event would be reduced or could even be eliminated.

In all, this section is relevant as this dissertation pursues to propose amendments to the Spanish DST to make it a more appropriate tax in accordance with current legislation.

[129] In accordance with this interpretation of Article 134.7 of the Spanish Constitution provided by Falcon y Tella (1982), the Spanish Constitutional Court in its judgment of July 20, 1981 (judgment 27/1981) considered that the modifications that entail substantial and extensive changes to a tax are not forbidden to be carried out through a budget law. In addition, in its judgment of March 5, 2015 (judgment 44/2015) the Spanish Constitutional Court considered that the limitations provided by the Constitution to a budget law cannot be interpreted expansively.

2.18. Consequences of enacting this tax

This section will take into account the financial consequences for the Spanish Treasury of implementing the tax, but also the consequences for the Spanish economy as well as other potential risks.

2.18.1. Consequences for the Spanish Treasury

According to a report issued by EU Commission on the impact assessment of the DST Directive Proposal, if a DST at a EU level was applied, about €6,000 million could be collected.[130] Based on the information provided in this report, considering the proportion that the Spanish digital market represents in the EU (9.1%), it could be estimated that €546 million could have been collected yearly in Spain from this tax (PWC, 2019). In October 2018, the Spanish Government was expecting the annual tax collection deriving from the Spanish DST to be €1,200 million.[131]

Though the Spanish Government used the Commission's report to come out with this figure, the difference between these two amounts is due to three factors (PWC, 2019): (i) The Spanish DST taxes intragroup transactions while the DST Directive Proposal does not, increasing the amount collected to €728 million; (ii) the amount of the threshold representing the significant digital presence is reduced, increasing the amount collected to €968 million; and (iii) the Spanish Government estimates that the digital market will expand and that would increase the amount collected to €1,200 million.

However, the €1,200 million was contested by the AIReF which, in its report of January 2019, lowered the €1,200 million initially estimated by the Spanish Government to a range between €546 and €968 million[132] since according to AIReF report, the EU Commissions data already contemplated the expected increase of the digital market in 2019. Consequently, in February 2020, the Spanish Government

[130] EU (2018b). *Commission Staff Working Document. Impact Assessment, Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services*, (SWD (2018), 82 final, March 21, 2018).
[131] Spanish Government (2018, October 19). *Impuesto sobre determinados servicios digitales*.
[132] Spanish Data Protection Agency (2003). *Carácter de dato personal de la dirección IP*. Informe 327/2003.

reduced the estimated collection of the Spanish DST to €968 million.[133] Though it could be considered that the Spanish Government was optimistic, and even if this estimation became true, the collection of the Spanish DST would only amount to 0.45% of the overall annual Spanish tax revenue (Escribano, 2021).

The reality was that in fiscal year 2021, the amount that was collected from the Spanish DST according to the STA was of €240 million,[134] far below the amounts initially estimated. This amount represents an average of €60 million per quarter, although it grew from €40 million in the first quarter to €73 million in the fourth quarter, being an indication according to the STA of the initial difficulties in complying with this new tax. Considering that the overall annual collection of the STA in fiscal year 2021 was of €223,385 million, the Spanish DST amounted to about 0.11% of the overall annual collection.[135] According to information provided by the STA, the tax was levied on 216 taxpayers, and it affected 52 groups of companies. Information on whether the taxpayers were domestic or foreign (or foreign-parented) was not provided. Though such detailed information on the Spanish DST does not exist at the time of submission of this dissertation,[136] the 2022 Annual Report on Tax Collection establishes that the amount that was collected from the Spanish DST according to the STA, was of €278 million,[137] while for year 2023 according to the Spanish State Budget, it is estimated that the amount collected will be of €285 million.[138]

2.18.2. Consequences for the Spanish economy

The negative effects of enacting the Spanish DST according to a report performed by PWC (2019) must be mentioned. According to this report, in the short term this tax will cause a negative economic impact on the Spanish GDP estimated at between €586

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[133] Spanish Government (2020, February 18). *Proyecto de ley de los impuestos sobre servicios digitales y sobre transacciones financieras.*

[134] STA (2023, April 15). *Nota informativa 4: El nuevo Impuesto sobre Determinados Servicios Digitales.*

[135] STA (2023, April 1). *Informes Anuales de Recaudación Tributaria - Ejercicio 2021 - Resumen*.

[136] Note that the report of the STA on the Spanish DST regarding the year 2021 was not released until April of 2023.

[137] STA (2023). *Informe Anual de Recaudación Tributaria Año 2022*. It must be pointed out that according to this document the amount that was collected from the Spanish DST for 2021 was of €166 million. However, this is likely a mistake as it does not correspond to the more detailed information provided regarding this tax by the STA.

[138] Spanish Government (2022). *Presupuestos Generales del Estado 2023*.

million to €662 million. The report established that the negative impact would affect especially the main users of digital services who are SMEs, and end consumers.

As explained in by PWC (2019), Spanish companies using the covered digital services will see their profits reduced by between €450 million and €562 million. This will be the result of: (i) the cost increase of using online platforms and marketing due to the enactment of the Spanish DST, and (ii) the reduction in sales due to the foreseeable transfer of part of the price to the end customer.

Also, as indicated by the mentioned report, Spanish consumers will experience a reduction in their welfare due to: (i) an increase in the price of digital products and services, and (ii) the revenue lost from the services and goods that Spanish consumers will stop purchasing. This reduction of welfare has been quantified at between €515 million and €665 million.

This risk of the cost being transferred to consumers and businesses is reasonable taking into account the almost monopolistic nature of the potential taxpayers, and also due to the elasticity of supply and demand (Escribano, 2020) as there are a limited number of companies that provide digital services that some people are dependent on them and have become part of their daily lives. In fact, this risk has already been materialized as in the case of Amazon and Google who in 2021 announced respectively a 3% and a 2% increase in their commissions (Salvatierra, 2021, January 20; Muñoz & Delle Femmine, 2021, March 3), probably due to the enactment of the Spanish DST.

2.18.3. Other potential risks

There is the possibility that the US could start a trade war with Spain and other countries that have enacted DSTs.

Section 301 of the Trade Act provides the US with authority to initiate an investigation and respond to unfair trade practices carried out by a foreign country. As of today, USTR has investigated different DSTs[139] and the final reports identified that due to

[139] The USTR conducted investigations under Section 301 of the Trade Act on the DSTs of the following countries (date of the report in parenthesis): France (December 2, 2019), India (January 6, 2021), Italy (January 6, 2021), Turkey (January 6, 2021), Austria (January 14, 2021), Spain (January 14, 2021), and the UK (January 14, 2021). The USTR also initiated Section 301 investigations of DSTs

the design of the revenue thresholds, these taxes amounted to discriminatory taxation because they had a disproportionate impact on US entities (in the case of the Spanish DST, 64% of the taxpayers are US entities).[140] In addition, the DSTs were qualified by the USTR as unreasonable due to the extraterritorial application to non-residents and against customary international tax law. They were also found to be as disproportional for entities with low profits and for digital service providers due to the ring-fencing scheme of these taxes (Kim, 2021).

In the case of the Spanish DST, in June of 2020, the USTR initiated an investigation into the Spanish DST under Section 301 of the US Trade Act. In January of 2020, the final report was published, and it concluded that this Spanish tax was discriminatory, unreasonable, and restricted US commerce, on the same accounts as the other DSTs.

In response to these findings in March of 2021, the USTR proposed imposing a 25% ad valorem tariff on certain Spanish goods.[141] However, this decision was suspended indefinitely and never came into effect because on October 8, 2021, 136 jurisdictions participating in the OECD/G20 Inclusive Framework on BEPS reached an agreement on a two-pillar solution to address the tax challenges of the digitalization of the economy. Days later, on October 21, 2021, Austria, France, Italy, Spain, the UK, and the US, issued a joint statement in which the European countries in that group undertook a compromise to withdraw their respective unilateral digital services taxes once the OECD Pillar One took effect.[142] This agreement led the US to terminate the proposed trade actions and to commit to not imposing any further trade actions against the mentioned European countries. On the other hand, the European countries within that group agreed that the amount of the DST levied to a company during the negotiation period of Pillar One will be able to be deducted from the amount that the entity has to pay in the future for amount A of Pillar One. This negotiation period, also referred to as the "interim period" for the purposes of this joint statement, begins

regarding Brazil, Czech Republic, European Union, and Indonesia, but terminated them on March 31, 2021, as these jurisdictions had not enacted nor implemented the DSTs during the period in which the investigation took place. See: Office of the USTR (n.d.). *Section 301 – Digital Services Taxes*.

[140] For example, in the case of the French DST 2/3 of the taxpayers are US entities; in the case of the Italian DST 62% of the taxpayers are US entities.

[141] See: Office of the USTR (2021, March 31). *Proposed Action in Section 301 Investigation of Spain's Digital Services Tax,* 86 Fed. Reg. 16813.

[142] OECD (2021). *Joint statement from Austria, France, Italy, Spain, the United Kingdom, and the United States regarding a compromise on a transitional approach to existing unilateral measures during the interim period before pillar 1 is in effect.*

on January 1, 2022 and ends on either the date the Pillar One comes into force, or on December 31, 2023, whichever comes earlier.

This tax credit is not calculated directly as the amount paid by an entity as DST during the negotiation period of Pillar One, but rather will be the result of the calculation method established in the joint statement. This calculation method consists of: (i) calculating the "Interim Pillar One Amount" that is, the result of multiplying (a) the amount of tax that is owed by the taxpayer as a result of Pillar One Amount A during the first year that Pillar One is in effect; by (b) a fraction, the numerator of which is the number of days during which the DST was in force during the interim period (years 2022 and 2023), and the denominator of which is 365 (i.e. number of days in a year); (ii) the "Interim Pillar One Amount" subtracted from the amounts of DST paid by the taxpayer during the interim period, being the difference the tax credit in favor of the taxpayer; (iii) this tax credit will be compensated with the amount to be paid of Amount A of the first full year of the implementation of Pillar One; (iv) if the amounts of DST paid by the taxpayer exceed the amount to be paid of Amount A of the first full year of the implementation of Pillar One, such excess will be creditable against the portion of the CIT liability attributed to Amount A during the following fiscal years until the taxpayer has used the entire amount of this tax credit.

It can be concluded that the intention of this agreement is that taxpayers will be able to deduct the amounts paid of DSTs during the negotiations of Pillar One from the amount that the entity has to pay in the future for Amount A of Pillar One. The DSTs could be seen as an advance payment of Amount A of Pillar One in the domestic CIT. However, two issues arise in relation to this agreement.

First, instead of calculating the "Interim Pillar One Amount" as done by the agreement, it seems more reasonable to have allowed for a total compensation between the amounts of DSTs paid and the future Amount A of Pillar One. That is to say, the tax credit should be the amount of DSTs paid by the taxpayers during 2022 and 2023.

Second, it seems appropriate to recall that the object of the DSTs and of Pillar One are not the same, nor is the determination of the taxpayer. In the case of the DSTs, the taxable event is the provision of certain digital services (online advertising services, online intermediary services, and data transmission). However, Pillar One is not a tax but rather a set of new tax allocation rules that are complementary to the current residence criterion based on the idea that a portion of multinationals' residual profit, likely to be generated by intangibles, should be taxed in the jurisdiction where revenue is sourced. Thus, it attributes taxing powers to the source states, being irrelevant if an entity provides digital services or not. On the other hand, the taxpayers of the DSTs are the entities with a net turnover of more than €750 million and with revenues from digital services of more than €3 million. The supplementary Pillar One taxation criterion will apply to all companies, not digital companies alone, with a net turnover greater than €20 billion and with profitability greater than 10%.

Not all entities that fall under the scope of Pillar One will have been taxpayers of the DSTs previously, since this tax is limited to entities that provide certain digital services, as opposed to Pillar One that covers all MNEs regardless of the economic activity they provide. Also, there will be taxpayers of the DSTs who will be out of the scope of Pillar One, such as entities providing a covered digital service whose net turnover is between €750 million and €20 billion or which have a profitability that is not greater than 10%. Though these entities will not be able to compensate what they have paid on the DSTs, they will end up having a more advantageous situation since they will no longer have to pay the DST as the implementation of Pillar One implies the derogation of the DSTs, and neither the new tax allocating rules of Pillar One will affect them.

It can be concluded that the delimitation of the application of Pillar One to all large MNEs regardless of their economic activity highlights the inadequacy of Pillar One as a tool to correct the shortcomings of the current international tax system in a digitalized economy. Although most of the companies that provide digital services are MNEs, this does not seem to be a sufficient reason for why the response to the lack of taxation of digital services providers in the source states should be solved by taxing all large MNEs regardless of the type of economic activity they carry out.

In July 2023, foreseeing that the works on Pillar One were behind schedule and more time was needed to discuss technical details, 138 out of the 143 jurisdictions negotiating Pillar One released a statement agreeing to extend the current standstill on enacting new DSTs (in place until the end of 2023) through 2024, and potentially through 2025 as well, if at least 30 jurisdictions accounting for at least 60% of the ultimate parent of in-scope MNEs signed the MLC before the end of 2023.[143] In addition, in October 2023 the OECD released the draft of the "Multilateral Convention to Implement Amount A of Pillar One" that includes in its Annex A a list of specific measures that must be removed for all businesses as part of the implementation of Amount A, including the DSTs enacted by Austria, France, Italy, Spain, Tunisia, Turkey, and the UK, as well as India's equalization levies on e-commerce and online advertisement services.[144]

The MLC provides for the removal of DST as well as relevant similar measures and outlines criteria to prevent the enactment of such tax measures in the future. The countries that do not agree to remove their domestic DSTs forfeit their right of allocation of Amount A in the period that DSTs are in force. The MLC draft also sets the criteria to identify future DSTs and relevant similar tax measures: first, the tax measure is applied by reference to market-based criteria such as the location of the users; second, the measure is applied solely to non-resident entities or foreign owned entities (this criterion can potentially allow the existence of DSTs); and third, the tax measure must fall out of the scope of DTCs.[145]

It is reasonable to believe that under this context, Austria, France, Italy, Spain, the UK, and the US, will agree to extend the effects of the joint statement of October of 2021 through 2024 (or potentially through 2025) as work on the technical details of Pillar One is needed.

Another avenue that the US could follow is to submit a complaint before the WTO based on the idea that the Spanish DST discriminates against US or US parented entities. The WTO offers the possibility for Member State governments to resolve trade controversies. The downside is that the WTO's resolution process can be long-lasting since a decision from the Appellate Body could take up to two years or more (Károlyi, 2022).

[143] OECD (2023a). *Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy.*
[144] OECD (2023b). *Multilateral Convention to Implement Amount A of Pillar One*, p. 91.
[145] OECD (2023b). *Multilateral Convention to Implement Amount A of Pillar One*, p. 77.

In all, it seems unreasonable that, given the advancements done at an OECD level to update the current tax system to nowadays, the US would file a complaint before the WTO or even start a trade war against the countries that have enacted a DST. This is the reason why this dissertation does not provide for an analysis regarding the DSTs with WTO law, though some authors such as Haslehner (2019), Pinto Nogueira (2019), and Károlyi (2022) have carried out such an analysis.

Another impending risk is that, as will analyzed throughout this dissertation, taxpayers might want to challenge the self-assessments paid as they might consider the tax to be unlawful on different grounds. If that is the case and the courts uphold the taxpayers' claims, the STA will have to refund them and, in that foreseeable scenario, taxpayers could initiate claims on the liability of the State as legislature for beaches of the law in the event the Spanish DST is deemed to be unconstitutional by the Spanish Constitutional Court, or contrary to EU law by the CJEU.

2.19. Conclusions

This chapter has provided an exhaustive description of the Spanish DST. Much of the description has been based on a comparison between the Spanish DST and the DST Directive Proposal which was developed by the European Commission and upon which the Spanish DST was modeled.

Some controversial issues raised by the Spanish DST have been discussed. One issue is that the Preamble of the act that governs this tax considers that it does not fall under the scope of DTCs. Secondly, the fact that a turnover threshold of €750 million has been established could raise discrimination issues as it will reasonably affect mostly foreign (or foreign-parented) entities. Another potential issue that has been identified is that the tax will be levied regardless of whether the taxpayer has profits or losses. All of these controversial issues, as well as others, will be analyzed in the following chapters.

A key point covered in this chapter has been a description of how the digital services covered by the Spanish DST (online advertising services, online intermediary services, and data transmission services) are in line with the goal of the tax, which is to tax digital services in which the user plays a crucial rule. Yet, it could be argued that the role played by the users (i.e. data provision) may carry less relevance if compared to the role of the taxpayers that provide such service (i.e. development of a digital platform which allows for data collection) because the actual value generated by each of the players involved is very difficult to quantify precisely.

Consequently, the methods for calculating the tax base are complex and require the taxpayer to gather vast amounts of information. The large quantity of information places a limit on the capacity of the STA to cross-check the data provided by the taxpayer.

Nevertheless, the methods established to calculate the tax base seem to be coherent as there is a certain degree of correlation between the value that the users generate in Spain and the amount levied by the Spanish DST. In other words, the calculation method of the tax base under the Spanish DST can be seen as consistent with the tax policy principle of taxing value where it is created as it taxes revenues where the users are located.

Truth be told that even if it is considered that the taxpayers are the ones that generate the most value, in theory, the high quantitative threshold that determines who a taxpayer is together with the low tax rate of the Spanish DST leave plenty of room for other states to tax these entities' revenue. However, it could constitute a problem of its own the fact of whether these other states with power to tax these entities through their domestic CIT, meaning the taxpayer's state of residence, coincide or not with the place where the most relevant value is created for the business. Though an interesting dilemma, an analysis of this issue falls beyond the scope of this dissertation.

Overall, the Spanish DST presents some compelling avenues, but it also poses some risks to the rule of law that this dissertation will deeply analyze and propose to solve. The fact is that the OECD Two Pillar solution intends to create a new income tax system that will affect some MNEs instead of focusing on transforming the international tax system in accordance with long-standing rules that have proven to work over many years (Barnes & Rosenbloom, 2020). As explained by these authors, gross-basis taxes on certain streams of income are the traditional way in which states have collected taxes on payments from non-residents. Consequently, DSTs might, after all, be the way to go to tackle the taxation challenges of the digital economy.

After having described the Spanish DST in detail, assessing the tax, and highlighting the potential challenges it faces, the following chapter will address the first hypothesis which calls to analyze whether the Spanish DST falls under the scope of DTCs. This will be the first of the three chapters which address the hypotheses drawn as described in Chapter 1.

CHAPTER 3: THE COMPATIBILITY OF THE SPANISH DST WITH DTCs

3.1. Introduction

In this chapter, it will be discussed whether the Spanish DST falls within the scope of the DTCs. This is of special importance since this tax should have a limited application if it falls within the scope of the DTCs signed by Spain.

First, the nature of the Spanish DST will be discussed, and arguments will be set fourth which may challenge current considerations (Section 3.2). This is relevant because once the nature of the tax is defined, it will have to be determined whether or not the nature of the tax is relevant for establishing whether it falls within the scope of DTCs. In addition, the nature of a tax is a consideration used to determine a main characteristic of the tax that could have an effect on its legality, separately from whether it falls under the scope of DTCs.[146] Then DTCs will be discussed, and an analysis will be done to determine whether the Spanish DST could fall under the scope of DTCs and thereby represent or not an infringement on tax treaty law (Section 3.3). After that, the chapter will briefly refer to the debate on whether DSTs are creditable under US law. Finally, conclusions will be drawn (Section 3.4).

3.2. The nature of the Spanish DST

The nature of a tax is a descriptive aspect of the tax and is an aspect which could be relevant in determining whether or not the tax infringes on law.[147] A tax can be of a *direct* or an *indirect* nature. The distinction between direct and indirect taxes has unclear boundaries. Academics have theoretically established two different perspectives in order to discern between direct and indirect taxes depending on whether the classification is done from an economic perspective or from a legal perspective (Sainz de Bujanda, 1987).

[146] As indicated by the Committee of experts that drafted the Libro Blanco sobre la Reforma Tributaria (2022), even though the Spanish DST Act defines the DST as a tax of an indirect nature, it is not clear whether the Spanish DST has a direct or an indirect nature, nor even its compatibility with the DTC. In this sense, García-Herrera Blanco (2019), Bahía Almansa (2020), and Sánchez Archidona Hidalgo (2020), all a agree that the nature of the Spanish DST has been a largely debated issue among academics.

[147] According to Egea Pérez-Carasa (2020), double taxation only occurs when revenue is taxed by two or more taxes of the same nature.

From an economic perspective, direct taxes are those levied on income or wealth as these are direct indicators of economic capacity; while indirect taxes are those levied on consumption or economic traffic which are indirect indicators of economic capacity (Sainz de Bujanda, 1987). From a legal perspective, a tax of a direct nature is paid directly to the authorities by an individual or entity onto whom the tax burden directly falls, such as in the case of an income tax or a wealth tax. A tax of an indirect nature is one which is levied on an entity, but the cost of which must be passed on to the consumer or user of a good or service as part of the purchase price, such as VAT or excise taxes (Sainz de Bujanda, 1987).[148]

In practice, taxes can be found that are to be considered as indirect taxes according to the economic perspective but not according to the legal perspective. As a matter of example, the Spanish Property Transfer Tax (in Spanish, *Impuesto sobre Transmisiones Patrimoniales Onersosas*) is levied on the transfer of property and rights, but no mechanism to transfer the tax burden is contemplated since the taxpayer is set to be the acquirer of the property or the right.

One strategy to eliminate the ambiguity of the nature of some taxes is to establish a criterion by which the ability to pay is taken into consideration (Ismer & Jescheck, 2018). From this new perspective, the main difference between a direct tax and an indirect tax is that direct taxes focus on the economic capacity of the recipient of the revenue, and not on the payer of the revenue, while the aim of indirect taxes is to tax the ability to pay of the payer of the revenue and the specific transaction. Consequently, the Spanish Property Transfer Tax is considered as an indirect tax even though there is no mechanism to transfer the tax burden, and, in fact, it is more like a wealth tax than a consumption tax (De la Torre, 2023).

3.2.1. The Spanish DST as an indirect tax

The European Commission in the DST Directive Proposal and the Spanish lawmakers in the Spanish DST Act have made it very clear that they believed that these taxes have an indirect nature.

[148] Pérez de Ayala (1989) concludes that direct taxes affect supply prices of production activities, while indirect taxes affect demand prices or, in other words, the costs for the consumer.

At a EU level, measures to harmonize domestic tax systems can be adopted either based on Article 113 of the TFEU in the case of indirect taxes, or based on Article 115 of the TFEU in the case of direct taxes (Károlyi, 2022). Article 113 TFUE establishes that:

> "The Council shall, […], adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition."

Accordingly, Article 113 of the TFEU is the appropriate legal basis for the harmonization of turnover taxes, excise duties, and other forms of indirect taxation. It is clear that the expression "other forms of indirect taxation" is implying that, at the time this provision was drafted, the lawmakers only considered indirect types of turnover taxes (Károlyi, 2022). In any case, the Commission has relied on Article 113 of the TFEU as the legal basis for the DST Directive Proposal, meaning it considers the DST, a turnover tax, as a tax of an indirect nature, or at least not a direct tax.

At the Spanish level, Article 1 of the Act that regulates the Spanish DST defines the tax as indirect, and does so in the following terms:

> "The Tax on Certain Digital Services is an indirect tax placed on, in the manner and conditions provided in this Law, the provision of certain digital services in which there is intervention by users located in the territory of application of said tax." [Translation by the STA][149]

In addition, the Spanish legislature defends that the Spanish DST is an indirect tax in the Preamble of the Act that regulates it as it does not take into account the ability of the taxpayer to pay since it is not a tax which is based on the taxpayer's wealth or income. Section III of the Preamble of the Spanish DST Act establishes:

> "By focusing on the services provided, without taking into account the characteristics of the provider, including their economic capacity, the Tax on Certain Digital Services is not a tax on income or wealth, and therefore is not

[149] See: STA (n.d.). *Law 4/2020, of 15 October on the Tax on Certain Digital Services* (Translation by the STA).

> covered by the double taxation agreements, as established in the reiterated Interim Report of the G20/OECD on the taxation challenges derived from digitization. It is configured, therefore, as an indirect tax, which is otherwise compatible with the Value Added Tax." [Translation by the STA][150]

It is clear that the DSTs are meant to be considered as an indirect tax in order to fall out of the scope of DTCs that cover direct taxes on income and wealth (Macarro Osuna, 2020). The intention of the lawmakers is that to state or to treat DSTs as indirect taxes automatically excludes them from the possibility that they could be considered an income tax and, therefore, keeps them out of the scope of DTCs.

Nevertheless, although the DSTs are classified as an indirect tax on both a EU level as well as a Spanish level, it does not comply with the legal approach of this classification since no mechanism is established to legally pass the tax burden from the digital services providers to its users. The Commission in the *Question and Answers* document published on the proposals for taxing the digital economy it stated that consumers should not bear the cost of these tax measures.[151] It is clear that the intention of the Commission is that the providers of the digital services are the ones who have to bear the tax burden.

Based on the above, there are strong arguments to consider the DSTs to be a turnover tax of a direct nature. This position is supported by the analysis of the EU Council Legal Service regarding the DST Directive Proposal (Haslehner, 2019). The analysis identified three characteristics of indirect taxes for the for the purposes of Article 113 of the TFEU, as explained by the mentioned author: (i) The tax is imposed on transactions (i.e. on consumption, production or transfer of ownership), (ii) it does not have a direct connection to the taxpayers' overall ability to pay; and (iii) its design presupposes that the taxpayer and the person who actually bears the tax are different.

The latter characteristic is clearly not met in the case of the DSTs since no mechanism is found in the tax design which would imply that the purpose of the lawmakers was that the taxpayer would transfer the tax burden to the user. Moreover, the possibility

[150] See: STA (n.d.). *Law 4/2020, of 15 October on the Tax on Certain Digital Services* (Translation by the STA).
[151] EU Commission (2018, March 21). *Questions and Answers on a Fair and Efficient Tax System in the EU for the Digital Single Market*.

that the estimated tax burden might be passed on to the user in the form of an increase in prices of the services covered by the tax is irrelevant as will be seen in an analysis of the *Promociones Oliva Park* case.

3.2.2. *Promociones Oliva Park* case

Though the distinction between direct and indirect taxes can be seen as theoretical, there are important practical consequences of classifying a tax as direct or indirect. The theoretical differentiation between direct and indirect taxes is not simple when brought to practice as illustrated by the judgment issued in the *Promociones Oliva Park* (C-220/19) case.[152]

The CJEU issued its judgment on March 3, 2021, in the *Promociones Oliva Park* case on the compliance with EU law of the IVPEE (in Spanish, *Impuesto sobre el Valor de la Producción de Energía Eléctrica*) in reply to a request for a preliminary ruling from the High Court of Justice of Valencia. In this judgment, the CJEU states that the IVPEE is not an indirect tax. Therefore, as a direct tax according to the CJEU, the IVPEE cannot infringe the Directive 2008/118/EC of December 16, 2008, on the general system of excise duty that allows EU Member States to enforce indirect taxes on products, under certain conditions, upon which a harmonized tax has already been levied. So, the conclusion of the CJEU is that the IVPEE does not infringe EU law.

Previous to the judgment, in determining the true nature of the IVPEE as either a direct or as an indirect tax, the High Court of Justice of Valencia had considered that there were indicators that the IVPEE was an indirect tax. Arguments to consider the IVPEE as an indirect tax would be: (i) The possibility for the taxpayer to pass the tax burden on to the final consumer, (ii) the use of revenue obtained by the taxpayer in the determination of the tax base, and (iii) the use of a uniformed fixed tax rate.

However, the CJEU concluded that the IVPEE could not be classified as an indirect tax for two reasons. Firstly, the Act that regulates the IVPEE does not include any mechanism to legally pass the tax on to the consumer as in the VAT, and the fact that the taxpayer can transfer the tax cost by means of increasing the price to the final consumer is not considered relevant. Secondly, the IVPEE takes into account the

[152] The following two sections are based on a preliminary commentary of the *Promociones Oliva Park* ruling from the CJEU written by Pownall Montoya (2021, April 26).

status of the taxpayer as a producer of electricity. The taxable base of this tax is determined from the revenue obtained by the taxpayer through the service provided. It does not consider the quantity of electricity effectively produced and incorporated into the electrical grid. In other words, there is no direct link between the IVPEE and the consumption of electricity, rather only the value of its production.[153] It is interesting to point out that Rozas Valdés (2016) had classified the IVPEE as a direct tax with the same arguments later used by the CJEU in the referred judgment.

3.2.3. The Spanish DST in light of the *Promociones Oliva Park* case

This judgment of the CJEU on the *Promociones Oliva Park* case could shed some light onto the ongoing debate on the nature of the DST. Although Spanish lawmakers classify the DST as an indirect tax, the two arguments used by the CJEU to consider that the IVPEE is not a tax of an indirect nature may also be applied to argue the direct nature of the DST.

First, neither the DST Act nor the act that governs the IVPEE include any mechanism to legally pass the tax on to the consumer. As pointed out, this characteristic, according to the CJEU, is relevant to consider the direct nature of a tax.

Second, it might be argued that both the DST and the IVPEE consider the status of the taxpayer. The IVPEE considers the taxpayer as a producer of electricity while the DST establishes that the taxpayers are providers of certain types of digital services. Where the IVPEE determines a tax base drawn from revenue obtained from the provision of a service, the DST considers certain thresholds based on the taxpayer's turnover and revenue from the provision of certain kinds of digital services to determine whether it could be considered to be a taxpayer. This feature could be interpreted as an indication that the DST is focused on the economic capacity of entities that provide certain types of digital services. In other words, this could be a defining element that could lead to identify it as a direct tax. As demonstrated by the *Promociones Oliva Park* case, an important element used to determine the direct

[153] In paragraph 43 of the ruling on the *Promociones Oliva Park* case, the CJEU establishes: "As a preliminary point, it should be noted that the IVPEE is classified, in the Preamble to Act 15/2012, as a direct tax on 'the activities of producing and incorporating electricity into the electricity system', namely the 'economic capacity of producers of electricity'."

nature of a tax is, according to the CJEU, whether that tax considers the status of the taxpayer.

However, the second key factor in this case, in regards to the fact that the IVPEE considers the status of the taxpayer, cannot be applied in the case of the Spanish DST. The Spanish DST turnover threshold cannot be seen as an element designed to take into account the economic situation of the taxpayer. It is not used to measure the ability of the taxpayer to pay rather it is an element designed to facilitate the identification of the taxpayers in accordance with the purpose of the tax, which is to tax large digital service providers that provide services in which the user's contributions are key to the value creation process of the entity.

Nevertheless, the judgment of the CJEU on the *Promociones Oliva Park* case regarding the IVPEE offers a precedent by which the real nature of the DST may be reconsidered because there is no mechanism to legally pass the tax on to the consumer.

3.2.4. Further considerations on the true nature of the DST

As described in the judgment of the CJEU on the IVPEE, and as can be reviewed in the judgment of the CJEU of January 18, 2017, on the *IRCCS - Fondazione Santa Lucia* case (C-189/15), among other case-law cited in paragraph 29 of the latter judgment,[154] the CJEU considers that the nature of a tax must be determined by a Court under EU law in accordance with the objective characteristics by which a tax is levied but without considering the classification given under domestic law. For example, in determining the judgment of the *Promociones Oliva Park* case, the court based its ruling on characteristics such as the lack of a mechanism to legally pass the tax on to the consumer, and the status of the taxpayer, but not on the domestic classification of the tax.

Also, it is relevant to bear in mind that the Spanish Constitutional Court has developed a jurisprudential doctrine based on the principle of the irrelevance of *nomen iuris*, in cases in which the lawmakers have used incorrect terms. For example, in the judgment of the Spanish Constitutional Court of May 19, 2011 (judgment 73/2011), or of

[154] CJEU judgments of June 24, 2010, C-338/08 and C-339/08, *P. Ferrero e C. and General Beverage Europe*, para. 25; and of December 12, 2006, C-446/04, *Test Claimants in the FII Group Litigation*, para. 107.

November 10, 1994 (judgment 296/1994), this Court estimates that in order to analyze the true nature of a tax, the legal denominations used by the lawmakers in the regulation that governs a tax are irrelevant.

Pérez Merino (2023) has concluded that the Spanish DST is an excise tax whose object of taxation is the provision of certain digital services in which there is a monetization of user's data; thus, it is not a generic tax on revenue but an excise tax. As pointed out by the mentioned author, an excise tax is an indirect tax in accordance with the Spanish Excise Taxes Act.[155] However, the approval of an excise tax requires the existence of a non-financial purpose (e.g. addressing the social costs of certain consumption, protecting the environment, discouraging specific activities considered harmful to the public interest, etc.) different from the collection purpose (Calvo Ortega & Calvo Vérgez, 2022). According to Pérez Merino (2023), the reason that justifies the approval of this special tax lies in the need to respond to the tax challenges of digital economy, and in particular, to compensate for the lack of taxation of digital entities in the territory where digital services are provided. In a similar line of thinking, Belda Reig (2021) also concludes that the Spanish DST is an excise tax and considers that it serves as an economic disincentive to curtail the massive collection of personal data by digital service providers. However, Gómez Fuster (2021) considers that the Spanish DST cannot be considered as an excise tax as the act that governs it does not contemplate any legal mechanism to pass on the tax to the user. In addition, the Spanish DST Act does not make any reference to classify the tax as an excise tax.

Bahía Almansa (2021) sustains that the Spanish DST is also an indirect tax because it taxes an indirect manifestation of economic capacity that is the monetization of user's data by digital providers in accordance with the revenues obtained from certain digital services. That is to say, the Spanish DST is meant to tax each transaction considering the economic capacity in an indirect manner, being this a characteristic of indirect taxes. Though the DST has been approved as a measure to adapt the Spanish tax system to the new digital reality in order to compensate for the lack of direct taxation of digital companies making this tax seen as a complementary tax to the CIT and the

[155] Article 1.1 of Act 38/1992, of December 28, on Excise Taxes establishes that excise taxes are taxes of an indirect nature levied on specific forms of consumption (in Spanish, *Ley 38/1992, de 28 de diciembre, de Impuestos Especiales*).

non-resident income tax, it may actually appear to have a greater similarity to an indirect tax than to a direct tax from this point of view.

Though it can be argued that the Spanish DST presents characteristics to define it as an indirect tax, the fact that the act that governs the tax does not contemplate the legal mechanism to pass on the tax to the consumer is key to classify it as a direct tax in accordance with Macarro Osuna (2020), Sanchez-Archidona Hidalgo (2020), and Banacloche Palao (2021).

However, as pointed out by García Herrera-Blanco (2019), the clear line that once distinguished between direct and indirect taxes is no longer valid as can be seen with the Spanish DST.[156] Consequently, the lack of a perfect fit for the Spanish DST tax in one of the two categories means that it can be classified as a hybrid tax, as defended by Egea Pérez-Carasa (2020).

3.2.5. Interim conclusions

As seen, the Spanish DST presents a hybrid nature as it shares characteristics of both direct and indirect taxes. Though it is classified as an indirect tax by the act that governs it, it could be considered as a direct tax as well. As discussed, the judgment of the CJEU on the *Promociones Oliva Park* case on the IVPEE appears to provide a strong argument to question the indirect nature of the Spanish DST since the tax does not include a legal mechanism to transfer the tax burden to the users.

While the discussion up until this point has centered on the direct and indirect nature of the tax in order to determine whether or not the Spanish lawmakers have used the right term to describe it, the following section will discuss whether the Spanish DST as a direct tax, or as a tax of a hybrid nature, falls under the scope of the DTCs.

3.3. The Spanish DST under the scope of DTCs

DTCs regulate the allocation of taxing rights for preventing and providing against double taxation (Pistone & Ullman, 2021). The OECD MTC[157] is a model tax treaty that is designed with the goal of allocating taxing rights between countries in cross-

[156] Casado Ollero (1981) already expressed the problem of the lack of an adequate criterion to distinguish between a direct and an indirect tax.
[157] OECD (2019). *Model Tax Convention on Income and on Capital 2017.*

border situations to avoid double taxation of income and wealth taxes and is used as a reference by which DTCs are drawn up.[158] It is important to note that in the commentaries of paragraph 1 of Article 2 of the OECD MTC, it is explained that the term “direct taxes” is considered imprecise. Therefore, the terms “direct tax” or “indirect tax” are not used to consider what taxes fall under the scope of the DTCs (Lang, 2005). Consequently, by expressly including that the Spanish DST is an indirect tax, it does not automatically exclude it from the scope of Article 2 of the OECD MTC since it is not relevant for the purposes of this provision.

Article 2 of the OECD MTC identifies the taxes that fall under the scope of DTCs and consists of four sections: Article 2(1) defines the scope of application of the DTC by stating that the DTC will apply to taxes on income and on capital; Article 2(2) provides for criteria to identify these taxes; Article 2(3) contains a list of taxes which fall under the scope of the DTC; and Article 2(4) establishes that the DTC will apply to identical or substantially similar taxes that go into force after the date of signature of the DTC.

Each paragraph of Article 2 of the OECD MTC will now be addressed in more detail.

Article 2(1) of the OECD MTC establishes that: “This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.”

This clause sets the limits of the DTCs to taxes levied on income and on capital. Contracting states only have the obligation to limit the exercise of their taxing powers and to give relief in cross-border situation regarding these boundaries. Such obligation is applicable to national and sub-national taxes. This provision also confirms that it is irrelevant how covered taxes are levied. Thus, gross and net taxes can fall under the scope of DTCs, as well as taxes levied by means of withholding (Pistone & Ullman, 2021).

The first paragraph of Article 2 provides for an introductory clause as it defines the scope of this provision that is subject to the definition of taxes levied on income and

[158] The definition of “OECD MTC” is based on the OECD’s Glossary of Tax Terms, see: https://www.oecd.org/ctp/glossaryoftaxterms.htm#T.

on capital found under Article 2(2). The second paragraph of Article 2 reads as follows:

> "There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation."

This clause provides for an autonomous definition of taxes levied on income and on capital in the sense that there is no need to refer to domestic law to interpret what these terms mean for the purposes of this provision. It includes a complete list of all types of taxes possible that could fall within the scope of DTCs and establishes that it is irrelevant whether the tax applies to the entire income or capital or to their elements. Furthermore, taxes levied on capital gains, payroll taxes, and capital appreciation taxes are expressly included in the definition. Consequently, these three categories of taxes also fall within the scope of DTCs as they are to be considered as taxes on income or on capital for the purposes of DTCs. This is an indicator of the predisposition of the drafters to broaden the scope of DTCs (Ismer & Blank, 2018; Cui, 2019a; Pistone & Ullman, 2021).

Article 2(3) contains a list of the taxes existing in each state at the time of conclusion of the DTC to which the treaty should apply. The Commentary on Article 2 states that the objective of the list is to illustrate the generic definition contained under paragraphs 1 and 2.[159] However, the list is also considered by the Commentaries to be as non-exhaustive.[160] Though these two statements seem to be contradictory, the fact is that they are not, especially taking into account the wording of paragraph 3 that establishes the following: "The existing taxes to which the Convention shall apply are in particular: […]". The use of the expression "in particular" ensures the declaratory purpose of the list while allowing for additional taxes to also be covered by the DTC. Ultimately, as pointed out by Pistone & Ullman (2021), the generic definition

[159] OECD MTC, Commentary on Article 2 para. 6.
[160] OECD MTC, Commentary on Article 2 para. 6.

provided under paragraphs 1 and 2 would be unnecessary in the event the list needed to be exhaustive.

Finally, Article 2(4) provides a clause that allows the list contained in paragraph 3 to be updated without having to amend the DTC every time a new tax is created. To this end, paragraph 4 establishes that the DTC will apply to "identical or substantially similar taxes" to the taxes already covered by the DTC. Article 2(4) reads as follows:

> "The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws."

It is challenging to interpret when this condition is met. As mentioned by Pasquale & Ullman (2021), the reference made to "existing taxes" drives the interpretation of this paragraph to the taxes listed in Article 2(3) but without undermining the general definition of covered taxes under Articles 2(1) and 2(2). Finally, in order to ensure the effective compliance of this provision, it is relevant to highlight that paragraph 4 establishes the obligation for the contracting states to notify each other of any relevant changes in their respective tax laws.

According to what it has been presented, there are two possible ways to conclude that a newly enacted tax falls within the scope of an existing DTC: First, it is a tax on income or on capital under Article 2(1) and 2(2); or second, it is an "identical or substantially similar" to a tax already covered by the DTC.

The next step of the analysis to determine whether the Spanish DST falls under the scope of DTCs must consist in establishing whether this tax can be considered as a tax on income or on capital within the meaning of Article 2 since, as explained, technically, under the OECD MTC, only taxes on income or on capital can fall within the scope of a DTC.

Before moving on to the following section, it must be stated that the Spanish DST cannot be regarded as a tax on capital. The taxable event of capital tax is the ownership of assets while the taxable event in the case of the Spanish DST is the provision of certain services. Thus, the Spanish DST does not relate in any way to the assets owned by the taxpayer. However, a more detailed analysis is required in order to conclude whether the Spanish DST is a tax on income or not.

3.3.1. Article 2 of the OECD MTC and the Spanish DST

This dissertation will now analyze how the Spanish DST relates to Article 2 of the OECD MTC addressing, in first place, the issue of whether the Spanish DST is a tax on income, and, in second place, the issue of whether the Spanish DST is an identical or substantially similar tax to another tax covered by the DTCs. If it is concluded that the Spanish DST is either a tax on income or is an identical or substantially similar tax to a tax covered by the DTCs, then this will imply that the tax falls under the scope of the DTCs.

3.3.1.1. Identifying *income* under DTCs

No definition of income is provided in the OCDE MTC. The academic literature has recognized the need for a definition of the term and has attempted to fill this gap (Wheeler, 2012; Macarro Osuna, 2020).[161]

Furthermore Article 3(2) of the OECD MTC, which regulates the rule of interpretation, indicates that if a term is not defined in the convention, it should be interpreted in accordance with domestic law unless the situation requires otherwise. Therefore, under Article 3(2) a definition of *income* as used in Articles 2(1) and 2(2) should be interpreted according to domestic law.

However, as defended by Lang (2005), Articles 2(1) and 2(2) of the OECD MTC cannot be interpreted considering domestic law as Article 2(3) refers directly to domestic law by offering a list of taxes that fall under the scope of the DTC. Otherwise, according to Lang (2005), there would be no need for Articles 2(1) and 2(2).

In contrast, Cui (2019a) considers that when interpreting the meaning of income, domestic law and domestic case-law must be taken into account so it can be correctly interpreted in accordance with the context of the DTCs. As pointed out by Pistone &

[161] For further information on the concept of *income* in tax policy, see Thuronyi (1990).

Ullman (2021) a definition provided by domestic law would refer to the determination of the tax base, while the purpose of the OECD MTC is to determine the taxing rights. Therefore, the definition of *income* could vary since domestic law and the OECD MTC pursue different purposes, and this is why the term has to be interpreted autonomously, without considering domestic law (Kotha, 2021).

These authors suggest that since the interpretation of Article 2 of the OECD MTC should not consider domestic law, a broad interpretation must be made of the term *income*. However, Cui (2019a) advises against a broad interpretation of the definition of income as it makes it difficult for countries to adopt taxes that do not fall under the scope of the DTCs, limiting governments' taxing powers.

A broad interpretation could have implications on the consideration of the Spanish DST, as this is a tax applicable to the revenue from the supply of certain digital services, yet not to the taxpayer's total income. The Spanish DST may qualify as an income tax covered by the DTC under Article 2 of the OECD MTC as will be explained.

It is beyond the scope of this dissertation to provide a definition of income applicable to DTCs. However, it becomes necessary to establish a criterion to distinguish taxes on income, or on elements of income, from other taxes.[162]

3.3.1.1.1. Income, turnover, and the Spanish DST

Ismer & Jescheck (2017) conclude that the main difference between an income tax and a turnover tax is that income taxes focus on the economic capacity of the recipient of the revenue (the provider of the service), and not on the payer of the revenue (the consumer of the service), while the aim of turnover taxes is to tax the economic capacity of the payer of the revenue and the specific transaction.

Academics have often defended that the DST is a turnover tax, and that it, therefore, does not fall within the scope of DTCs (O'Shea, 2018; Cui, 2019a; Hohenwarter et al. 2019; Kofler & Sinnig, 2019; Simmonds, 2019; Sartori, 2021). However, the wording of Article 2 defines the scope of a DTC solely in a non-exclusive manner and does not

[162] See Martín Jiménez (2005) for more information on the interpretation of Article 2 of the OECD MTC.

expressly exclude any specific types of taxes and nothing in Article 2 nor its Commentaries excludes turnover taxes from DTCs. The Commentary on Article 2 also does not exclude any specific types of taxes although it does clarify that social security and similar charges that entitle the payer to receive certain benefits do not fall under the scope of the DTCs. These charges must be excluded in any case, since they do not fit in the definition of the term "tax" used by the OECD MTC (Pistone & Ullmann, 2021). Nevertheless, the Spanish DST will only fall within the scope of DTCs if it is considered to be a tax on income, or an identical or substantially similar to a covered tax.

3.3.1.1.2. OECD Interim report and the Spanish DST

It is relevant to mention that the OECD Interim Report (2018) takes into account the scope of Article 2 of the OECD MTC. To establish the background of this report, it should be noted that in the Final Report on Action 1 of the BEPS Plan, the OECD raised the possibility of introducing an *equalization levy* in view of the lack of consensus on how to address the challenges of the digital economy.[163] Due to the interest of certain countries in adopting taxes on digital services, the OECD published the OECD Interim Report (2018) that establishes minimum standards that should be taken into consideration by lawmakers when drafting laws that would govern these types of taxes.

To this end, paragraph 417 of the OECD Interim Report (2018) established that income taxes have a direct link with the taxpayer, keeping in line with the differentiation between income and turnover taxes established by Ismer & Jescheck (2017). Nevertheless, paragraph 420 of the OECD Interim Report (2018) establishes that:

> "The mere fact that the tax may be collected from the supplier and that there is a threshold that must be met before a person is required to register and account for the tax will not generally be sufficient to bring the tax within the scope of the Convention."

[163] OECD (2015). *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, para. 302.

In addition, it must be borne in mind that in paragraph 418 of the OECD Interim Report (2018), it is stated that it is indifferent whether the tax is on a net or a gross amount when determining if a tax is covered under Article 2.

Also, according to the OECD Interim Report (2018), a tax on digital services that does not fall under the scope of a DTC would have to meet the following three characteristics:

> "(i) levied on the supply of a certain defined category or categories of e-services and imposed on the parties to the supply without reference to the particular economic or tax position of the supplier; (ii) charged at a fixed rate, calculated by reference to the consideration paid for those services (without reference to the net income of the supplier or the income from the supply); and (iii) not creditable or eligible for any other type of relief against income tax imposed on the same payment." [OECD Interim Report (2018). para. 421].

It is clear that the Spanish DST follows closely the design features establish by the OECD Interim Report (2018) in order to avoid falling under the scope of Article 2 of the OECD MTC. Following the reasoning of Hohenwarter, Kofler, Mayr & Sinnig (2019) with regards to the DST Directive Proposal, it can be concluded that though the turnover thresholds used in the Spanish DST may be viewed as referring to the economic situation of the service providers, the fact is these are set with the objective to simplify the identification of the taxpayers and the application of the tax, and not to take into account the ability to pay of the taxpayers.

Hohenwarter, Kofler, Mayr & Sinnig (2019) also consider that the DST is not a tax on income and therefore falls out of the scope of application of Article 2 of the OECD MTC since it has the following characteristics: (i) The taxable amount is based on turnover (revenue); (ii) no deductible expenses are allowed; (iii) the taxpayer's profit or loss is not taken into account; (iv) the taxpayer's profit margin is not taken into account; (v) it cannot be deducted from the payment of foreign or domestic income tax; (vi) and it applies without discrimination to cross-border or domestic services. After analyzing the features of the DST, Hohenwarter, Kofler, Mayr & Sinnig (2019) conclude that it resembles a tax on transactions or on turnover, but not an income tax, especially considering that it has absolutely no connection with the CIT as seen. In addition, Pérez Merino (2023) points out that: (i) the tax is accrued in each single transaction; (ii) the objective is to tax revenue of the value created by users in relation to certain services while income taxes focus on taxing profits; and (iii) the DSTs tax only specific services while income taxes tax profits as a whole.

There is no point in denying that the DST meets the characteristics defined by the above-mentioned authors although the first four characteristics listed by Hohenwarter, Kofler, Mayr & Sinnig (2019) could be contested by defending that the DST uses a low tax rate compared to corporate taxes as a corrective mechanism since the DST taxes gross revenue while the CIT taxes net income (Turina, 2018).

Nevertheless, the DST taxes revenue, which is an element of income (Simmonds, 2019); it could be argued that, to a certain extent, it considers the economic capacity of the provider of the services to determine whether it is a taxpayer or not; and the act that governs the tax does not include any mechanism to legally pass the tax cost to the consumers being a tax on the supplier.

To summarize, the most relevant element which can be used to determine that the Spanish DST is similar to an income tax is that the act that governs the tax does not establish any mechanism to legally pass the tax to the consumer. Other elements which can be used to identify the Spanish DST as a turnover tax include that it does not take into account the specific ability to pay of the taxpayer, it does not allow the deductibility of all expenses, it does not have a connection with the CIT as it is only deductible as a business expense, it is accrued in each single transaction, and it taxes revenue of very specific services.

Drawing from these observations, it can be concluded that the Spanish DST is a hybrid tax containing elements which are similar to income taxes and others that are more likely to be found in a turnover tax. Thus, an analysis of the Spanish DST in the light of Article 2 of the OECD MTC is not a straightforward exercise.

3.3.1.2. A tax of a hybrid nature and its implications for the DTCs

The fundamental question, therefore, will be to determine whether the existence of a tax of a hybrid nature that presents elements which are characteristic of income taxes and, at the same time, others particular to turnover taxes can be considered, in whole or in part, as an income tax for the purposes of the DTCs.

To address this question, it is necessary to consider the conclusions drawn by AG Kokott in the *Vodafone* case (C-75/18) regarding the Hungarian telecommunications tax.[164]

3.3.1.2.1. Conclusions of AG Kokott on the *Vodafone* case

As stated by AG Kokott, the *Vodafone* case could be relevant for possible DSTs cases.[165] This case raises the question of whether a tax on a company's revenue in accordance with its turnover should be considered a turnover tax or if it could be qualified as a direct income tax.

By way of summary, the Hungarian special tax is levied on the provision of electronic communication services, taxing its providers whether they are resident or non-resident. The Hungarian tax is also levied on store retail trade as well as supply of energy. As set forth in the Preamble of the act that governs the Hungarian special tax, the aim of this tax is described as follows: "In the context of the adjustment of the budgetary balance, the Parliament introduces this law on the establishment of a special tax imposed on taxpayers whose capacity to bear public burdens surpasses the general obligation to pay tax."[166]

Therefore, it is clear from the Preamble that this tax targets large corporations, as is the case of the Spanish DST. The taxable amount of the Hungarian special tax is calculated from the turnover of the taxable undertakings. The tax rates are progressive in accordance with the turnover, with an initial tax rate of 0%.

AG Kokott considers that a direct tax may be levied not only on profit, but also on turnover and that the turnover obtained is, therefore, also an indicator of the economic capacity of an entity as there is a relation between profits and turnover, as high profits are not possible without a high turnover:

[164] For more information on the *Vodafone* case, see Mason & Parada (2020).
[165] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 1.
[166] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 7.

> “In the present case, however, an *indirect* connection between the annual turnover generated and financial capacity is certainly identifiable. As I have already stated in my Opinion in Hervis Sport, the level of turnover can certainly represent a standardizing indicator of taxable capacity. This is suggested, first, by the fact that high profits are not actually possible without high turnover and, second, by the fact that as a rule the profit from additional turnover (marginal profit) increases with falling fixed unit costs. It would therefore appear by no means unreasonable to regard turnover, as a reflection of an undertaking’s size or market position and potential profits, also as a reflection of its financial capacity and to tax it on that basis.” (Opinion of AG Kokott, case C-75/18, *Vodafone Magyarország*, para. 121).

In all, AG Kokott states that:

> “The intention is therefore to tax the particular financial capacity of those undertakings and not the financial capacity of recipients of telecommunications services. The Hungarian special tax is similar in this regard to a special (direct) corporate tax for certain undertakings, in this case telecommunications undertakings.” (Opinion of AG Kokott, case C-75/18, *Vodafone Magyarország*, para. 35).

The arguments given by AG Kokott can be used to defend that the Spanish DST is a direct tax levied on the revenues generated by specific services. Thus, it can be considered a direct tax or a tax on income, since it is levied on the provider of the service while considering the provider’s economic capacity measured by means of thresholds.

AG Kokott has considered turnover as an indicator of the ability to pay. As explained by Pistone & Ullman (2021), this does not mean that taxes on turnover are taxes on profits; however, it does not preclude the idea that a tax on turnover cannot be a tax on (gross) income.

3.3.1.2.2. The Spanish DST as a tax on the use of data

Although, from a literal interpretation of Article 2 of the OECD MTC, it could be understood that the Spanish DST is not a tax on income, in a broad interpretation, it could be interpreted that a tax based on revenue could fall under the scope of the DTCs when considering that the main purpose of the tax is to target corporations with a specific level of turnover and to correct the shortcomings of the CIT in a digitalized economy. However, as argued earlier in this chapter, the use of the thresholds in the case of the Spanish DST, has to be seen as administrative parameters to identify the taxpayers rather than as means to consider the economic situation of the taxpayers. It is believed that if the Spanish DST included tax brackets with different tax rates in its design as done by the Hungarian tax referred to in the above-mentioned case, then it could be defended that this tax does take into account the ability to pay of the taxpayer.

The DST is a tax on the revenue generated from the supply of certain digital services. This characteristic highlights that the transactions of the services covered are relevant while the income obtained from these transactions is less relevant. In fact, it shows that the revenue operates more as a proxy of value creation than of income (Pistone & Ullman, 2021). According to Sartori (2021), the DSTs are taxes on the use of personal data and, therefore, cannot be regarded as a tax on income. Consequently, this author reasonably concludes the revenue (turnover) obtained from the covered services is what constitutes the taxable base and that represents the quantification of the value created by the use of the personal data gathered from the users. In other words, the DSTs tax the value created, and thus such revenue cannot be seen as an element of income.

In addition, and as explained by Simmonds (2019), the fact that the DSTs do not allow the deduction of expenses makes this a relevant indicator that it cannot be an income tax. She supports this idea based on a Hungarian Supreme Court case in which the scope of the covered taxes under the DTC signed between Germany and Hungary was examined in regards to a local business tax levied in Hungary. The court considered that since the tax was levied on net turnover with limited deductions, as compared to income tax where all expenses are deductible, it could not be considered as an income tax since it was levied on the provision of goods and not on the income received from such provision. Thus, though the contested tax resembled a direct tax on turnover, it could not be deemed as an income tax, and consequently was ruled out of the scope of the DTC between Germany and Hungary.[167]

Also as pointed out by Simmonds (2019), the same tax was the object of the ruling by the CJEU in the *KÖGÁZ and Others* case (joined cases C-283/06 and C-312/06) in which its compatibility under the VAT Directive was being analyzed. The CJEU ruled that even if this local business tax was a tax on production, its burden was not passed on to consumers. Consequently, it could not be considered as an indirect tax. This example shows the difficulty in drawing the borders between income taxes and turnover taxes.

After this analysis, it can be concluded that there are more convincing arguments to consider the Spanish DST not to be a tax on income.[168] Though Article 2 of the OECD MTC provides for a broad interpretation to cover a tax on revenue, it is unclear that the Spanish DST would be considered as a tax on income since it is a tax on the use of personal data, it is doubtful that it takes into account the specific ability to pay of the taxpayer, it does not allow the deductibility of all expenses, and does not have connection with the CIT as, technically, it is only deductible as a business expense.

3.3.1.3. Identifying an *identical or substantially similar tax* under DTCs

Once the term *income* has been interpreted from the perspective of Article 2(1) and 2(2), the issue of whether the Spanish DST is an *identical or substantially similar tax* to another tax covered by the DTCs from the perspective of Article 2(4) must be addressed.

As pointed out by Ismer & Jescheck (2018), neither the OECD MTC nor the Commentaries provide any guidelines to understand when a tax should be considered to be identical or substantially similar. However, Schuch & Lan (2021) conclude that the taxes listed under Article 2(3) are the benchmark to use when determining what "substantially similar" means.

[167] Hungarian Supreme Court, September 4, 2008, Case Kfv.I.35.103/2008/4, Case-Law IBFD.
[168] It is a contested issue among academics whether the Spanish DST is a tax on income or not. In favor of considering the Spanish DST as a tax on income are Macarro Osuna (2020), Sánchez-Archidona Hidalgo (2020), and Fúster Gómez (2021). Contrary to this position are García-Herrera Blanco (2019), and Pistone & Ullman (2021).

In theory, DTCs should explicitly list the taxes of both contracting states that fall within the scope of the treaty, and such covered taxes normally qualify under the generic definition found in Article 2(1) and 2(2). Sometimes the list of covered taxes includes a tax that neither qualifies as a tax on income nor as a tax on capital (Pasquale & Ullmann, 2021). As examples, these authors mention the DTC signed between the UK and the US that covers the British petroleum revenue tax, and the DTC signed between France and the UK, as well as the DTC signed between France and Honk Kong which cover social security charges, and the DTC signed between Italy and the US (1999) that lists the Italian Regional Tax on Productive Activities which is a tax on turnover (Simmonds, 2019).

These taxes are covered by the DTC since they are expressly named under the list found in Article 2(3). Consequently, including a non-income tax to the list can extend the scope of the DTC beyond that specific tax due to Article 2(4). This provision uses a similarity test to determine whether a newly enacted tax is covered by the DTC based on the list of taxes contained under Article 2(3), as it will be explained. Thus, if the treaty negotiators of the contracting states include a non-income tax in the list of Article 2(3), any tax that is substantially similar, as determined by a similarity test, must be considered to fall under the scope of the DTC.

3.3.1.3.1. The similarity test

The term "substantially" under Article 2(4) refers to the fact that the taxes that can be introduced after the conclusion of the treaties must be similar in substance to the taxes listed under Article 2(3) (Pistone & Ullman, 2021). Consequently, considering that the tax object and the calculation of the tax base can be defined as the essential characteristics of a tax (Ismer & Blank, 2015), these would be the main elements that would have to be analyzed when performing the similarity test. Thus, neither the name given to the tax nor its formal configuration should be deemed as decisive for this assessment (Brandstetter, 2011).

It must also be analyzed if the collection method of a tax should be considered relevant for the purposes of Article 2(4). As explained, Article 2(1) expressly establishes that the DTC covers taxes on income and on capital being irrelevant the manner in which they are levied or collected. Article 2(4) does not make any express reference to the collection method. Nevertheless, there is no doubt that the basis for conducting the similarity assessment is the list of taxes contained under Article 2(3). As mentioned in paragraph 6 of the OECD Commentaries on Article 2, the essential purpose of the list of Article 2(3) is to illustrate the general definition of taxes covered found in Article 2(1) and 2(2). In consequence, Article 2(4) must be read considering Article 2(1) and 2(2). Taking into account the relation between these provisions, it can be stated that the method of collection must be disregarded when performing the similarity test under Article 2(4) (Pistone & Ullmann, 2021).

Another issue with the similarity assessment is in relation to the list of taxes covered under Article 2(3) in which the treaty negotiators of both contracting states list individually the taxes they deemed covered. Under Article 2(4), the doubt arises whether the similarity of a newly enacted tax has to be analyzed based upon both lists or only based on the list of the state that enacted the new tax.

There are strong arguments to conclude that both lists must be used as benchmarks for the similarity assessment. Article 2(4) simply uses the expression "existing taxes" not distinguishing between the lists of the contracting states. This interpretation is corroborated by the purpose of the provision which is to avoid that the DTC becomes obsolete due to potential subsequent reforms in domestic tax law (Pistone & Ullmann, 2021). In situations in which a given tax exists in one contracting state but not in the other, the inclusion of this tax in the list of Article 2(3) could be seen as evidence that the treaty negotiators would have included a similar tax in the other contracting state list as well in the event that such a tax had existed at the time of the conclusion of the treaty (Lang, 2005).

A similar view was used by the Federal Court of Australia to decide on the *Undershaft* cases.[169] The court considered that Australian capital gains tax was covered by the DTC signed between Australia and the UK although the tax was enacted after the conclusion of the treaty and was not like any other Australian taxes (Pistone & Ullmann, 2021). Nevertheless, the court held the Australian tax was covered by the DTC as it argued that it was substantially similar to the UK capital gains tax and to

[169] Federal Court of Australia, February 3, 2009, *Undershaft (No 1) Ltd v Commissioner of Taxation* and *Undershaft (No 2) BV v Commissioner of Taxation*, Case-Law IBFD.

the UK CIT, both taxes explicitly listed under the tax treaty (Pistone & Ullmann, 2021).

3.3.1.3.2. Case-by-case analysis

It is not possible to provide a generic answer to whether the Spanish DST is a substantially similar tax since the outcome of the similarity test depends on the taxes listed in the particular DTC. As concluded by Pistone & Ullman (2021), DSTs could fall under the scope of Article 2(4) of the OECD MTC only if the contracting states have a tax listed under Article 2(3) that has similar characteristics to the DSTs. It is essential to take into account its taxable object, its purpose, and also the calculation of the tax base to determine if a tax presents similar characteristics to the listed taxes for the purposes of Article 2(4) of the OECD MTC (Shaheen, 2018). However, as pointed out by Pistone & Ullman (2021), it seems unlikely that DTCs will include taxes similar to the DST given its unique characteristics. Therefore, the issue of whether the Spanish DST is substantially similar to any tax covered by the DTC of reference is left for the courts to decide on a case-by-case scenario.

3.3.1.3.3. Mutual Agreement Procedure

It must be pointed out that under Article 25(3) of the OECD MTC, contracting states could resolve doubts on the interpretation of a DTC by initiating a MAP,[170] but there is no obligation to do so.[171] To have the certainty that the contracting states would reach an agreement on how to interpret a DTC and to avoid legal uncertainty on how a court would resolve this type of situation, Ismer & Jescheck (2017) propose to introduce a clause in Article 2(4) of the OECD MTC under which contracting states would be forced to initiate a MAP to decide whether new taxes would be covered by the relevant DTC.

In all, it can be concluded that better arguments speak for considering the Spanish DST to be out of the scope of DTCs as it cannot be regarded as a tax on income. That said, it is not far-fetched that a court might rule that the Spanish DST is indeed covered

[170] Ribes Ribes (2003) and Serrano Antón (2011) have deeply analyzed the MAP.
[171] According to Macarro Osuna (2020), the taxpayers who consider that they have suffered from an incorrect application of a DTC, would have the possibility to go to international arbitration to settle the case.

by DTCs. Thus, the next section will analyze the potential consequences of such outcome.

3.3.1.4. The effects of considering the Spanish DST covered by Article 2 OECD MTC

Whether DSTs should be considered as income taxes for the purposes of Article 2 is a controversial issue. An affirmative response to this issue would be to cover DSTs in DTCs. Consequently, these taxes would have a very limited applicability. This has been a contentious topic among academics who have expressed different views. For instance, authors such as Macarro Osuna (2020), and Stevanato (2020) believe that DSTs are covered by DTCs, while others such as Hohenwarter, Kofler, Mayr & Sinnig (2019), Pistone & Ullman (2021), and Sartori (2021) consider that they are not.

There are two types of DTCs signed by Spain. Each type has a different version of Article 2 of the DTCs that define taxes covered by these treaties: (i) those that follow the OECD MTC such as the DTCs signed with China, Germany, Ireland, Luxembourg, Sweden, and The Netherlands, and (ii) those that do not follow exactly the same structure of the OECD MTC, such as the DTCs signed with the US, or South Korea.

Hence, when Article 2 of a DTC signed by Spain contains all of the four sections of Article 2 of the OECD MTC, it is reasonable to defend that the DST could be included under the scope of this DTC despite its formal configuration as an indirect tax taking into account the purpose for which it was introduced (that is, to supplement the CIT), and the defining elements that could lead to identify it as a tax on income (that is, a tax that considers the economic capacity of the provider of the service). This conclusion is in line with Egea Pérez-Carasa (2020) and with Macarro Osuna (2020).

Nonetheless, certain DTCs, such as the DTC signed with the US, do not contain sections one and two of Article 2 of the OECD MTC, but they do include sections three and four of the referred Article. Hence, since Article 2 of this DTC does not specifically state that the taxes on income and on capital fall under the scope of this DTC, the conclusion reached above could change since Article 2 establishes a list of taxes covered by the DTC (exclusively the personal income tax and the CIT) in accordance with Article 2(3) of the OECD MTC, and the adaptation clause in accordance with Article 2(4) of the OECD MTC.

Although the Spanish DST could be considered as a tax on income, it might be challenging to assert that the Spanish DST is an identical or a similar tax to the CIT in the terms described in Article 2(2) of the DTC signed with the US (or that it would be the equivalent to Article 2(4) of the OECD MTC), as discussed earlier.

With this in mind, it is reasonable to say that it could be challenging to justify that the Spanish DST is covered by the DTC signed with the US. This same interpretation is also reached by Egea Pérez-Carasa (2020) and by Macarro Osuna (2020).

As described in Mason & Parada (2020), the DST targets mainly US companies. As of today, the STA has not provided the nationality of companies that are affected by this tax. However, the USTR report on the Spanish DST has identified that:

> "In the course of this investigation, 39 companies, or company groups, were identified as likely to be subject to Spain's DST, meeting both threshold and covered services requirements. Of those companies, 25 were U.S. companies, two were Spanish companies, and the remaining 12 were from other countries." (p. 9).

As explained in Mason & Parada (2020), US companies that are targeted by digital taxes normally operate in Europe through at least one subsidiary. Therefore, if the provider of the digital service is a tax resident of a country that has ratified a DTC that follows the OECD MTC, though it may be a US-parented company, this digital service provider would be entitled to benefit from that DTC, overcoming the issues raised in Article 2 of the DTC signed between Spain and the US. In those cases, the applicable DTC would be the one of the European entity that provides the services to users located in Spain. For example, in a situation in which an Irish subsidiary of a US company renders digital services that fall under the scope of the DST to users located in Spain, the applicable DTC will be the one signed between Spain and Ireland, which includes the four sections of Article 2 of the OECD MTC.

One might conclude that if the Spanish DST is qualified as a tax on income, it should be covered by the DTCs ratified by Spain that contain the four sections of Article 2 of the OECD MTC.

3.3.2. Article 7 of the OECD MTC and the Spanish DST

It is clear that the reason for the Spanish lawmakers to describe the DST as an indirect tax is to exclude this tax from the scope of application of the DTCs that mostly cover taxes on income and capital, that is, taxes of a direct nature. After all, if the Spanish DST is considered to be a tax on income, then this tax should fall under the scope of the DTCs signed by Spain that contain the four sections of Article 2 of the OECD MTC, and the entities that would be potential taxpayers of this tax would be able to apply the tax benefits incorporated in the applicable DTC.

Of special importance to this matter is Article 7 of the OECD MTC as it regulates taxation rights in relation to business profits (Sánchez-Archidona Hidalgo, 2020). The supply of services is normally covered by the allocation rule on business profits under this article (Pistone & Ullman, 2021). This provision establishes that business profits obtained by a non-resident entity in a foreign jurisdiction can be taxed in this jurisdiction under the condition that the non-resident entity has a permanent establishment there. Specifically, Article 7(1) of the OECD MTC establishes that:

> "Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State."

Article 7 of the OECD MTC establishes the distributive tax rule on business profits that covers the provision of services. Therefore, under this article the source state can only tax profits that are attributable to a permanent establishment situated in its territory, while the resident state has the primary taxing right. Due to the nature of the services covered by the Spanish DST, these can be provided mostly remotely without the need of a permanent establishment. So, if the taxable person does not have a permanent establishment in the source state, that country has no taxing right. Thus, imposing a tax in these situations would infringe the DTC (Pistone & Ullman, 2021).

Therefore, not considering Spanish tax resident entities, it is reasonable to believe that the implication of defining the DST as a tax that falls under the scope of DTCs is that the Spanish DST would only be able to tax digital service providers that: (i) are tax residents in countries that have signed a DTC with Spain and that have a permanent establishment in Spain that renders the services subject to the Spanish DST to users located in Spain, or (ii) are tax residents in countries that have not signed a DTC with Spain and provide covered digital services to users located in Spain.[172]

It is important to have in mind that the idea behind the DST is to tax digital businesses that do not require a physical presence (Pistone & Ullman, 2021). So, the bottom line is that if the DST is considered to be a tax that falls under the scope of the DTCs, this tax will not be levied under those situations for which it was intended. Overall, the Spanish DST would be of a very limited application.

Finally, reference should be made to the Preamble of the Spanish DST that specifically establishes that the Spanish DST has the following objective: "a unilateral solution that allows Spain to immediately exercise taxation rights that legitimately correspond to it in its territory, as this is where the data and user contributions that generate value for the company come from."

As explained in this section, this justification to exercise taxation rights described by the Spanish legislature is not in line with Article 7 of the OECD MTC. Consequently, imposing a covered tax based on this line of reasoning would infringe DTCs. It could, therefore, be considered as a treaty override as the Spanish DST Act would establish taxing powers infringing DTCs (Macarro Osuna, 2020).

3.3.3. Relief for double taxation

Article 23 of the OECD MTC establishes the methods to eliminate double taxation. However, as explained above, if it is considered that the Spanish DST falls within the scope of a DTC, the levying of this tax would infringe the DTC under Article 7. Thus, Article 23 would not even have to be applied as it would be considered that Spain has no taxing rights over the revenue that the Spanish DST taxes.

In the event that it is considered that the Spanish DST does not fall under the scope of DTCs, the relief will depend on the domestic legislation of each state. The unilateral

[172] As stated by Fuster Gómez (2021), the STA will not be able to apply the Spanish DST to entities' revenue from the provision of covered digital services obtained in Spanish territory without a permanent establishment.

relief system of the US is worth mentioning due to its particularities that are related to the topic covered in this chapter.

The unilateral relief system provided by the US is by way of a foreign tax credit. Under Section 901 of the IRC a taxpayer is allowed to credit certain foreign taxes against its US income tax liability. Under this provision, these foreign tax credits extend to “income, war profits, and excess profits taxes” that are paid or accrued to any foreign jurisdiction. The IRC does not provide a definition of the term “income taxes”, though it does embody a certain concept of income (Pistone & Ullman, 2021). However, as stated by Simmonds (2019), a foreign levy will be considered as an income tax in the US sense in the event that it is likely to reach the taxpayer’s net gain, and if it fulfills the following three tests: (i) the realization test (the taxable event would also be a taxable event in the US), (ii) the gross receipt test (a tax is imposed on gross receipts), and (iii) the net income test (the tax allows for the recovery of significant costs).

Consequently, it is uncertain whether the Spanish DST, which is a gross tax on revenues, could fall within this definition. According to Sartori (2021), the foreign tax credit does not apply firstly, as there is no case of double taxation as the DSTs are not direct taxes, secondly, because there is no double taxation between two taxes of the same nature, and finally, because the DSTs do not fall within the net income test since the tax does not admit the deductibility of costs. As per Pistone & Ullmann (2021), the tax credit is not granted if there is no income tax. Simmonds (2019) also sees it unlikely that the DSTs could not fall under such definition since the tax does not allow the recovery of significant costs.

A potential argument in favor of the Spanish DST falling under the scope of the foreign tax credit would be that it is a tax levied in lieu of the CIT since its objective is to create a new nexus that substitutes the CIT. If this argument can be sustained, the Spanish DST would be creditable in the US under the US foreign tax credit system (Simmonds, 2019).

Under Section 903 of the IRC, the scope of the foreign tax credit is extended to taxes paid in place of an “income, war profits, and excess profits taxes”. Section 903 of the IRC intends to cover situations in which a specific type of business falls within a special tax regime in place of being covered by the general income tax regime (Pistone & Ullmann, 2021). Consequently, the foreign tax credit is not applicable to cases in which the special tax is levied in addition to an income tax (Lincoln IV, 2021). It seems reasonable to conclude that this is the case of the Spanish DST since this tax applies to both resident and non-resident taxpayers. A taxpayer who is a Spanish tax resident has to pay the Spanish DST in addition to the general CIT, while the non-resident taxpayer is only liable for the Spanish DST. Nevertheless, the non-resident taxpayer does not pay the DST in lieu of the Spanish CIT; they are simply not liable to the CIT in accordance with domestic tax rules.

As stated by Pistone & Ullmann (2021), there are reasonable doubts as to whether the DST is creditable under the US foreign tax credit system.

3.4. Conclusions

In this chapter, stronger arguments have been presented which demonstrate how the Spanish DST is not covered by the DTCs signed by Spain. It can also be concluded that Article 2 of the OECD MTC presents deficiencies. In an ideal world, the list contained in Article 2(3) would have to be updated automatically every time a new tax is created. There is no question that legal certainty would increase if this provision included a list of accepted criteria when determining what are to be considered taxes on income and on capital (Martín Jiménez, 2005), as well as including a mandatory MAP to resolve doubts if an issue arises on the interpretation of whether a new enacted tax should be covered or not (Ismer & Jescheck, 2018). It is easier said than done, and it is not clear if these proposals will ever see the light of day. However, for the sake of legal certainty and as a minimum standard, contracting states must comply with their obligation to notify the other contracting states of new taxes enacted under Article 2(4).

After having analyzed whether the Spanish DST falls under the scope of DTCs, the following chapter will address the second hypothesis which calls to examine whether the Spanish DST infringes EU law. This will be the second of the three chapters which address the hypotheses drawn as described in Chapter 1.

CHAPTER 4: THE COMPATIBILITY OF THE SPANISH DST WITH EU LAW

4.1. Introduction

The idea of DSTs was originally envisioned under the Action 1 Report of the OECD BEPS Project in the form of a potential equalization tax (Kofler, 2021). In 2018 it took form in a Commission proposal for a directive as a short-term measure to tackle the challenges of the digital economy. Though the proposal never became a directive due to the lack of consent among Member States, several countries, among them Spain, enacted unilateral DSTs based on the Commission’s proposal. However, such a law enacted unilaterally has the potential of containing aspects that may come into conflict with EU law.

This chapter reviews whether the Spanish DST infringes on EU law and is organized as follows. First, the potential infringement of fundamental freedoms will be discussed (Section 4.2). Second, an examination of whether the Spanish DST could be considered as prohibited State aid will be carried out (Section 4.3). Third, the compatibility of the Spanish DST with Article 110 of the TFEU is assessed (Section 4.4). Fourth, an analysis of the compatibility of this tax with VAT is performed (Section 4.5). Finally, conclusions are drawn (Section 4.6).

4.2. The compatibility of the Spanish DST with fundamental freedoms

The analyses carried out to date have found that there are strong arguments to defend the hypothesis that DSTs infringe on EU law as this tax affects mostly digital services providers that are foreign (or foreign parented) companies (Mason & Parada, 2020). Consequently, it could be considered that the enforcement of this tax is a discriminatory measure based on nationality and, therefore, restrictive to fundamental freedoms. However, Mason & Parada (2020) believe that the CJEU will reject this argument and rule that the digital services tax does not infringe EU law based on two cases (*Vodafone* and *Tesco*) related to Hungarian turnover taxes. Nevertheless, there is evidence which supports credible arguments that differentiate these two cases from an eventual Spanish DST case.

EU fundamental freedoms prohibit overt, direct discrimination, and also covert, indirect discrimination. Direct discrimination is a differentiation provided expressly in a regulation. In indirect discrimination the differential treatment of comparable situations is based on a criterion that is not contained expressly in any regulation, but its effects lead to the same result as a differentiation provided expressly in a regulation.[173]

Under Article 8 of the Spanish DST Act, taxpayers of the Spanish DST are those legal entities that exceed two thresholds: a) The net worldwide turnover must have been of over €750 million during the previous calendar year; and b) the total revenue from the provision of the services that are subject to the Spanish DST must have been of over €3 million during the previous calendar year.

The Spanish DST Act establishes high thresholds based on turnover to determine whether a digital service provider is subject to the tax. The use of these thresholds does not constitute a direct discrimination since the act does not distinguish between domestic and foreign companies. However, high-turnover entities are, indeed, mainly foreign or foreign-parented while lower-turnover entities tend to be domestic. A reasonable doubt can be raised as to whether this differentiation under these high thresholds would constitute indirect or covert discrimination against foreign or foreign-parented entities, consequently infringing fundamental freedoms.

Therefore, in this section it is analyzed whether there are legal grounds for taxpayers to claim that the Spanish DST infringes the EU fundamental freedoms. To do so, first, EU fundamental freedoms are defined. Second, an analysis to determine whether the Spanish DST is contrary to EU law is performed in accordance with CJEU case-law and also with the analysis carried out by AG Kokkot in the *Vodafone* and *Tesco* cases. Thus, it is analyzed whether: (i) there is a cross-border situation, (ii) there is a restriction of fundamental freedoms (i.e. discrimination), and (iii) the prima facie discriminatory measure can be justified. Third, a comparison is drawn between the Hungarian turnover tax cases (*Vodafone*, *Tesco*, and *Hervis* cases) and a future potential Spanish DST case. Fourth, it is analyzed whether the DSTs could be challenged for infringing fundamental freedoms if they were to be enacted by a directive. Finally, conclusions are drawn.

[173] CJEU judgments of April 26, 2018, case C-233/16, *ANGED*, para. 30; of February 5, 2014, case C-385/12, *Hervis Sport- és Divatkereskedelmi*, para. 30; of July 8, 1999, case C-254/97, *Baxter and Others*, para. 13; and of February 14, 1995, case C-279/93, *Schumacker*, para. 26.

4.2.1. EU fundamental freedoms

The Member States have not ceded their tax sovereignty to the EU, without prejudice of the harmonization of certain indirect taxes and some aspects of direct taxes. Member States are, in general, free to design their own tax systems. However, in doing so, they must comply with EU law and, particularly, with the fundamental freedoms (free movement of capital, freedom of establishment, and freedom to provide services), without in any way adversely distorting competition.[174]

Article 26(2) of the TFEU provides the definition of internal market as "the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties".

From this definition, the idea can be extracted that the internal market is linked with the free movement of production factors and outputs. The fulfillment of the internal market can be seen as the goal of the EU economic integration that calls for the removal of all barriers within the EU. To be able to complete this ultimate goal, the fundamental freedoms are crucial.

The fundamental freedoms under EU law guarantee that goods, services, capital, and persons can move within the EU without restrictions, and prohibit that a Member State discriminates against citizens or entities of another Member State.

It must be analyzed whether the Spanish DST infringes fundamental freedoms since it is reasonable to believe that this tax affects mostly foreign or foreign-parented entities and, therefore, could be considered as a discriminatory measure based on nationality.

The freedom to provide services (regulated under Article 56 to 62 of the TFEU) is most relevant when analyzing the compatibility of DSTs because this tax targets the provision of services and is levied regardless of the location of the taxpayer within the EU as it is levied based on the location of the users (Simmonds, 2019; Pistone, Pinto Nogueira & Turina, 2021). The fact is that the analysis would be exactly the

[174] CJEU judgments of November 19, 2009, *Commission/Italy*, case C-540/07, para. 28; of November 8, 2007, *Amurta*, case C-379/05, para. 16; and of December 12, 2006, *Test Claimants in Class IV of the ACT Group Litigation*, case C-374/04, para. 36.

same as if the contested freedom was to be the freedom of establishment (regulated under Articles 49 to 55 of the TFEU) since what needs to be determined is whether there is discrimination between domestic and foreign entities. The freedom of establishment could be relevant for those foreign-parented entities that are established in Spain to provide services to local users.

In accordance with AG Kokott opinion in the *Vodafone* and *Tesco* cases, though based in the freedom of establishment, the discrimination analysis entails a three-step process. The first step consists of analyzing whether a cross-border situation suffers from an unfavorable treatment in relation to domestic situations. The second step, closely related to the first step, consists in examining if the tax would constitute a restriction of fundamental freedom by treating foreign and domestic situations differently. In the event that it is identified that the tax constitutes a restriction of the fundamental freedom, it is necessary to take a third step by studying whether the measure might be justified by an overriding public interest, providing that the requirement of proportionality is fulfilled.

4.2.2. Cross-border situation

The EU fundamental freedoms are meant to protect competition and facilitate trade within the EU. Therefore, it is necessary to demonstrated that the unfavorable treatment affects cross-border situations, either directly or indirectly. In relation to the Spanish DST, the cross-border situation that must be protected is the supply of digital services by foreign or foreign-parented entities to users located in Spain.

Before continuing with this analysis, it is necessary to point out that the question can arise if entities from non-EU Member States, such as US entities, have standing to bring a claim against Spain for discrimination. It is common practice that US companies operate in Europe through at least one subsidiary, and those subsidiaries are the ones that have standing to bring fundamental freedoms challenges (Mason & Parada, 2020). For example, a US company would lack standing to bring a claim against Spain for discrimination based on nationality, but if this company had a subsidiary in The Netherlands that provides digital services that are taxable under the Spanish DST, this subsidiary based in a EU Member State would have standing to bring a nationality discrimination claim against Spain.[175] Another possible scenario would be a US company which had a subsidiary in Spain that provided digital services covered under the Spanish DST to users located in Spain. In this case, the Spanish subsidiary would also have standing and could claim against its own Member State that the tax discriminates against them by virtue of their foreign ownership.[176]

4.2.3. Restriction of a fundamental freedom

As stated in the opinion of AG Kokott in the *Vodafone* and *Tesco* cases, in order to analyze the restriction of fundamental freedoms, it is necessary to carry out the following steps. First, it is necessary to indicate that two or more comparison groups are effectively treated differently. If this is the case, the second step consists of examining whether the differential treatment of cross-border situations compared with domestic situations disadvantages the former. On occasions the CJEU deems it appropriate to consider an additional step based on whether the different treatment relates to situations which are objectively comparable.

4.2.3.1. Different treatment

First of all, it is necessary to clarify that the Spanish DST does not expressly treat domestic and foreign or foreign-parented entities unequally. For example, the Spanish DST could have explicitly said that this tax did not apply to domestic companies or explicitly include a lower tax rate for domestic entities. Alternatively, it defines certain turnover thresholds that cover, in principle, all entities and it establishes a flat tax rate that is applicable to all entities that meet the threshold requirement. However, solely high-revenue corporations that are providers of digital services fall under the scope of the tax and those corporations are normally foreign or foreign parented. So, this could constitute unequal treatment.

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[175] The EU fundamental freedoms do not strictly protect foreign nationals, but they do protect all cross-border economic situations. A foreign company is able to exercises its freedom of establishment through its domestic subsidiaries based in the EU or through the subsidiary based in the Member State that has been discriminated against. See CJEU judgment of April 1, 2014, C-80/12, *Felixstowe Dock and Railway Company and Others*, para. 23.

[176] The free movement of capital (Article 63 of the TFEU) can be invoked by non-EU entities, but not the freedom of establishment nor the freedom to provide services. The CJEU has determined that freedom of capital can be applied to non-EU residents, but not the other fundamental freedoms. See CJEU order of June 8, 2004, C-268/03, *De Baeck v. Belgium*.

4.2.3.1.1. Disadvantage for cross-border situations

Once the different treatment has been determined, it must be examined whether this unequal treatment creates a disadvantage to foreign or foreign-parented entities compared with domestic entities.

Direct discrimination against foreign or foreign-parented entities is not evident since the rules governing the Spanish DST do not make any distinction according to the entity's seat or origin. As mentioned, the Spanish DST Act does not treat foreign or foreign-entities differently from domestic undertakings. Nevertheless, fundamental freedoms also prohibit covert or indirect forms of discrimination. Therefore, the outcome of applying this tax must be considered. A relevant element to consider is whether the unequal treatment of digital services providers as regards the €750 million threshold of annual gross turnover results in a different treatment according to the nationality of the entity, or of its parent company.

As considered in the opinion of AG Kokott in the *Vodafone* and *Tesco* cases, in situations where indirect discrimination is being analyzed, it is first necessary to examine the correlation between the distinguishing criterion that leads to potential discrimination (in case of the Spanish DST the thresholds of subjection to this tax) and the ownership of the entities affected by the tax; and second, it must be analyzed whether the distinguishing criterion was intentionally chosen by the legislature with a discriminatory purpose.

4.2.3.1.2. Relevant correlation

In order to draw comparisons between cases, a relevant correlation must be drawn between them using quantitative and qualitative measures.

According to AG Kokott in the *Vodafone* and *Tesco* cases, the CJEU does not have a consistent stance on how to establish what type of numeric or quantitative correlation is necessary for determining indirect discrimination.[177] As pointed out by AG Kokott, in order to determine indirect discrimination, the CJEU has, on occasion, referred to a criterion that required a preponderance of non-nationals or non-residents to be

[177] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 61; and Opinion of AG Kokott, C-323/18, *Tesco-Global Áruházak*, para. 57.

affected,[178] while other times it has required non-nationals or non-residents to be at a disadvantage in the majority of cases,[179] and in other cases, the Court has considered it sufficient for a mere risk of disadvantage against non-nationals or non-residents to be demonstrated.[180]

As regards the qualitative correlation, the CJEU has also been inconsistent. On separate occasions, it has understood that the correlation must typically exist,[181] or must be inherent,[182] or can be due to incidental and factual circumstances.[183] Furthermore, the CJEU case-law has not made it clear whether the quantitative and the qualitative correlation should exist cumulatively or not.

In the *Hervis* case, the CJEU used a broad concept of indirect discrimination. It considered the criterion of the "majority of cases" sufficient since the disadvantaged group of taxpayers that where taxed at the highest tax band were foreign-owned entities.[184] Moreover, the CJEU, in this case, did not add any additional requirement other than this majority rule. So, this judgment can be interpreted in the sense that even an incidental and factual correlation between the distinguishing criterion and the place of seat of entities is sufficient for ruling in favor of indirect discrimination.

Nevertheless, AG Kokott states, in the *Vodafone* and *Tesco* cases, that strict criteria should be applied in order to rule in favor of the existence of indirect discrimination.[185] She considers that the concept of indirect discrimination aims to include cases which do not constitute discrimination from a formal perspective since the relevant regulation does not expressly discriminate, but the application of a given measure gives rise to discrimination.

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[178] CJEU judgment of June 1, 2010, joint cases C-570/07 and C-571/07, *Blanco Pérez and Chao Gómez*, para. 119.
[179] CJEU judgment of April 26, 2018, C-233/16, *ANGED*, para. 31.
[180] CJEU judgment of March 22, 2007, C-383/05, *Talotta*, para. 32.
[181] CJEU judgment of July 8, 1999, C-254/97, *Baxter and Others*, para. 13.
[182] CJEU judgment of June 1, 2010, joined cases C-570/07 and C-571/07, *Blanco Pérez and Chao Gómez*, para. 119.
[183] CJEU judgment of May 9, 1985, C-112/84, *Humblot*, para. 14.
[184] CJEU judgment of February 5, 2014, case C-385/12, *Hervis Sport- és Divatkereskedelmi*, para. 45.
[185] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 62; and Opinion of AG Kokott, C-323/18, *Tesco-Global Áruházak*, para. 58.

In the *Vodafone* and *Tesco* cases,[186] AG Kokott distinguished between quantitative and qualitative criterion regarding the extent and the nature of the correlation between the differential criteria (turnover), and the seat or ownership of the entities.

4.2.3.1.3. Quantitative criterion

AG Kokott considers that that the correlation should be identifiable in the vast majority of cases regarding the quantitative criteria. She states that it cannot be considered that a mere preponderance, meaning that more than 50% of the target companies are affected by the tax, is sufficient to fulfill the criterion of relevant correlation.[187] AG Kokott refers to *ANGED* case in which the CJEU concluded that the percentages of 61.5% and 52% of affected entities are not adequate to consider indirect discrimination though the court did not establish the threshold that would have to be fulfilled either.[188]

In relation to the Spanish DST, this tax was the subject of an investigation by the USTR.[189] The report revealed that the Spanish DST would be levied on 39 company groups. Of these entities, only two (5.13%) would be Spanish-headquartered, 25 (64.10%) would be US-parented companies, and 12 (30.77%) would be from other countries. From this report, it could be concluded that this tax disproportionately taxes foreign (or foreign parented) entities, or group entities since 95% of the entities, or group entities, affected by this tax are foreign (or foreign parented). In all, based on the analysis of the USTR, there are strong arguments to consider that the Spanish DST indirectly discriminates foreign entities from the perspective of the quantitative criterion.

It must be pointed out that in fiscal year 2021, the number of taxpayers of the Spanish DST was 216 belonging to 52 groups of companies according to the STA.[190] Though there is a difference between the USTR report on the Spanish DST and the STA in the

[186] AG Kockott’s opinions are similar in both cases. Nevertheless, her opinion in the *Vodafone* case is more extensive and this is why reference will be made to this case.
[187] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 63.
[188] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 70. CJEU judgments of 26 April 2018, C-233/16, *ANGED*, para. 38.
[189] Office of the United States Trade Representative (2021, January 14). *Report on Spain’s Digital Services Tax.*
[190] STA press release on the tax revenues of the Spanish DST obtained in fiscal year 2021, see: STA (2022, April 15). *Nota informativa 4: El nuevo Impuesto sobre Determinados Servicios Digitales.*

numbers of companies affected, it is reasonable to say that the tax falls mostly on foreign companies as the digital services market is dominated by them. It must be borne in mind that there are only 126 multinational groups with their head offices in Spain with a turnover over €750 million according to the information provided by the STA in the Country-by-Country Report of fiscal year 2020.[191] Thus, most of the MNEs operating in Spain are foreign or foreign-parented.

4.2.3.1.4. Qualitative criterion

Nevertheless, according to AG Kokott the quantitative criterion is not sufficient and, therefore, the qualitative criterion should be taken into account as well. She establishes that the distinguishing criterion should intrinsically or typically affect foreign companies and a merely incidental link cannot be considered as sufficient even though it is sufficiently high in quantitative terms to contemplate indirect discrimination.[192] In other words, the qualitative criterion's purpose is to omit incidental quantitative correlations. AG Kokott establishes that the use of an intrinsic connection as a distinguishing criterion would "clearly suggest the likelihood of a correlation in the vast majority of cases."[193]

As applied to the *Vodafone* and *Tesco* cases, this analysis prompted the question of whether the high turnover threshold correlated intrinsically with foreign-owned companies. AG Kokott defends that, even though it is more likely that companies with a high turnover will be foreign, there is no apparent reason to determine that foreign companies will obtain higher turnovers in a country compared to domestic companies.[194] Therefore, she concludes high turnover thresholds are not intrinsically correlated to foreign companies.

In relation to a possible Spanish DST case, the question to be raised in relation to the qualitative criterion would be exactly the same one as regards the *Vodafone* and *Tesco* cases, with the same probable conclusion. For this reason, it becomes essential to

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[191] STA press release on the Country-by-Country Report of fiscal year 2020, see STA (2023, June 28). *Nota país por país 2020*. The information regarding fiscal year 2021 will be provided in April 2024 according to the STA.
[192] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 74.
[193] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 78.
[194] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, paras. 79-81.

analyze the importance of the role of the possible intention of the legislature to discriminate.

4.2.3.1.5. Legislative intent

AG Kokott expressed that the intention of the legislature to discriminate could be relevant in the analysis of indirect discrimination to complement the qualitative criterion. She suggests that there are two ways to demonstrate legislative intent to discriminate. First, the qualitative test might be sufficient to consider indirect discrimination if there is proof of legislative intent to discriminate against foreign companies, even if there is no intrinsic correlation.[195] If it is proven that the legislature intentionally established the distinguishing criteria so foreign-owned companies would be at a disadvantage, it is clear that this disadvantage will be reflected in the qualitative analysis since the number of foreign owned entities affected will be much higher compared to domestic entities.[196] It is important to bear in mind that the correlation cannot be merely incidental if it is the intention of the legislature to disadvantage foreign owned entities.

Second, AG Kokott recognizes that the approach taken on the legislative intent can also be reached from the general legal principle of prohibition of abuse of rights which is applicable in EU law. That is to say the Member States should not take advantage of certain market circumstances and establish special distinguishing criteria to transfer the tax burden onto foreign entities by virtue of Article 4(3) of the TEU.[197]

Nonetheless, AG Kokott has stressed that the legislative intent must be analyzed on very strict conditions. She believes that it is necessary that there is clear evidence that the primary objective of the domestic measure enacted by a Member State was to disadvantage foreign entities.[198]

The views of AG Kokott on imposing such a strict criterion to consider legislative intent has been criticized by Parada (2019). This criterion mandates for clear evidence that the primary objective of the measure was to disadvantage foreign companies, but if there were any other obvious objective reasons underlying the measure, it does not

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[195] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 84.
[196] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, paras. 84-85.
[197] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, paras. 88-90.
[198] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 92.

seem possible that it would be accepted.[199] As explained by Parada (2019), the primary objective criterion defended by AG Kokott can be easily overcome by Member States by stating that the discriminatory measure has other objective reasons, such as addressing base erosion and profit shifting activities of large MNEs.

As applied to the *Vodafone* and *Tesco* cases, AG Kokott concluded that the primary objective of the legislature was not to tax only foreign companies. Because there was a lack of clear evidence to the contrary, and because there was no demonstrable intrinsic correlation between the level of turnover and the foreign ownership of the entities as discussed above, she reached the conclusion that there was no indirect discrimination.[200]

As this relates to the Spanish DST, it can be defended that there is a legislative intent to tax only large corporations. The Spanish Council of Ministers release of October 18, 2018,[201] established that: “In the case of both the Financial Transaction Tax and the Tax on Certain Digital Services, its application is aimed at large companies and multinationals” (translated by the author). Also, in the report on the analysis of the regulatory impact of the preliminary draft of the act that would govern the Spanish DST of October 23, 2018,[202] it is stated that it will “mainly affect multinational companies that provide the digital services that are the subject of the taxable event of the tax” (translated by the author).

In addition, during the press conference of the Spanish Council of Ministers of February 18, 2020,[203] the Spanish Minister of Finance Ms. María Jesús Montero said:

> “This tax will affect companies that have a business of more than 750 million euros, worldwide, and revenue derived from its activity of three million, at a national level. These are tax limits and objectives that, in no case, are discriminatory according to nationality or type of company. And we want to

[199] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 92.
[200] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 103.
[201] Release of the Spanish Government of January 19, 2021, see Spanish Government (2019, January 19). *Impuestos sobre transacciones financieras y sobre servicios digitales.*
[202] Blueprint of the Act No. XX/2018 on the Spanish DST of October 23, 2018 (in Spanish, *Memoria del análisis del impacto normativo del Anteproyecto de la Ley XX/2018, de XX de XX, del Impuesto sobre Determinados Servicios Digitales*).
[203] Intervention of the Spanish Minister of Finance Ms. María Jesús Montero on February 18, 2020, see Spanish Government (February 18, 2020). *Intervención de María Jesús Montero.*

make this clear, as it will affect all companies that meet these requirements, regardless of their origin." (Translated by the author).

From this intervention, it is clear that the Spanish Finance Minister tried to defend the tax by expressly saying that there is no intention to discriminate. These words can be interpreted such as that the Spanish Government acknowledges that the tax could have discriminatory results. Actually, a few months after that, the Spanish Minister of Finance Ms. María Jesús Montero said in the Spanish Congress during its session of June 4, 2020,[204] in which the enactment of the Spanish DST was debated, that:

> "And it is true that there is still no agreement among the States on the solution to be adopted; however, this has not prevented this tax from entering into force in other countries to continue advancing along this path; clearly not. Countries of reference such as the United Kingdom, France, Italy, Austria, Hungary, and also Spain, have already opted for regulatory measures to try to tax a part of the activity of the large technological multinationals in their territory (…).
>
> But, because it seems to be a matter of conscience, you object to a tax designed to tax mainly the activity of large multinational companies which hardly contribute to the countries where they generate profits." (Translated by the author).

Finally, it should be also pointed out that the Senator of the Socialist Party Ms. Julia María Liberal, said in the Treasury Commission of the Spanish Senate during the session of October 1, 2020,[205] in which the Spanish DST was being debated, that:

> "The Popular Party Group even talks about some cases in which it is the taxpayer who is going to have to face up to it. No, not at all. Ladies and gentlemen of the Popular Party, we are always talking about big companies; companies with a turnover of more than 750 million euros, and that the previous year had only 3 million euros in digital revenues. Any Spanish

[204] Spanish Congress session records of June 4, 2020, see Spanish Congress (June 4, 2020). *DS. Congreso de los Diputados, Pleno y Dip. Perm., núm. 26, de 04/06/2020*, p. 17.
[205] Spanish Senate session records of October 1, 2020, see Spanish Senate (October 1, 2020). *DS. Senado, núm. 73, de 01/10/2020*, p. 30.

> company or any small company does not reach those thresholds." (Translated by the author).

The interventions quoted prove an intention of the legislature to tax only large foreign owned companies. Nevertheless, AG Kokott[206] refers to the opinion of AG Wahl in *Austria v Germany* (C-591/2017),[207] that considers that declarations made by politicians are not sufficient to determine the discriminatory intent of a measure. However, without taking into consideration the mentioned political declarations, the intention to discriminate can still be deduced from the regulatory design of the Spanish DST, as will be explained.

As stated in Section V of the Preamble of the Spanish DST Act, the first threshold (€750 million threshold) limits the application of this tax to large companies, while the second threshold (€3 million threshold) limits the application of this tax to situations in which there is a significant digital footprint of the taxpayer in Spain as regards to the DST. The Preamble of the Spanish DST establishes the clear intention of the legislature to tax only large companies, which are those capable of providing the covered digital services that are based on data and user input, and which rely on the existence of extensive networks, and have a strong market position. The Preamble justifies this first threshold by saying that it is the same as the one established in the Country-by-Country Report which should provide legal certainty since both the STA as well as corporations will be able to determine more easily whether a company is subject to the tax or not. The Preamble also adds that due to the first threshold, SMEs, as well as startups, will be excluded from this tax since, for this type of companies, the compliance cost associated with the Spanish DST could have a disproportionate effect on them. Though the Preamble attempts to give reasons for why the Spanish DST establishes such high thresholds, it clearly describes an intention of the legislature to tax only large MNEs, and these are mostly foreign; establishing the thresholds of €750 million of global turnover and of €3 million in digital services revenues not only excludes SMEs, but large Spanish companies as well.

Annex I of the EU Commission Regulation 651/2014 of June 17, 2014, declaring certain categories of aid compatible with the internal market in application of Articles

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[206] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 91.
[207] Opinion of AG Wahl, C-591/17, *Austria v Germany*, paras. 70-71.

107 and 108 of the TFEU, sets the definitions of micro enterprises and SMEs. Under article 2 of Annex I of this regulation, a medium-sized enterprise is an enterprise with fewer than 250 employees, with an annual turnover not exceeding €50 million, and/or an annual balance sheet that does not exceed €43 million. Accordingly, if an enterprise exceeds the mentioned thresholds, it is considered a large company.

Therefore, if the Spanish legislature's objective was to limit the application of the tax to large companies as stated in the Preamble of the Act that regulates the tax, it should have established the annual turnover threshold of €50 million.

The report of the USTR on the Spanish DST identified the consequences of lowering the €750 million threshold to €50 million and €100 million:

> "An analysis conducted in this investigation identified that both the percentage and absolute number of U.S. companies affected by Spain's DST increases when compared with lower revenue thresholds. If a threshold of €50 million was to be applied, the analysis identified 249 companies, of which 20 (8%) had an ultimate parent in Spain and 80 (32.1%) had an ultimate parent in the United States. Increasing the threshold to €100 million identified 170 companies, of which 8 (4.7%) had an ultimate parent in Spain and 70 (41.2%) had an ultimate parent in the United States. In comparison, applying the actual threshold of Spain's DST, €750 million, the analysis identified 60 companies, of which 2 (3%) had an ultimate parent in Spain and 34 (56.7%) had an ultimate parent in the United States." (p. 13)

From this data, it can be concluded that the Spanish legislature intended to tax foreign MNEs, and to exclude Spanish companies from this tax when stablishing the €750 million threshold. The STA might try to justify that this was not the primary objective of the tax since there were other underlying objectives of the measure such as the creation of a new nexus based on the location of the user to ensure a fair taxation in a digitalize economy. However, this argument could have been sustained if the threshold was of €50 million, but a €750 million threshold, as has been proven, is clearly unjustifiable.

In all, it can be concluded that in the case of the Spanish DST, indirect discrimination does occur. So, there is an indirect restriction of fundamental freedoms from the enactment of the Spanish DST. First, the €750 million thresholds chosen by the Spanish legislature disadvantages foreign or foreign parented entities from a qualitative perspective since the vast majority of entities affected by this tax are foreign or foreign parented entities. Second, there is sufficient evidence that the above-mentioned threshold was established intentionally by the Spanish legislature to tax mainly foreign or foreign parented entities and to exclude domestic entities from this tax.

4.2.3.2. Objectively comparable situation

As mentioned by AG Kokott in the *Vodafone* and *Tesco* cases, in situations in which it was assumed that indirect discrimination existed, the CJEU has, at times, additionally examined whether the two groups that are treated unequally are in a situation that is objectively comparable.[208] However, the CJEU has desisted in performing such an analysis according to AG Kokott,[209] who considers that it is a criterion that should not be used.[210] Nevertheless, for the purposes of a complete examination, it has been deemed appropriate to carry out a comparative analysis under the Spanish DST.

The comparability analysis must be done in the light of the objective of the tax measure which is to contribute to social fairness by creating a new nexus based on the location of the users, as can be concluded from the Preamble of the Spanish DST Act and from the Explanatory Memorandum of the DST Directive Proposal.[211] This tax can be seen as a tool to correct the shortcomings of the current international tax system in a digitalized economy.

The compatibility analysis is performed to determine whether the entities that fall under one of the two situations are comparable or not in the light of the objective of

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[208] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 104. For related case-law, see: CJEU judgments of July 4, 2018, C-28/17, *NN*, paras. 31 to 38, and the case-law quoted in paragraph 31 of this judgment.

[209] See the case-law referenced in paragraph 105 of the Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*: CJEU judgments of July 4, 2013, C-350/11, *Argenta Spaarbank*, paras. 18-34; of October 23, 2008, case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, paras. 27-39; and of May 15, 2008, C-414/06, *Lidl Belgium*, paras. 18-26.

[210] This point of view has been explained in various opinions of AG Kokkot. In paragraph 105 of Opinion of AG Kokott, case C-75/18, *Vodafone Magyarország*, refers to the following: Opinion of AG Kokott of July 7, 2014, C-48/13, *Nordea Bank*, paras. 21-28, and Opinion of AG Kokott of July 19, 2012, C-123/11, *A*, paras. 40-41; among others.

[211] Explanatory Memorandum to the DST Directive Proposal, pp. 3-4.

the tax. Fair taxation implies that there is no place for an unequal treatment if the situations are comparable. In this case, the comparability test determines whether the digital service providers that reach the €750 million thresholds (that are mostly foreign or foreign-parented entities) are comparable to those digital service providers that do not reach such thresholds (predominantly domestic entities).

The Preamble of the Spanish DST justifies the €750 million threshold in several ways. One is for the purpose of administrative simplification since it is the same as the one established in the Country-by-Country Report. Another argument is centered on the concept of economies of scale since only large companies are able to supply digital services based on large data and user contributions which depends on the existence of broad networks of users, high data traffic, as well as the exploitation of a strong market position. In this regard, it must be pointed out that it is reasonable to believe that large companies that do not reach such a high threshold, such as large domestic companies, are able to use economies of scale and to hold a strong market position, nevertheless. Finally, the Preamble adds that due to this threshold, SMEs, as well as startups, will be excluded from the Spanish DST. However, establishing the €750 million threshold excludes not only SMEs, but large domestic companies as well.

Consequently, it is difficult to argue that conditions determined by the application of this threshold are not comparable. Under the Spanish DST, treatment is radically different among entities with similar levels of digital revenue (i.e. those that are just below and just above the thresholds). When an entity becomes a taxpayer, it will be taxed at 3% for all the revenue of digital services covered that is obtained in Spain, while an entity that falls short of the thresholds will not be taxed at all. It is hard to see this outcome as fair.

Following in the analysis to determine whether a measure adopted by a Member State is contrary to a fundamental freedom, it is also necessary to determine whether a prima facie discriminatory measure can be justified on any of the grounds accepted by the CJEU as overriding reasons for the general interest.

4.2.4. Justification for indirect discrimination

In this section, an analysis of the potential justification of a prima facie discriminatory Spanish DST will be performed.

The subsequent justifications have been accepted by the case-law of the CJEU to rationalize a discriminatory tax measure: the need to maintain a balanced allocation of taxing rights,[212] the need to maintain the coherence of the tax system,[213] and the prevention of tax evasion and tax avoidance.[214] These justifications are intended to protect the legitimate right of Member States to tax the economic activity carried out within their borders[215]. Taxpayers cannot choose in which jurisdiction they want their income to be taxed and losses or expenses to be deducted since these elements are related to the jurisdiction where the economic activity is carried out, and these would jeopardize the right of Member States to exercise their taxation powers on the activities performed within their borders.[216] So, the balance in the allocation of taxing rights and the coherence of the tax system combined with the territoriality principle whereby Member States are entitled to tax the economic activity generated within their borders[217] can be interpreted as allowing Member States the right to tax value creation within their territory.[218]

It could be argued that the Spanish DST aims to maintain the balanced allocation of taxation rights among Member States because it subjects certain digital services to taxation when the users are located in Spain. It could be defended that such grounds of justification might not be applicable since the allocation of taxing rights are regulated under DTCs. In other words, Spain would be trying to change the allocation of taxing rights unilaterally by the enactment of the Spanish DST which creates a new nexus based on the location of the users. Nevertheless, the Spanish DST is not a tax on income and therefore does not fall under the scope of DTCs as discussed earlier. Thus, this could be seen as a credible justification in favor of a discriminatory tax measure.

An underlying objective of the Spanish DST is to tackle aggressive tax planning and guarantee fair taxation. However, the prevention of tax evasion as a justification is

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[212] CJEU judgments of January 20, 2021, C-484/19, *Lexel*, para. 59; and of September 12, 2006, C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, para. 56.
[213] CJEU judgments June 12, 2018, case C-650/16, *Bevola*, para. 45; and of June 30, 2016, C-123/15, *Max-Heinz Feilen*, para. 30.
[214] CJEU judgments of January 20, 2021, C-484/19, *Lexel*, para. 49; and of September 12, 2006, C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, para. 55.
[215] CJEU judgment of July 18, 2007, C-231/05, *Oy AA*, para. 54.
[216] CJEU judgment of July 18, 2007, C-231/05, *Oy AA*, para. 55.
[217] CJEU judgment of May 31, 2018, C-382/16, *Hornbach Baumarkt*, para 40.
[218] CJEU judgment of May 31, 2018, C-382/16, *Hornbach Baumarkt*, para. 46.

only valid for domestic tax measures set to fight against purely artificial arrangements that are used to get around the application of the regulations of a Member State.[219] Nevertheless, the prevention of tax evasion and tax avoidance together with the need to protect the balanced allocation of taxing rights have been accepted as justifications.[220] On the other hand, the CJEU has stated that the loss of revenue of a Member State cannot be considered as grounds that justify a discriminatory tax measure, nor the objective of increasing tax revenues.[221]

In all, it is doubtful whether the arguments based on the idea that the Spanish DST tackles the challenges of the digital economy cannot be used to justify this discriminatory tax measure in accordance with the CJEU case-law.

4.2.4.1. Proportionality of the restriction

The CJEU has established that a discriminatory measure may be justified by reasons of public interest if the measure is suitable to attain the objective pursued but cannot go beyond what is imperative to achieve that objective.[222] Therefore, a proportionality test must be performed.[223]

The proportionality test for the Spanish DST will be carried out based on a three-step process; the appropriateness, necessity, and proportionality of the measure will be tested as done by AG Kokott in the *Vodafone* and *Tesco* cases in accordance with the practice of the CJEU in fundamental freedom cases. Though AG Kokott did not find that the contested taxes were discriminatory, an examination was still carried out regarding justifiability and proportionality focusing the analysis on the ability to pay principle. As stated in the Preamble of the contested taxes, the objective of the tax was to tax entities with an ability to pay that exceeds the general obligation to pay taxes. Consequently, AG Kokott's reasoning becomes irrelevant for a potential

[219] CJEU judgment of September 12, 2006, C-196/04, *Cadbury Schweppes and Cadbury Schweppes Overseas*, para. 51.
[220] CJEU judgments of July 18, 2007, C-231/05, *Oy AA*, para. 66; and of December 13, 2005, C-446/03, *Marks & Spencer*, para. 43.
[221] CJEU judgments of January 20, 2021, C-484/19, *Lexel*, para. 68; of April 16, 2015, C-591/13, *Commission/Germany*, para. 78; of September 6, 2012, C-380/11, *I. VI. Finanziaria di Diego della Valle & C.*, para. 50; and of June 6, 2000, C-35/98, *Verkooijen*, paras. 48-59.
[222] CJEU judgments of February 5, 2014, C-385/12, *Hervis Sport- és Divatkereskedelmi*, para. 42; of March 24, 2011, C-400/08, *Commission* v *Spain*, para. 73; and of October 5, 2004, C-442/02, *CaixaBank France*, para. 17.
[223] For a detailed examination of the proportionality analysis performed by the CJEU in relation to domestic measures and its compatibility with EU fundamental freedoms, see Pinto Nogueira (2016).

Spanish DST case as the act that governs the tax specifically states that the tax does not take into account the ability to pay of the taxpayer.

4.2.4.1.1. Appropriateness

In examining the CJEU's case-law it can be concluded that this court has established that domestic legislation is appropriate for attaining the objective pursued if it reflects a concern to attain such objective in a consistent and systematic way.[224]

The Spanish DST lacks in consistency and systematic character. The €750 million threshold to consider what entities are payers of this tax clearly takes domestic entities outside its scope while discriminating against digital foreign services providers. It is also difficult to justify that entities just below and above the threshold are not comparable from the perspective of the fair taxation objective since both groups rely on the data of the users of their digital services in the same way. In addition, part of the value created by these users is not being taxed as a result of the high threshold established.

Therefore, this tax discriminates against digital foreign services providers and should not be deemed as an appropriate measure to achieve the aim of the Spanish DST which is to ensure a fair taxation of the digital economy.

4.2.4.1.2. Necessity

According to the CJEU's case-law in relation to the proportionality test, this court has considered that when there is a possibility to choose between various appropriate measures, the one that must be taken is the least onerous.[225]

The Spanish DST covers digital services that are provided without any requirement to maintain a physical presence in the jurisdiction where the users are located. Therefore, most of the providers of these digital services are not necessarily subject to the

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[224] CJEU judgments of June 11, 2015, C-98/14, *Berlington Hungary and Others*, para. 64; of July 12, 2012, C-176/11, *HIT and HIT LARIX*, para. 22; and of November 17, 2009, C-169/08, *Presidente del Consiglio dei Ministri*, para. 42.

[225] CJEU judgments of June 30, 2016, C-134/15, *Lidl*, para. 33; of May 4, 2016, C-477/14, *Pillbox 38*, para. 48; of February 15, 2016, C-601/15, *PPU-N*, para. 54; of January 22, 2013, C-283/11, *Sky Österreich*, para. 50; of July 8, 2010, C-343/09, *Afton Chemical*, para. 45; and of July 11, 1989, C-265/87, *Schräder HS Kraftfutter*, para. 21.

Spanish CIT. So, in order to solve the defects of the CIT systems, Spain has enacted a DST as other EU Member States have done.

Cui (2018) defends the enactment of the DSTs over other measures such as the creation of a digital permanent establishment. However, instead of enacting unilateral taxes that establish a new nexus based on the users, resources should be directed to reform the international tax system multilaterally in order to tackle the challenges of the digital economy. A consensus should be reached at an OECD level to reform the international tax system before states unilaterally adopt measures to overcome deficiencies. Thus, there are grounds to consider that there are means at a multilateral level that are less onerous than unilateral solutions such as the Spanish DST to achieve the desired goals. The OECD could be working on harmonizing DSTs. However, the efforts do not seem to be moving in this direction.

4.2.4.1.3. Proportionality

The CJEU case-law has ruled that measures must be appropriate to attain the objective pursued.[226] In other words, the restrictions and their consequences cannot be disproportionate.[227]

It could be argued that the Spanish DST does not appear to have a choking effect on the taxpayers since there are very large corporations who the tax is levied on. However, it does have a relevant compliance cost since it requires taxpayers to process a large amount of information to calculate the tax base, and that could be deemed disproportionate.

Furthermore, and as explained, the justifications for the Spanish DST do not fit well with its characteristics making this tax a disproportionate measure. To this end, the coherence between the design of the Spanish DST and its objectives can be questionable. It could be considered that the Spanish DST intends to discriminate since: (i) the design of the tax (with special attention to the €750 million threshold) does not correspond to the objectives proposed by the legislature (achieving fair

[226] CJEU judgments of December 21, 2011, C-271/09, *Commission v Poland*, para. 58; and of October 11, 2007, C-451/05, *ELISA*, para. 82.

[227] Judgments of June 30, 2016, C-134/15, *Lidl*, para. 33; of January 22, 2013, C-283/11, *Sky Österreich*, para. 50; of November 9, 2010, C-93/09, *Volker und Markus Schecke and Eifert*, para. 76 et seq.; and of July 12, 2001, C-189/01, *Jippes and Others*, para. 81.

taxation in a digitalize economy), and (ii) due to this deviation between the design of the tax and the objectives of the legislature, the impact of the tax on foreign or foreign parented entities is considerably greater than on domestic companies. Accordingly, there are grounds to conclude that the Spanish DST is not a proportional tax.

4.2.5. Implications of the *Vodafone* and *Tesco* cases

The *Vodafone* and *Tesco* cases could have an impact on a potential challenge of the Spanish DST. These two cases challenge the Hungarian special tax on net turnover that was also challenged in the *Hervis* case but with other progressive tax rates. In Hungary, a graduated tax on net turnover was imposed on certain given activities such as retail, telecommunications, and energy services.

Regarding retail stores (*Tesco* case), the tax rates were: (i) 0% for the band covering a taxable amount up to HUF 500 million (approximately €1.5 million); (ii) 0.1% for the band between HUF 500 million and HUF 30,000 million (approximately between €1.5 million and €90 million); (iii) 0.4% for the band between HUF 30,000 million and HUF 100,000 million (approximately between €90 million and €300 million); and (iv) 2.5% for the band above HUF 100,000 million (approximately €300 million).[228]

Regarding telecommunications operators (*Vodafone* case), tax rates were: (i) 0% for the band covering a taxable amount up to HUF 100 million (approximately €1.5 million); (ii) 4.5% for the band between HUF 500 million and HUF 5,000 million (approximately between €1.5 million and €15 million); and (iii) 6.5% for the band above HUF 5,000 million (approximately €15 million).[229]

Due to this tax rate structure, all the taxpayers that fell within the lowest bracket (0% tax rate) were Hungarian-owned entities, while nearly all the entities in the highest bracket were foreign-owned (Mason & Parada, 2020). Under this scenario, *Vodafone* and *Tesco*, two different UK-headquartered companies, initiated discrimination claims before Hungarian courts against this tax, defending that the higher tax rate for higher net turnover entities resulted in indirect discrimination since higher net

[228] CJEU judgment of March 3, 2020, C-323/18, *Tesco-Global Áruházak*, para. 66.
[229] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*. para. 46.

turnover entities are normally foreign. The Hungarian courts referred to the CJEU to seek an answer on the possible infringement of EU law.

The *Vodafone* and *Tesco* claims have certain similarities to the claim that could be raised against the Spanish DST as they basically raise the same question that could be raised in a potential Spanish DST challenge before the CJEU. That is, whether a tax that considers the amount of turnover for an entity to become a taxpayer can constitute indirect discrimination that infringes the fundamental freedoms in a situation in which the tax burden falls mostly on foreign owned entities.

In the *Hervis* case, an Austrian-parented entity also challenged this Hungarian tax that, at the time, had a different regulation. Under the act that governed this tax, a Hungarian entity had to consolidate its turnover with the turnover obtained in Hungary of other members of the corporate group, including foreign entities, to determine the applicable tax rate. Consequently, entities that formed part of a group were subject to higher tax rates compared to stand-alone entities. The CJEU considered that this could result in an infringement of the freedom of establishment. In the *Hervis* ruling, the CJEU considered a simple majority rule in which if most of the taxpayers that were negatively affected by this disadvantageous tax treatment were foreign or foreign-parented, then the consolidation rule would be deemed as a discriminatory tax measure under the EU fundamental freedoms. It must be pointed out that the CJEU left the referring domestic court to decide whether discrimination occurred or not based on the number of foreign entities affected.

Based on the *Hervis* precedent, it is reasonable that the taxpayers challenging the Hungarian tax in the *Vodafone* and *Tesco* cases were optimistic of obtaining a favorable ruling from the CJEU since it had set a low bar favorable to the taxpayer when claiming national discrimination. Nevertheless, the CJEU upheld the Hungarian tax in the *Vodafone* and *Tesco* cases.

4.2.5.1. CJEU rulings on the *Vodafone* and *Tesco* cases

In the cases involving *Vodafone* and *Tesco*, the CJEU excluded the existence of direct discrimination.[230] The court analyzed if the progressive rate structure of the tax could

[230] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország.* para. 44.

result in indirect discrimination. To this end, the court considered the impact that the tax had on foreign-owned entities and domestic entities. Such an examination is comparable to the analysis of the quantitative criterion carried out by AG Kokott in her opinion. The court made reference to its preceding case-law concluding that the measure must create, in most of the cases, a disadvantage towards foreign-owned entities.[231] By carrying out this examination, the court established that in the *Vodafone* case, which involved the telecommunications tax, only domestic owned entities fell within the lowest band, the ratio of domestic and foreign-owned entities was evenly split within the intermediate band, and predominantly foreign-owned entities fell within the higher band.[232] In relation to the *Tesco* case, which concerned the store retail trade tax, only domestic entities fell within the first band, while predominantly foreign-owned entities fell within the third and fourth bands.[233] Accordingly, most of the tax revenue was obtained from foreign-owned companies and these were subject to a considerably higher tax rates.

Nevertheless, the CJEU recalls its case-law that considers that Member States are free to establish the tax system that they deem to be most appropriate. So, the enactment of a progressive tax on turnover falls within the discretion of each Member State. In addition, the court considered that the amount of turnover is a neutral criterion of differentiation and believed that it was an important indicator of an entity's ability to pay.[234] It is relevant to mention that the court refers to the Preamble of the contested taxes in which it is stated that the objective of these taxes is to impose a tax on entities with an ability to pay that exceeds the general obligation to pay taxes.[235]

The CJEU concluded, based on the quantitative examination performed, that the circumstance that most of the tax is borne by foreign-owned entities is not enough to rule that the measure is discriminatory as this is due to the market situation in Hungary in which foreign-owned entities maintain a dominant position. Therefore, according to the court, this is a fortuitous situation, or a matter of chance, and the result would be the same in the case of a proportional tax.[236] Consequently, the CJEU decided that

[231] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, para. 43.
[232] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, paras. 47-48.
[233] CJEU judgment of March 3, 2020, C-323/18, *Tesco-Global Áruházak*, para. 67.
[234] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, paras. 49-51.
[235] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, para. 51.
[236] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, para. 52.

the progressive rates of the contested taxes could not inherently create any discrimination.[237]

4.2.5.2. Analysis of the rulings of the *Vodafone* and *Tesco* cases

Whether the fundamental freedoms precluded national legislation that has the effect of the tax burden falling on foreign-owned entities was referred to the CJEU by a domestic Hungarian court. In addition, the court also asked whether that effect should be considered as indirect discrimination. The question that the CJEU was posed is phrased very narrowly (Károlyi, 2021). Consequently, as expressed by both the CJEU and AG Kokott, if the answer had been affirmative, all Hungarian taxes on businesses would more than likely be contrary to fundamental freedoms as it seems that the domestic market is dominated by foreign-owned entities. According to Károlyi (2022) the referred question should have made reference to the disproportionate nature of the tax on foreign-owned entities due to the progressivity of the taxes and considering the ability to pay, as it was one of the aims of the contested taxes. The judgments were also criticized by Mason & Parada (2020) since the CJEU restricted the analysis of the referred question to whether progressive tax rates are in accordance with EU law (as there is no doubt that they are not prohibited under EU legislation) rather than examining the choice made by the domestic legislature regarding the thresholds and tax rates, and what happens if the tax burdens fall mostly on foreign-owned entities. The answer to Mason & Parada's (2020) questions will have to be provided if a Spanish court refers a question on the legality of the Spanish DST under EU law to the CJEU as the *Vodafone* and *Tesco* rulings do not provide an answer to these questions. This is true especially considering that the ability to pay is not an aim expressly stated in the Preamble of the Spanish DST.

The CJEU has not cleared the uncertainties regarding the methodology to follow in order to determine indirect discrimination and it did not follow the coherent methodology proposed by AG Kokott exactly.

In relation to the quantitative test, the court did refer to its previous case-law to establish that discrimination and unfavorable treatment of the cross-border situation is necessary in most cases. That said, the court did not precisely define what "most

[237] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, para. 54.

cases" means. According to the rulings in the *Vodafone* and *Tesco* cases, the quantitative criterion was met since there was quantitative evidence that the tax mostly affected foreign-owned entities, but that was not decisive since the court considered it relevant to take into account the market situation as has been explained.

In relation to the qualitative criterion, the court considered that it was not sufficient to fulfill the quantitative criterion to establish discrimination and stated that unfavorable treatment cannot be fortuitous. The court did not seem to find an intrinsic correlation between the progressive tax rates and the seat of the entities. However, in relation to the second part of the qualitative criterion proposed by the AG Kokott that consisted of analyzing the intent of the legislature, it was entirely omitted by the court and such examination was not carried out.

4.2.5.3. The importance of the *Hervis* case

In the *Hervis* case, the CJEU applied the majority rule; it was considered that the tax was discriminatory if the tax burden fell mainly on foreign-owned entities. It could be concluded that the *Vodafone* and *Tesco* rulings overturned the *Hervis* ruling as both rulings established a stricter criterion than the majority rule and considered the use of a mere quantitative criterion insufficient to rule for indirect discrimination.

According to Károlyi (2022), the *Hervis* case must be differentiated from the two more recent rulings. The tax analyzed in the *Hervis* case contains a rule that consisted of aggregating turnovers of group members to establish the applicable tax rate. It can be interpreted that the qualitative criterion was tacitly taken into account by the court since it can be defended that there is an inherent correlation between high turnovers and MNEs (i.e. groups of foreign-owned entities) since these company groups tend to be involved in cross-border economic activities, while domestic entities typically tend to do business only in their country and do not normally form part of a group structure.

This correlation between high turnover and foreign ownership based on a group structure was implicitly mentioned by AG Kokott in the *Vodafone* and *Tesco* cases when indicating that "high-turnover undertakings tend to operate across national borders within the internal market and there may therefore be a certain likelihood that such undertakings are also active in other Member States."[238] Nevertheless, she considered this declaration to be less relevant due to the territorial nature of the taxes as these were calculated in accordance with the turnover collected within the borders of only one Member State, and concluded that it cannot be deduced that foreign-owned entities will generate higher turnovers than domestic entities in that given Member State.[239]

The group structure in the *Hervis* case, as opposed to the *Vodafone* and *Tesco* cases, was relevant due to the consolidation rule that made the taxpayer aggregate the turnover generated in Hungary of all the members of the group that it belonged to in order to obtained the applicable tax rate.[240] Using the words of the CJEU, the taxpayer that belonged to a group was taxed based on "fictitious turnover".[241] As pointed out by Károlyi (2022), the *Hervis* case ruling can be interpreted as such that the court accepted that the amount of turnover obtained by the group used to calculate the applicable tax rate was inherently from the group structure and from foreign ownership. In other words, the CJEU applied the quantitative criterion (the majority test) and the qualitative criterion (the inherent correlation test). So, the only aspect of the *Hervis* ruling that might have seen to be overruled is the application of the "majority" rule as the *Vodafone* and *Tesco* rulings applied the "most cases" rule.

In addition, as brought up by Károlyi (2022), the *Hervis* case exemplifies the problems of a rule that obligates taxpayers to aggregate turnovers of group members even if they carry out their activities in different sectors of the market, especially considering that the controversial tax was a tax on retail. In the *Hervis* case, the taxpayer had to aggregate the turnover of its subsidiaries dedicated to the sport retail industry, but also the turnovers of SPAR shops that obviously are in an entirely different market segment. So, it justifies the words chosen by the CJEU in the statement that taxation was based on fictitious turnover for group members since the aim of the tax was to target only the retail sector, but not other segments of the market. This can be superbly comparable to the design of the €750 million worldwide turnover of the Spanish DST that includes not only turnover obtained by the provision of digital services, but also

[238] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 79.
[239] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 80.
[240] CJEU judgment of February 5, 2014, C-385/12, *Hervis Sport- és Divatkereskedelmi Kft*., para. 10.
[241] CJEU judgment of February 5, 2014, C-385/12, *Hervis Sport- és Divatkereskedelmi Kft*., para. 36.

the turnover of other segments of the market. Therefore, even though it can be argued that the consolidation rules might only be used to reflect the size of the group for the purposes of the tax, it might go against the aim of a tax to tax a specific sector of the market.

Overall, the consolidation rule of the €3 million threshold of the Spanish DST that considers only the turnover generated in Spain of digital services covered is definitely a better measure to reflect the size of a group in a given country and in a given sector.

4.2.5.4. Differences between Spanish DST and the Hungarian cases

Once analyzed the CJEU case-law on non-digital turnover taxes, it is relevant to examine the similarities and the many differences that an eventual Spanish DST case to be brought before the CJEU in light of the fundamental freedoms could have in regards to the above analyzed Hungarian turnover tax cases since, due to those differences, the outcome of the case could be very distinct. The relevant differences are described below.

4.2.5.4.1. Scope of the taxes

The Spanish DST, contrary to other turnover-based taxes, covers only revenues from three types of digital services while other turnover-based taxes are levied on entire economic sectors or industries. The fact that the Spanish DST is shaped to cover very narrow revenue streams proves an intent of the legislature to tax only specific given entities. This is not relevant since the Spanish DST covers digital services in which the users play an essential role in the value creation process. Thus, the covered services are in line with the objective of the tax.

Furthermore, the Spanish DST is levied on gross turnover rather than on net turnover. This can be a relevant issue from the point of view of the ability to pay principle since it can be defended that gross revenue does not consider the expenses incurred by the taxpayer and thus does not express the taxpayer's ability to pay as effectively as net revenues (Mason & Parada, 2020). It must be noted that the Spanish DST excludes VAT and similar taxes from the calculation of the tax base. As pointed out by Károlyi (2022), the Hungarian turnover-based business taxes were levied on net turnover which, according to Hungarian accounting rules, means that VAT and other similar taxes are excluded. Therefore, there is no difference between the Spanish DST and the Hungarian turnover-based business taxes in this regard.

4.2.5.4.2. Thresholds

Two revenue thresholds are determined in order to qualify as a taxpayer for the Spanish DST. One is based on the worldwide turnover threshold of €750 million, and the other on domestic digital services covered revenue at a threshold of €3 million. The Hungarian turnover-based business taxes do not include these kinds of thresholds. As has been argued, the worldwide threshold is problematic as it only covers very large companies which tend to be foreign or foreign parented. The domestic threshold of €3 million is also problematic since, in this case, it is too low as explained in Chapter 2.

In addition, after having analyzed the cases of Hungarian turnover-based business taxes, it can be found that the €750 million worldwide turnover threshold of the Spanish DST is problematic in the indirect discrimination test when it comes to analyzing whether the use of a turnover threshold (the distinguishing criterion) inherently correlates to the nationality or seat of the legal entities (the protected criterion). AG Kokott analyzed the existence of possible discrimination of the Hungarian store retail and telecommunication taxes under the qualitative criterion. She gave importance to the territorial nature of the tax since it was stressed that, despite the fact that entities with high turnovers are prone to be MNEs which operate across borders and thus being foreign-owned, it does not necessarily mean that they will obtain higher turnover than domestic entities in a given jurisdiction for the purposes of a territorial tax. She concluded that the tax was not discriminatory.[242]

The CJEU has not specifically set the focus on the territorial nature of the tax. However, it also rejected the argument that the taxes were discriminatory by focusing on the characteristics of the Hungarian market, which was dominated by foreign MNEs.[243] As interpreted by Károlyi (2022), the CJEU implicitly contemplated the fact that domestic and foreign-owned entities compete in a given Member State and it

[242] Opinion of AG Kokott, C-323/18, *Tesco-Global Áruházak*, paras. 75-76; Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, paras. 79-80; and Opinion of AG Kokott, C‑385/12, *Hervis Sport- és Divatkereskedelmi Kft.*, para. 51.
[243] CJEU judgment of March 3, 2020, C-323/18, *Tesco-Global Áruházak*, para. 72.

cannot be deduced from the act that governs the tax that foreign-owned companies will collect a higher turnover than domestic entities within that given territory. Nevertheless, the Spanish DST Act sets a very high worldwide turnover threshold to decide whether an entity qualifies as a taxpayer. Therefore, in the case of the Spanish DST, an inherent correlation exists between being a taxpayer and being foreign-owned due to this threshold. Thus, the use of this threshold causes an unfavorable treatment for foreign-owned entities.

As has already been explained, only a few foreign-owned corporations are taxpayers of the Spanish DST since the worldwide turnover threshold is very high. From a quantitative perspective, the Spanish DST has a greater disproportionate affect when compared with other turnover-based taxes such as the ones contested in the *Vodafone* and *Tesco* cases. As explained, the USTR Report on the Spanish DST identified 60 potential taxpayers, of which only 2 (3%) were Spanish entities, while in the *Vodafone* and *Tesco* cases, the telecommunications and retail trade taxes revealed a more diverse outcome. In the *Vodafone* case (the telecommunications tax), in a given year, 16 entities fell within the highest tax band of which 6 were domestic entities. The statistics also exhibited that foreign-owned entities also fell within the middle tax band.[244] In the *Tesco* case (retail trade taxes), the result is different since the entities that fell within the base band were all domestic-owned while those entities that fell within the third and fourth bands were predominantly foreign-owned.[245] In both cases it is very clear that there is less of a disproportionate impact for foreign-owned entities compared to the results shown by the USTR Report on the Spanish DST.

4.2.5.4.3. Aggregation rule

The Spanish DST's €750 million turnover thresholds are to be calculated at a group level on an aggregated basis in accordance with Article 8 of the Spanish DST Act. The consolidation rule is what the CJEU used to distinguish the *Tesco* and *Vodafone* cases from the *Hervis* case.[246] So, the *Hervis* case is an interesting precedent that must

[244] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 18.
[245] CJEU judgment of March 3, 2020, C-323/18, *Tesco-Global Áruházak*, para. 67.
[246] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, para. 55; and of March 3, 2020, C-323/18, *Tesco-Global Áruházak*, para. 75.

be considered when analyzing whether the Spanish DST is a discriminatory tax due to this aggregation rule.

In the *Hervis* case, the CJEU determined that the steeply progressive tax rate structure combined with the consolidation rule, which consisted of aggregating turnovers of group members to establish the applicable tax rate, might result in indirect discrimination if the highest tax bracket affected foreign-parent companies in most cases. It was left to the domestic referring court to decide whether or not this was the case.[247]

The CJEU considered it questionable to aggregate the turnovers of the group members in order to obtain the applicable tax rate on what the court called "fictitious turnover". The CJEU set the focus on the distinction between members which formed part of the group and those that did not, rather than putting the emphasis on the distinction based on the level of turnover obtained through the aggregation rule.[248] As explained by Károlyi (2022), though no reference was made to any inherent discrimination test, from the ruling it can be understood that the CJEU recognized that higher tax rates would inherently be applicable to group members compared to stand alone entities due to the consolidated rule that established the tax rates based on the aggregated turnover and because group members, or MNEs, are also inherently foreign. So, the CJEU essentially performed an indirect discrimination analysis applying the qualitative test which they passed on to the referring domestic court in order to verify whether the tax affected in most cases foreign entities. So, following the interpretation of the *Hervis* case by Károlyi (2022), it could be concluded that the Spanish DST infringes fundamental freedoms for being a discriminatory tax as the consolidation rule is very similar to the tax analyzed in the *Hervis* case.

4.2.5.4.4. Tax rate

According to Károlyi (2022), there are only two possibilities regarding the single flat tax rate of the DSTs. Either an entity does not fall within the scope of the tax because it does not reach the two revenue thresholds, or if it does, it becomes a taxpayer and the entire revenue of the digital services covered are going to be taxed at a single flat

[247] CJEU judgment of February 5, 2014, C-385/12, *Hervis Sport- és Divatkereskedelmi Kft*, paras. 35-36, and 39.
[248] CJEU judgment of February 5, 2014, C-385/12, *Hervis Sport- és Divatkereskedelmi Kft*, para. 31.

rate of 3%. So, there are two possible average tax rates (0% or 3%)[249] as either the entire revenue from covered digital services is taxed at 3%, or the entire revenue from these services will not be taxed. The outcome of this tax rate structure can be severe compared to the Hungarian cases of turnover-based taxes analyzed in which the exemption (0% tax rate) or lower tax rates based on thresholds (or bands) are applicable to the turnover of all taxpayers, including those whose amount of revenue falls partially under the highest bands. By using this tax rate structure, many average tax rates are probable, and there are guarantees that taxpayers with a similar amount of turnover will be subject to a similar tax burden even if part of their turnover falls under different tax bands. Both AG Kokott and the CJEU considered that establishing lower bands would benefit all taxpayers.[250]

However, in the case of the Spanish DST, a taxpayer which exceeds the revenue thresholds to any degree will be fully taxed on a relevant tax base, while another entity might just fall below one of the thresholds and be exempt from this tax entirely. Consequently, such a result cannot be considered to be in accordance with the aim of the Spanish DST to ensure a fair taxation of the digital economy.

Consequently, there are many differences between the taxes analyzed in the *Vodafone* and *Tesco* cases with the Spanish DST. Therefore, these cases could not be applied mutatis mutandis to a future Spanish DST challenge, but there is no doubt that the *Hervis* case can be essential to consider this tax contrary to EU fundamental freedoms.

4.2.6. Implementation of the DSTs through a directive

In this section, it will be analyzed if the enactment of the DST as a EU directive could have also carried out fundamental issues challenges. The Commission proposed a directive in March 2018 that regulated a DST applicable within the EU as a solution to tackle the taxation challenges of the digital economy there. However, the directive did not obtain the support of all Member States prompting that some countries adopted unilateral DSTs taking as an example the Commission's DST Directive Proposal.

[249] The average tax rate is the total tax paid divided by the taxable turnover.
[250] Opinion of AG Kokott, C-75/18, *Vodafone Magyarország*, para. 54; and CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, para. 53.

If the DST were to be enacted by a EU directive (secondary EU law), it would also have to comply with treaty law (primary EU law), thus it would have to be in accordance with the provisions of fundamental freedoms regulated in the TFEU.[251] This hierarchy of primary EU law over secondary EU law is not expressly stated in the treaties. However, the CJEU case-law has established that this superiority can be deduced from Article 249 of the TFEU since secondary EU law finds its legal foundation in primary EU law (Kofler, 2009). The CJEU case-law seems to establishes a different yardstick when examining fundamental freedom issues derived from EU than when derived from domestic legislation since rather than using the same proportionality test in the justification phase of the fundamental freedom examination as done regarding domestic measure, it only requires the EU legislation to not result in a manifestly inappropriate measure (Haslehner, 2019).[252] As a result, the number of rulings by the CJEU that lead to the invalidation of secondary legislation for infringing fundamental freedoms is low (Szudoczky, 2014).

Haslehner (2019) explains two reasons why the CJEU gives a preferential treatment of EU legislation over domestic measures when it comes to examine potential fundamental freedoms violations.

First, legislation enacted at a EU level is likely not to discriminate against Member States. Since tax measures need to be adopted with agreement of all Member States, it can be taken for granted that no Member State would accept a legislation that would discriminate against its own citizens and entities. That said, it must be taken into account that EU legislation is the outcome of discussions and compromises between governments, and in the course of these negotiations, it is possible that states might be willing to give certain concessions to secure a stronger position in another issue (Kofler, 2009). In the case of the DSTs, the target taxpayers are particularly US entities. However, US entities normally operate in Europe with at least one subsidiary resident in a Member State. Thus, Member States in which potential taxpayers (US subsidiaries) are located will not be favorable to enacting a DST. For example, Ireland

[251] CJEU judgment of October 26, 2010, C-97/09, *Schmelz*, para. 50.
[252] CJEU judgment of December 10, 2002, C-491/01, *British American Tobacco*, para. 123.

which is known to be a country in which US MNEs tend to locate their subsidiaries, was not supportive of the EU digital services tax.[253]

Second, and as also explained by Haslehner (2019), by introducing a EU directive, due to the coordinated actions of Member States, the internal market will be less fragmentated than if a measure were to be introduced unilaterally by Member States. In the case of DSTs, the unilateral enactment of this tax with variations in regards to its taxable revenue streams, tax rates, and thresholds can affect the functioning of the internal market. Though the harmonized tax would not abolish all the concerns regarding this tax, it could simplify the task of the taxpayer as it would then have to comply with a harmonized tax instead of multiple unilateral taxes with different features.

It could also be argued that the preferential treatment of EU legislation over domestic legislation of the CJEU could also be explained due to the premise that all harmonized tax measures at a EU level have the goal to strengthen the internal market instead of restricting it (Kofler, 2009).

In all, the arguments for a more tolerant analysis of the fundamental issues by the CJEU toward a directive might not be that clear for a DST directive due to the potential challenges that it faces that are similar to those of the Spanish DST. Though the CJEU case-law suggests that a directive is more likely to be considered as consistent with EU fundamental freedom than domestic legislation, in an eventual case before the CJEU, the court should examine the Spanish DST as a tax enacted by a Member State without necessarily taking into account the fact that this tax practically mimics the Commission DST Directive Proposal. Though it has never been enacted, that might be an indicator that some Member States find it discriminatory. The bottom line is that if, in the future, a EU directive regulating a DST is enacted under the same terms as the DST Directive Proposal, it could also be analyzed under the fundamental freedom articles of the TFEU, and there are strong arguments that suggest it could infringe fundamental freedoms.

[253] Reuters (2018, October 28). *Czechs join Ireland, Nordic countries in opposing EU digital tax*.

4.2.7. Interim conclusions

In this section, arguments have been presented which demonstrate how the Spanish DST infringes EU fundamental freedoms. It has been shown that there are arguments to defend that the Spanish DST indirectly discriminates between domestic and foreign-owned entities. There is no doubt that large digital services providers which meet the €750 million turnover threshold and those that do not reach it, are comparable. In addition, it has been demonstrated that there is a correlation between the threshold used and the nationality of the entities affected by the tax. Therefore, it can be concluded that the legislature selected the €750 million turnover threshold so only large foreign MNEs would be affected by this tax, thus this threshold has a discriminatory purpose that is prohibited under EU law.

It has also been demonstrated that certain characteristics of the Spanish DST distinguish it from the Hungarian turnover-based business taxes analyzed by the CJEU in the *Vodafone* and *Tesco* cases. In these cases, the court considered that they did not discriminate and, therefore, were not contrary to EU law. In contrast, in the case of the Spanish DST, there is a closer relation between the design of the €750 million worldwide revenue threshold and foreign MNEs that could entail indirect discrimination. In addition, the Spanish DST Act establishes that for entities that form part of a group, this threshold affects the global figures of the group. In the *Hervis* case, the CJEU concluded that a similar rule consisting of aggregating turnovers of group members to establish the applicable tax rate might result in discrimination by nationality infringing the freedom of establishment if the highest tax bracket affected mostly foreign companies based in another EU Member State. So, the *Hervis* case is an interesting precedent that must be considered when analyzing whether the Spanish DST is a discriminatory tax that could lead to the CJEU considering that the Spanish DST is contrary to EU law. In all, the discriminatory test to determine if a tax measure infringes EU fundamental freedom is probably met since the quantitative criterion is thought to be fulfilled as it is reasonable to believe that the tax affect mostly foreign owned entities, and the legislative intent to discriminate has been proven. Therefore, it can be concluded that the Spanish DST is a discriminatory tax measure that infringes the EU fundamental freedoms.

4.3. The compatibility of the Spanish DST with State aid rules

State aid control is a relevant competence of the EU in order to establish the competition rules necessary for the functioning of the internal market, an objective set forth under Article 3(1)(b) of the TFEU, being therefore an essential component of the EU integration process (Merola, 2016). State aid rules have become a resource for the EU Commission to exercise some supervision of the direct taxation system of Member States (though subject to the revision of the CJEU) due to the publication of the Commission Notice regarding the application of State aid rules to direct taxation,[254] since beforehand, these rules were seldom applied to direct tax measures (Lang, 2021). That said, Member States must exercise the competence in the field of taxation in accordance with EU law, especially considering fundamental freedoms and State aid rules.

As discussed in Chapter 2, the Spanish DST seeks to tax those digital services in which there is a monetization of user's data by the digital services providers.[255] For this purpose, Article 8 of the Spanish DST Act considers as taxpayers those legal entities that exceed two thresholds: a) The net worldwide turnover must have been of over €750 million during the previous calendar year; and b) the total revenue from the provision of the services that are subject to the Spanish DST must have been of over €3 million during the previous calendar year.

The first threshold represents the criterion by which the application of the tax is limited to MNEs. This selective method of determining the taxpayer raises the question of whether this delimitation of the taxpayer is contrary to the EU rules that prohibit State aid. The second threshold, based on the significant digital presence, could also be deemed as selective, and thus could constitute State aid, contrary to EU law. Prima facie, however, the existence of this second threshold to determine a significant digital presence seems reasonable for a tax whose goal is to tax companies that form part of the digital economy while the first threshold seems to be more controversial since the reason why it should be limited to MNEs is questionable. In addition, it could also be questioned whether the selected services create

[254] EU (1998). *Commission Notice on the application of the State aid rules to measures relating to direct business taxation*, (OJ C 384/03, December 10, 1998).
[255] According to Campos Martínez (2023), though user's data monetization is associate with large technological MNEs, any entity can potentially do it if they can collect, store, and process data.

discrimination though as discussed in Chapter 2, the covered digital services seem to be consistent with the objective of the tax. Thus, it seems reasonable to center the debate initially on the first threshold as it potentially presents serious doubts regarding its compatibility with EU State aid rules.

Recently the CJEU has ruled on the application of the State aid rules regarding progressive turnover taxes in which the Commission challenged these taxes on the grounds that they constituted State aid incompatible with the internal market. The CJEU ruled that the contested taxes, the Hungarian advertisement tax and the Polish retail trade tax, did not infringe State aid rules.

The goal of this section is to perform an analysis based on these judgments, together with existing tax-related case-law of the CJEU, to draw conclusions of a possible case in which the Spanish DST were to be challenged on the grounds that it constituted State aid contrary to EU law. To do so, first the concept of State aid is defined, giving special attention to this concept in tax cases. Second, the mentioned Hungarian and Polish cases are analyzed. Third, based on the analysis carried out thus far, it will be possible to pinpoint the State aid issues that the Spanish DST could challenge. Fourth, it is analyzed whether the DSTs could be challenged for violating State aid rules if they were to be enacted by a directive. Finally, conclusions are drawn.

4.3.1. The concept of State aid

The essential rules on State aid are found under Articles 107 and 108 of the TFEU. Specifically, Article 107(1) of the TFEU provides the definition of State aid prohibited under EU law in the following terms:

> "Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

Consequently, Article 107(1) of the TFEU sets out the prohibition of State aid to guarantee the proper functioning of the internal EU market, and to maintain a level playing field for competition among companies within the EU.[256]

Article 108(3) of the TFEU establishes that any measure that is likely to lead to a difference in treatment between entities and affect competition within the EU market must be notified to and authorized by the Commission before the proposed measure is put into effect by the concerned Member State. This is also referred to as the standstill obligation. Consequently, as explained by Pérez Rivarés (2012), Member States cannot implement aid measures without notifying the Commission and without the authorization of the Commission, because the consequence of failing to notify the Commission and the absence of an authorization from the Commission is the unlawfulness of the aid measure.

All of the above might not be applicable as the aid measure concerned may fall under one of the categories exempted from prior notification to the Commission. Article 109 of the TFEU establishes that the Council can determine other categories of aid in its regulations that are to be deemed compatible with the internal market, and under the Council regulation, the Commission can also adopt regulations (Károlyi, 2022). Accordingly, the Commission introduced the so-called General Block Exemption Regulation under which certain aid for SMEs, research and development, as well as environmental protection, among other categories of aid, are considered to be compatible with the internal market.[257]

First of all, it must be ruled out whether the Spanish DST can be subsumed under one of the exceptions provided under the EU Commission Regulation 651/2014 as this regulation provides exceptions to aid for SMEs. As explained in the previous section with regards to the compliance of the Spanish DST with EU fundamental freedoms,

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[256] Article 4.3 of the TEU establishes that: "Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties." In addition, as recognize under Article 3.3 of the TEU, among the objectives of the EU is the establishment of a common market and the maintenance of a highly competitive economy. For accomplishing this goal, it is necessary to have a system which ensures that competition is not distorted, that is, a regulatory framework that avoids introducing competitive advantages for some companies to the detriment of others.

[257] EU Commission Regulation 651/2014 of June 17, 2014, declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, and EU Commission Regulation 1407/2013 of December 18, 2013, on the application of Articles 107 and 108 of the TFEU to the minimis aid.

the Preamble of the act that governs the tax considers that due to €750 million threshold, SMEs, as well as startups, will be excluded from the Spanish DST. Under Article 2 of Annex I of the EU Commission Regulation 651/2014 a medium-sized enterprise is an enterprise with fewer than 250 employees, with an annual turnover not exceeding €50 million, and/or an annual balance sheet that does not exceed €43 million. Consequently, establishing the €750 million threshold excludes not only SMEs, but large companies as well. Thus, it cannot be concluded that the Spanish DST is a State aid measure granted for SMEs. Therefore, none of the categories of the exemption from notification of the Regulation 651/2014 is applicable to the Spanish DST. Secondly, the exclusion of notification for being considered a minimis aid under the EU Commission Regulation 1407/2013 will depend on the amount which the aid is quantified as, which is impossible to know before the measure has been implemented. According to EU de minimis regulation, aid of no more than €200,000 over a three-year period to a single entity will not trigger a State aid violation since, if this ceiling is not exceeded, it is considered that competition will not be distorted or threaten to be distorted.[258]

In all, it seems that the Spanish DST measure is subject to the standstill obligation established under Article 108(3) of the TFEU. In this regard, in the Preamble of the Spanish DST Act, it is indicated that the notification of the proposed measure was made to the Commission for the purposes established under the EU Directive 2015/1535 of the European Parliament and of the Council of September 9, 2015, laying down a procedure for the provision of information in the field of technical regulations and of rules on Information Society services. In the event that this notification of the Spanish DST has taken place in compliance with the standstill obligation, the existence of an authorization by the Commission in favor of the approval of the tax with the €750 million threshold is foreseeable, since the DST Directive Proposal establishes this same threshold and justifies it in several ways.[259]

[258] Commission Regulation 1407/2013 of December 18, 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid Text (referred as the EU De Minimis Regulation), recital 3.
[259] The Spanish legislature establishes essentially the same reasons in the Preamble of the Spanish DST to justify the €750 million threshold.

Accordingly, the DST Directive Proposal provides the following reasons to justify the €750 million threshold:[260] (i) the application of the DST is limited to entities of a certain scale, which are those which have strong market positions that allow them to benefit from network effects and exploitation of big data and thus build their business models around user participation; (ii) business models which fall within the scope of the tax are such that profits are made in one jurisdiction while value is generated in another leading to profits being taxed in a different jurisdiction from where value is created; (iii) the economic capacity of the entities qualifying as taxable persons for meeting the €750 million threshold should be seen as an indicator of their capacity to attract a high volume of users, which is necessary for such business models to be viable; (iv) the opportunity of carrying out aggressive tax planning lies with larger companies; (v) the same threshold is used as that used to comply with the country-by-country reporting obligations. This is intended to bring legal certainty and to make it easier and less costly for businesses and tax authorities to determine whether an entity is liable to the DST; and (vi) the €750 million threshold should exclude SMEs and start-ups for which the compliance burdens of the DST would be likely to have a disproportionate effect.

Thus, if these prior notification and authorization procedures have been made, the measure would be lawful by authorization of the Commission. If, on the other hand, the standstill obligation has not been complied with, the taxpayer selection measure would be considered unlawful. As explained by García Muñoz & Martínez Corral (2021), the legality of a State aid measure essentially refers to its formal compatibility with EU law from the perspective of Article 108 of the TFEU; thus, the lawfulness or unlawfulness of an aid depends on whether the measure has been authorized by the Commission or whether it falls within the scope of an exemption of the obligation to notify the Commission and receive the proper authorization from it.

The Commission is the competent authority to assess the aid scheme and to authorize it (State aid compatible with EU law) or to not authorize it (State aid incompatible with EU law). In other words, the Commission has become the highest decision-making institution on what measures Member States can adopt in their tax systems, especially with regard to direct taxation (Martín Jiménez, 2012). This is without

[260] DST Directive Proposal, p. 10.

prejudice to the possibility to appeal the decision adopted by the Commission before the European courts (Pérez Merino, 2023).

Thus, in a case of a State aid measure in which the concerned Member State has not complied with the standstill obligation, the State aid will be in any case unlawful. However, it may be an unlawful State aid measure but compatible with EU law, or an unlawful State aid measure and incompatible with EU law. The compatibility with EU law will depend on the analysis of the content of the measure, not on whether there has been a prior notification and authorization by the Commission (Pérez Merino, 2023).

As indicated by García Muñoz & Martínez Corral (2021), if the State aid measure is considered unlawful but compatible with EU law, the Spanish state would not have to modify the first threshold (being in accordance with EU law) nor recover the aid amounts from the companies that have benefited from the non-taxation (digital companies[261] with a net turnover of equal to or less than €750 million and with revenues obtained in Spain from covered service of over €3 million). However, as explained by Moreno González (2021), if the State aid measure is unlawful and incompatible with EU law, this would mean that the Spanish state would have to eliminate the first threshold and recover the aid amounts from the beneficiary companies which have not been taxed because of that threshold (digital companies with a net turnover equal to or less than €750 million and with revenues obtained in Spain from covered service of over €3 million).

The recovery of the aid amounts seems practically impossible. The impossibility lies in the difficulty to settle the tax years later for potentially hundreds of companies that have provided digital services exceeding the significant digital footprint threshold during the time that the tax was in force.[262] In addition, the fact that these entities were not subject to the tax means that they do not have, or at least had no obligation to have, a geolocation system to locate the users who use their digital interface. Thus, without the information on the localization of the users, it is not possible to determine

[261] Digital companies should be understood as those companies with a significant digital presence in Spain, that is companies with a total annual revenue from the provision of the services that are subject to the Spanish DST of over €3 million.
[262] Article 262 of the Spanish GTA and Article 17 of the Regulation 2015/1589 establish a limitation period of 10 years to recover aid and such period will begin counting on the day on which the unlawful aid is awarded to the beneficiary.

which of the digital transactions subject to the tax have to be settled in Spain. All this makes it practically impossible to be able settle the tax on entities that have provided certain digital services in Spain and have a net turnover equal to or less than €750 million.

Instead of making the entities that benefited from the aid scheme (digital entities with a net turnover of less than or equal to €750 and with revenues obtained in Spain from covered service of over €3 million) pay the tax so that all entities are on an equal ground (that all digital entities with a relevant footprint in Spain would have pay the tax), a possible solution would be that the Spanish State could reimburse the amounts collected from the entities that had been selectively subject to the Spanish DST (Pérez Merino, 2023). In this way, equality would also be achieved as the effect of the reimbursement would be as if the tax had never existed for the taxpayers.[263]

However, it must be stated that CJEU case law on State aid cases[264] has established that the possible incompatibility of an aid measure contested under EU law is not capable of affecting the lawfulness of the tax, and consequently the entities who are liable to pay that tax cannot claim that the tax measure constitutes State aid in order to avoid payment of that tax or to obtain a repayment of the tax paid. As pointed out by Pérez Merino (2023), this possible solution would not necessarily be in line with the current case-law from both the CJEU and the Spanish Supreme Court.[265]

Turning back to the analysis of the compatibility of the tax with EU law, State aid will be compatible with EU law in the event that the selective measure can be subsumed within one of the cases referred to in sections two and three of Article 107 of the TFEU. On one hand, Article 107(2) list aid that is deemed compatible with the internal market, while on the other hand, Article 107(3) contains a list of aid that can be exempt from State aid rules depending on the Commission's discretion (Micheau, 2014). However, the tax cannot be subsumed under any of these two sections. Therefore, it

[263] Szudoczky & Károlyi (2020) propose, on a problem similar to the one described regarding the Spanish DST, the reimbursement of the amounts collected by the state with respect to the entities that were selectively subject to a tax.

[264] CJEU judgement of March 3, 2020, C-75/18, *Vodafone Magyarország*, para. 28; of April 26, 2018, C-233/16, *ANGED*, para. 26; and of October 5, 2006, C-368/04, *Transalpine Ölleitung in Österreich*, para. 51.

[265] The Spanish Supreme Court judgements of October 25, 2019 (judgement 3570/2019), and of January 29, 2017 (judgement 50/2019) have adopted the same position as the CJEU.

is necessary to examine the possible State aid for the criterion chosen to select the Spanish DST taxpayer as it only effects MNEs.

It should be recalled that the concept of State aid must be understood in a broad sense, not only as a "positive measure" through which funds are transferred directly by the State to specific companies (e.g. subventions), but also including in this concept, those "negative measures" in the form of tax burdens which are imposed on certain companies (Díaz de Durana, 2021). Measures that entail additional taxation for certain companies while leaving their competitors exempt from these additional charges can constitute State aid to the benefit of the non-taxpayer, provided that both taxpayers and non-taxpayers are in a comparable situation from a factual and legal point of view (Maier & Werner 2005; and Bacon, 2017). Consequently, the fact that taxpayers of the Spanish DST are selected on the basis of their net turnover generates a suspicion of being faced with prohibited State aid, provided that there is no valid reason to justify this selection.

In accordance with settled case-law,[266] the CJEU has established that to characterize a domestic measure as State aid within the meaning of Article 107(1) TFUE, all of the following four conditions must be fulfilled.

First, an intervention by the state or one carried out through state resources is necessary.

Second, it must give a selective advantage which is beneficial to the recipients. Regarding State aid rules, this advantage must be of an economic nature by which the recipient obtains a financial advantage that would not have been obtained if it wasn't for the enactment of any measure. As a result of the measure, the recipient gains a better financial situation, or its position worsens but to a lesser extent compared to others (Quigley, 2015). The measure that provides the advantage must be selective, thus the measure must only benefit certain entities or the production of given goods, discriminating other entities or productions.[267]

[266] CJEU judgments of March 16, 2021, C-596/19 P, *Commission v Hungary*; of March 16, 2021, C-562/19 P, *Commission v Poland*; of December 19, 2018, C-374/17, *A-Brauerei*; of December 21, 2016, joined cases C-20/15 P, *Commission v World Duty Free Group*; of March 6, 2018, case C-579/16 P, *Commission v FIH Holding and FIH Erhversbank*; among others.
[267] Opinion of AG Wahl, C-524/14 P, *Commission v. Hansestadt Lübeck*, para. 74.

Third, the domestic measure must distort or could threaten to distort the competition. Therefore, this criterion refers to the possibility that the measure has an effect on competition. The CJEU gives limited relevance to this criterion in the State aid analysis (Lang, 2012). It could be understood that this requirement is easily satisfied if the measure has an effect, or threatens to have an effect, on the production costs as an increase of such would distort competition (Quigley, 2015). So, to analyze the distortion of competition, the competitive position of the entities before and after the enactment of the domestic measure must be analyzed, since the measure itself could modify the competitive situation of the market (Quigley, 2015).

Fourth, the domestic measure must be prone to affect trade between Member States. It can be overlapped by the distortion of competition as both deal with competitive positions (Nicolaides & Metaxas, 2014; Quigley, 2015). This criterion can also be simply fulfilled since it only needs that the activities or goods affected by the measure be subject to trade between Member States (Quigley, 2015). It is satisfied if the measure depicts a more difficult penetration of entities from other Member States to the relevant Member State market since there is no threshold established under which it is assumed that trade is not affected.[268]

Ferreiro Serret (2023) has systematized these requirements set by the CJEU that a measure must meet to constitute State aid into three conditions: The first condition is that the measure must distort competition and affect trade between Member States; the second condition requires that the measure must be from the state; and the third and final condition is that the measure must give rise to an advantage for certain undertakings or products, i.e. a selective advantage.

4.3.1.1. State aid in tax cases

Though the three criteria just described were developed by the CJEU in non-tax related case-law, they are still being used in the State aid analyses in the field of taxation. Nevertheless, in tax matters the focus is on the selectivity criterion (Ferreiro Serret, 2023) since the other criteria can easily be fulfilled in tax cases.

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[268] CJEU judgments of July 17, 2008, C-206/06, *Essent Netwerk Noord and Others*, para. 76; of July 21, 2005, C-71/04, *Xunta de Galicia*, para. 41; and of March 21, 1990, C-142/87, *Belgium v Commission*, para. 43.

First, in relation to the criteria of distortion of competition and the effect of trade between Member States, these can easily be fulfilled in tax cases since the possibility of distorting competition and affecting trade is sufficient (Martín Jimenez, 2017). The Commission[269] and the CJEU[270] consider this criterion to be fulfilled when the measure is likely to improve the competitive position of the beneficiaries compared with the other entities against which they compete. Thus, there is a distortion of competition when the State grants a financial advantage to an entity in a liberalized sector in which there is, or could be, competition.[271] When a tax is enacted, such as the Spanish DST, which only affects certain entities or services, it is quite straightforward that it might distort competition as only some, but not all, entities that compete in a market are affected, as affected entities might increase prices. It is reasonable to believe that this could affect trade between Member States since the penetration in that market might be less appealing than to enter into another market that does not include such a specific tax.

Second, in relation to the criterion in which the measure must be financed from state resources, according to the Commission[272] and the CJEU,[273] when the aid is obtained through an advantageous tax measure, it is clear that the State waives revenues, so it is considered that the advantage is provided through state resources. Thus, this requirement is automatically fulfilled in tax cases when the tax measure is considered to grant a favorable tax treatment for certain companies that results in a loss of tax revenue for the state (Martín Jiménez, 2017; Englisch, 2019).[274]

Therefore, the fulfillment of the criterion of selectivity and that of advantage are key in order to determine whether a tax measure constitutes State aid. To this extent, AG Saugmandsgaard Øe established that "The condition of selectivity is crucial for the purposes of classification as State aid in matters of taxation, since a tax measure which

[269] Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU, para. 187.
[270] CJEU judgment of September 17, 1980, C-730/79, *Phillip Morris*, para. 11.
[271] CJEU judgement of June 15, 2000, C-280/00, *Altmark Trans.*
[272] In the Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU (para. 51) it is established that a shortfall in tax revenue due to exemptions or reductions in taxes granted by a state, or exemptions from the obligation to pay fines are examples that fulfill the state resources requirement of Article 107(1) of the TFEU.
[273] CJEU judgment of March 15, 1994, C-387/92, *Banco Exterior de España*, para. 14.
[274] CJEU judgment of September 19, 2000, C-156/98, *Germany v Commission*, para. 25.

differentiates between economic operators does, in principle, satisfy the other conditions required for such classification."[275]

According to the Commission[276] and the CJEU[277], when Member States enact positive measures that benefit one or more entities through which money or assets are granted to certain entities, it can be easily concluded that these measures are selective since they provide a more favorable treatment to only a few entities. However, this situation is less clear when Member States enact measures applicable to all entities that fulfill certain criteria which mitigate the charges that entities would generally have to bear (i.e. tax exemptions for entities that fulfill certain criteria).[278]

In accordance with settled case-law of the CJEU,[279] a three-step analysis must be carried out in order to classify a tax measure as selective.[280] The first step identifies the relevant reference system, also referred to as the normal system of taxation.[281] The second step determines whether the contested measure derogates from the reference system to the extent that it discriminates between economic operators who, in view of the objective pursued by the tax system, are in a comparable legal and factual situation. Analyzing whether a derogation exists is fundamental in this part of the test and allows for a conclusion to be reached on whether the tax measure is prima facie selective. The tax measure is not selective if it does not constitute a derogation from the reference system. The third step examines whether the prima facie selective tax measure could be justified by proving that the derogation is due to the nature or the

[275] Opinion of AG Saugmandsgaard Øe, C‑374/17, *Finanzamt B v ABrauerei*, para. 47.
[276] EU (2016). *Commission Notice on the Notion of State Aid as referred to in Article 107(1) of the TFEU*, para. 126.
[277] CJEU judgment of June 4, 2015, C-15/14 P, *Commission* v *MOL*, para. 60.
[278] EU (2016). *Commission Notice on the Notion of State Aid as referred to in Article 107(1) of the TFEU*, para. 127.
[279] EU (2016). *Commission Notice on the Notion of State Aid as referred to in Article 107(1) of the TFEU*, para. 128.
[280] CJEU judgment of September 8, 2011, joined cases C-78/08 to C-80/08, *Paint Graphos and Others*, para. 49; and of September 6, 2006, C-88/03, *Portugal v Commission*, para. 56.
[281] The EU (2016). *Commission Notice on the Notion of State Aid as referred to in Article 107(1) of the TFEU*, para. 113, defines the reference system as: "The reference system is composed of a consistent set of rules that generally apply - on the basis of objective criteria - to all undertakings falling within its scope as defined by its objective." The CJEU has not established a clear criterion on how to determine the reference system. In accordance with the cases *BNP Paribas v Commission* (C-452/10 P), *Portugal v Commission* (C-88/03), and *Adria-Wien Pipeline* (C-143/99), it could be said that the reference system to be considered is the normal tax system applied in a region and/or the tax measure in itself. Therefore, the objective of the tax system and of the tax plays a crucial role to understand if the contested measure derogates from the reference system (i.e. the normal system of taxation).

general scheme of the reference tax system. If the prima facie selective tax measure is justified, it will not be considered as selective and will not be considered as State aid.

Recent CJEU case-law has examined jointly the criterion of advantage and that of the selectivity as it occurred in the *Commission v Poland* and *Commission v Hungary* turnover tax cases, since both criteria are measured based on the general or normal level of taxation (Károlyi, 2022). An advantage is given in the field of taxation when a Member State forgoes tax revenue that should have been collected under the normal domestic level of taxation, and consequently, the beneficiaries of this decision are mitigated from tax expenses that would normally have been included in the budget of an entity (Károlyi, 2022). In other words, the beneficiaries of an advantage granted by the state are placed in a more favorable position from a financial point of view compared to other entities, resulting in a loss of revenue for the state.

The selectivity (or selective advantage) criterion boils down to a discriminatory test as has been concluded by the CJEU in recent case-law, indicating that the analysis of whether a measure is selective is similar to the analysis of whether a measure applies to certain economic operators in a non-discriminatory manner,[282] or that the concept of selectivity is linked to that of discrimination.[283] The analysis performed by the CJEU has been reduced to a discrimination test since the identification of a derogation from the tax system is no longer necessary when the tax system itself creates discrimination between comparable entities.[284] As concluded by Lang (2021) based on recent case-law, the State aid examination performed by the CJEU in the field of taxation results in carrying out a discrimination test by determining if different treatment exists between comparable entities, being unnecessary to differentiate between normal level of taxation and advantageous taxation.

[282] CJEU judgment of October 6, 2021, joined cases C-51/19 P and C-64/19 P, *World Duty Free Group SA and Kingdom of Spain v Comm*ission, para. 33.
[283] CJEU judgment of December 21, 2016, C-524/14 P, *Commission v. Hansestadt Lübeck*, para. 53.
[284] CJEU judgment of November 15, 2011, joined cases C-106/09 P and C-107/09 P, *Commission v Government of Gibraltar and United Kingdom*.

4.3.2. Hungarian and Polish State aid cases

In the *Vodafone*[285] and *Tesco*[286] cases, the question regarding the compatibility of different progressive turnover-based taxes on certain activities and sectors in a Member State's tax system with State aid rules was raised before the CJEU. The court ruled that the State aid related questions were not admissible in these cases, so it did not analyze the compatibility issue. For instance, the CJEU indicated that the revenue collected from these taxes is transferred to the State budget, and it is not used toward the funding of a tax advantage for specific taxpayers. Therefore, this tax cannot, in itself, constitute State aid.

Nevertheless, in two subsequent cases regarding the Hungarian advertisement tax *(Commission v Hungary)*, and the Polish retail tax *(Commission v Poland)*, the CJEU did deliberate on this issue.[287]

The Hungarian case relates to an advertisement tax that went into force in 2014. Moreno Gonzalez (2021) indicates that this tax on the turnover derived from the publication of advertisements was approved by the Hungarian state as a response to the adaptation of the tax system to the new technologies that have arisen, and has a certain similarity with the Spanish DST in regards to its objective although the Hungarian tax has a more limited object, as it only effects advertisements. In any case, the tax was designed to complement the Hungarian CIT system. The act that governs the tax established that the taxpayers, which can be natural persons and legal entities, are the publishers that have the right to control the advertising spaces. The taxable amount was the annual net turnover that was generated from publishing, broadcasting, or displaying advertisements in Hungary on various media and traditional platforms, and the tax was levied at progressive rates. Specifically, the tax included six tax bands, and the tax rates ranged between 0% for turnover below HUF 500 million, and 40% for turnover above HUF 20,000 million. The tax rate applicable to the highest band was increased to 50% effective on January 1, 2015.[288]

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[285] CJEU judgment of March 3, 2020, C-75/18, *Vodafone Magyarország*, paras. 18-32.
[286] CJEU judgment of March 3, 2020, C-323/18, *Tesco-Global Áruházak*, paras. 30-44.
[287] CJEU judgment, March 16, 2021, C-562/19 P, *Commission v Poland*; and of March 16, 2021, C-596/19 P, *Commission v Hungary*.
[288] Commission Decision 2017/329 of November 4, 2016 on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, paras. 13-14.

As explained by Károlyi (2022), the described progressive tax rate structure of the Hungarian advertisement tax was the reason behind the initiation of the formal investigation procedure before the European Commission, and it was changed several times. In June 2015, Hungary amended the tax by replacing the progressive scale of six tax rates ranging from 0 % to 50 %, to a dual rate system of 0% up to HUF 100 million, and a flat rate of 5.3% for the exceeding part.[289]

The Polish case regards the retail trade tax levied on the turnover generated from the sale of goods to consumers.[290] As explained by Parada (2019), the taxpayers are all the retailers that operate in Poland and the taxable amount is the taxpayer’s monthly retail sales turnover. Taxpayers with a total monthly turnover above PLN 17 million were subject to this tax, and a progressive tax rate applied which consisted of a tax rate of 0.8% for the part of monthly turnover between PLN 17 million and PLN 170 million, and 1.4% for the part of monthly turnover over PLN 170 million. Consequently, companies with a total monthly turnover below PLN 17 million were exempt from this tax.[291]

4.3.2.1. Analysis of the cases

The Hungarian[292] and Polish cases referred to above could be analyzed jointly since the decisions of each of the authorities (the Commission, the General Court, and the CJEU) on the State aid compatibility issue of the progressive taxation on turnover were aligned.[293] However, the analysis will be centered on the Hungarian tax on

[289] Commission Decision 2017/329 of November 4, 2016, on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, para. 22.
[290] Commission Decision 2018/160 of June 30, 2017 on the State aid SA.44351 (2016/C) (ex 2016/NN), (Commission Decision on the Polish retail trade tax), para. 13.
[291] For practical purposes it could be said that the tax included three tax bands, and that the tax rates ranged between 0% for monthly turnovers bellow PLN 17 million, and 1,4% for monthly turnovers above PLN 170 million.
[292] As indicated by García de Pablos (2020), this Hungarian tax on advertising was also the object of controversy between Google and the Hungarian tax authority for having infringed the obligation to submit a tax declaration of persons exercising an activity subject to this tax in accordance with the Hungarian legislation, though this case does is not directly relevant for analyzing if the first threshold of the Spanish DST is contrary to EU law. See CJEU judgment of March 3, 2020, C-482/18, *Google Ireland*.
[293] The structure of both taxes (Hungarian and Polish) and the related controversy is very similar. In fact, the respective appeals were decided by the CJEU on the same date and with practically identical rulings, and the Hungarian and Polish States were parties to both legal proceedings.

advertising as it has a closer relation with the Spanish DST than the Polish retail tax, which does not have any relation with the digital economy.[294]

4.3.2.2. Commission

The main legal reason for the Commission to initiate a State aid investigation was based on the steeply progressive tax rate structure.[295] In its final decision the Commission concluded that the progressive tax rate structure constituted prohibited State aid.[296] The Commission found that the act that governed the contested tax granted a selective advantage to smaller entities with a lower level of turnover as they benefited from lower average tax rates.[297] It declared that this advantage was selective regarding sectoral turnover taxes as all affected taxpayers were in a comparable factual and legal position in relation to the objective of the taxes that was, basically, public burden-sharing and revenue collection. Consequently, the Commission considered that all taxpayers should pay the same proportion of tax relative to their turnover. Therefore, the Commission decided that the progressive tax rate structure could not be part of the reference system of these turnover taxes. Thus, it was a derogation from the reference system that could not be justified by the structure of the system whose aim was to share public burden and to collect revenue. The Commission also added that, in its opinion, progressive rates for turnover taxes are only admissible in exceptional circumstances such as if the externalities generated by an activity that a tax is intended to cover also increase progressively, that is, more than proportionally in relation to its turnover.[298]

[294] The Hungarian tax bears some similarity to the Spanish DST. However, the Spanish DST has two major differences with respect to the Hungarian tax: (i) the DST is defined as a tax of an indirect nature, although this classification is debatable as it has been seen in Chapter 3, and (ii) the DST has a single tax rate; while the Hungarian tax is categorized as a direct tax and is calculated according to a scale of tax rates.
[295] Commission Decision 2017/329 of November 4, 2016, on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, para. 50.
[296] Commission Decision 2017/329 of November 4, 2016, on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, para. 90.
[297] Commission Decision 2017/329 of November 4, 2016, on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, para. 53.
[298] Commission Decision 2017/329 of November 4, 2016, on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, para. 69.

4.3.2.3. General Court

The General Court, after the appeal of the Hungarian Government, annulled the Commission's decision[299] and considered that when establishing the reference system (also referred to as the common or normal system of taxation), it is not possible to exclude certain tax rates since they form part of the essential elements of a tax system irrespective of whether these are levied at a flat rate or according to a progressive scale. In the ruling, the spotlight was put on the Commission's approach that indicated that the reference system of the contested taxes was a tax with a single rate with no exemption which leads to a hypothetical reference system. So, the court concluded that the selectivity of a tax measure must be analyzed taking into account the real characteristics of the reference system without making suppositions.[300] Overall, the General Court set forth that the reference system was made up of the contested tax itself together with its progressive tax rate structure. Moreover, it also recognizes another aim of the contested tax aside from obtaining tax revenue, which is their redistributive objective and the taxation based on the ability to pay of the taxpayers. Based on this objective, the General Court considered that the level of turnover was a proxy for economic capacity, thus it found high-turnover and low-turnover entities to be incomparable.[301] Finally, the General Court stated that the use of a progressive or proportional method of taxation is left to the decision of Member States who are able to decide between one method or the other for the design of their own taxes, as long as it is not established in an arbitrary manner. In any case, the General Court ruled that such arbitrariness was not proven by the Commission.[302] In addition, the General Court did not consider it relevant that the two highest tax brackets (30% and 40%) applied only to one company and that that company paid approximately 80% of the overall tax collected.[303] In all, the General Court concluded that the Commission had not been able to sufficiently justify the existence of selectivity (a difference in treatment between comparable entities without a valid reason), and as a result, the

[299] GC judgment of June 27, 2020, T-20/17, *Hungary v Commission*.
[300] GC judgment of June 27, 2020, T-20/17, *Hungary v Commission*, para. 81.
[301] GC judgment of June 27, 2020, T-20/17, *Hungary v Commission*, paras. 87-90.
[302] GC judgment of June 27, 2020, T-20/17, *Hungary v Commission*, paras. 104-105.
[303] GC judgment of June 27, 2020, T-20/17, *Hungary v Commission*, para. 108. Moreno González (2021) interprets that for the General Court the decisive aspect for assessing selectivity is that the advantage that can be identified for certain companies leads to differences that are contrary to the objective of the tax. However, if the objective of the tax requires that the tax burden must be spread or its impact limited, there will be no selectivity when the different tax treatment is directly linked to this objective.

existence of State aid was not demonstrated which led the court to nullify the Commission's decision (Iglesias Caridad, 2020).

4.3.2.4. Court of Justice of the EU

The CJEU dismissed the appeal of the Commission. It first recalled the cumulative criteria under Article 107(1) of the TFEU that must be satisfied for a tax measure to be considered as State aid. It started its examination by explaining that Member States have competence in the field of direct taxation. Thus, Member States are able to design their tax system as they deem most suitable, including the tax rate structure of a tax, although in doing so, they must comply with EU law.[304] The CJEU established that the State aid rules do not prohibit progressive taxation.[305] It also indicated that this conclusion would be no different when the basis of the assessment of the tax was turnover since the amount of turnover constitutes a criterion of differentiation that is neutral and a pertinent standard of the taxpayer's ability to pay in accordance with what was already ruled in the *Vodafone* and *Tesco* cases.[306] The CJEU added that State aid control is about eliminating selective advantages rather than finding what the best tax system could be.[307] Consequently, the CJEU considered that the characteristics of the tax, including progressive tax rates, constituted the reference system (the normal system of taxation).[308]

The CJEU concluded that the Commission had incorrectly identified the reference system. Nevertheless, the CJEU considered that reference system as such might also constitute a selective advantage in the event the Commission was able to reveal that it included a manifestly discriminatory feature.[309] The CJEU made reference to the *Gibraltar* case ruling by stating that the Gibraltar tax system circumvented EU law on State aid by creating a manifestly discriminatory general tax system that favored

[304] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, paras. 43-44.
[305] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, para. 46.
[306] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, para. 47. This idea is similarly expressed in CJEU judgments of March 3, 2020, C-75/18, *Vodafone Magyarország*, para. 50; and C-323/18, *Tesco-Global Áruházak*, para. 70.
[307] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, para. 47.
[308] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, para. 48.
[309] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, para. 48.

offshore entities, which appeared to be inconsistent regarding the objective of creating a general tax that affected all entities.[310]

Finally, it must be pointed out that the CJEU did not resolve the question of whether the contested taxes included manifestly discriminatory elements since the Commission did not provide such evidence.[311] As a result, the CJEU did not analyze the criterion of selectivity and upheld the General Court's ruling.[312] As explained, the selectivity criterion is key when State aid rules are applied in the field of taxation. In this sense, the CJEU has established that the analysis of the selectivity criterion implies in the first place the determination of the reference system within which the measure falls, these being of greater importance in tax matters as the existence of an advantage can be determine only when it is compared with what is considered to be normal taxation.[313] The CJEU's ruling on the progressive turnover-based tax cases backs this argument as the analysis performed could not be completed because the Commission did not correctly determine the reference system which is necessary in order to define the scope of the State aid rules.

In summary, the CJEU limited its examination to two matters. The first issue being whether the Commission had correctly determined the reference system, and the second issue being whether the Commission had provided evidence that the reference system was conceived in a manifestly discriminatory way. The CJEU concluded that all the elements of the taxes formed part of the reference system, including the progressive tax rates that the Commission had excluded, and considered that it was not able to continue with the analysis as the reference system was incorrectly determined. Consequently, after the ruling of the CJEU, the annulment of the Commission's decision on the Hungarian tax on advertising became final.

4.3.3. State aid elements of the Spanish DST

In the framework of the Spanish DST, two issues come up in relation to the appropriate reference system. The first concerns digital services that are covered. Since the Spanish DST is levied on revenue of the digital services covered, it should be asked

[310] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, para. 49.
[311] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, para. 50.
[312] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*, para. 52.
[313] CJEU judgments of June 28, 2018, C-203/16 P, *Andres (Heitkamp BauHolding) v Commission*, para. 88.

whether the non-taxation of entities that provide non-covered digital services can be considered as a selective advantage. The second concerns thresholds. An entity is a taxpayer of the Spanish DST depending on its level of turnover, so it must be analyzed whether the €750 million worldwide turnover threshold constitutes a derogation from the reference system.

4.3.3.1. Digital services covered

The first difference is based on the fact that the Spanish DST is levied on very specific revenue as it only falls under the scope of this tax revenue from digital advertising, digital intermediary services, and transfer of collected data. So, it must be analyzed whether the revenue that is covered and that which is not covered are comparable in light of the objective of the tax (of the reference system). However, as will be explained in Chapter 5, the comparability analysis of digital vs. traditional services, and covered digital vs. non-covered digital services, leads to the result that no discrimination occurs since the groups are non-comparable. Therefore, there would be no grounds to consider as a selective advantage the non-taxation of entities that provide non-covered services.

As has been explained, a measure is selective if it constitutes a derogation from the normal tax system (reference system). This is the case when a measure favors certain entities over others which are in a comparable factual and legal situation. This differentiation is not justified by the nature or general structure of the reference system (i.e. the objective of the tax system or of the tax in itself).[314] Consequently, this differential treatment can be deemed as discriminatory. The CJEU, based on the *Adria-Wien Pipeline*, *British Aggregates,* and *ANGED* cases, has concluded that for the determination of a correct reference system, it is indifferent whether certain activities fall within or out of the scope of the tax. So, if the activities are comparable in light of the objective of the tax, they will form the reference system, irrespective of the limits established by the lawmaker (Károlyi, 2022).

However, the reference system of the Spanish DST should be limited to the taxation of the digital services covered. It is important to bear in mind that the objective of the

[314] CJEU judgments of September 6, 2006, case C-88/03, *Portugal v Commission*, para. 54, and of September 8, 2011, joined cases C-78/08 to C-80/08, *Paint Graphos and Others*, para. 49.

tax is of great importance in the State aid analysis. The objective of the Spanish DST is to tax the value created through the users. In other words, it taxes activities in which the user plays a key role to create value. Consequently, the selection of covered services is in accordance with the normal system of taxation (the objective of the tax).

4.3.3.2. Thresholds

The Spanish DST is imposed on entities that exceed a very high turnover threshold. Furthermore, unlike other progressive turnover-based taxes, the Spanish DST thresholds does not establish any sort of graduation. The digital services providers with a net turnover that does not exceed €750 million or with revenues of digital services covered in Spain lower that €3 million do not fall under the scope of this tax. Nevertheless, once the established thresholds are exceeded, the whole amount of revenue obtained in Spain that derives from digital services covered becomes taxable, and not only the exceeding part. Two average tax rates are applicable in DSTs in theory: a 0% rate is applicable when one or both of the thresholds are not met and the entity falls outside the scope of the tax, or a 3% rate is applicable when the two thresholds are exceeded and the entity falls under the scope of the tax. This tax rate structure does not seem to meet with the objective of fair taxation as it treats entities with similar levels of digital revenue (i.e. those entities that are just below and just above the set threshold) entirely differently. This effect does not happen with gradually progressive turnover-based taxes since the average tax rates can be evenly allocated, and consequently, entities are treated in a fairer way in accordance with their generated revenue (Károlyi, 2022). It must be borne in mind that the CJEU has established that when assessing a State aid measure, this assessment is not based on whether there is a more appropriate way to design the tax, but rather assessing the existence or not of selectivity in the measure.[315]

In addition, as reasoned in the EU freedom infringement section of this dissertation, it is hard to argue that entities with €750 million turnover (very large companies) or €50 million turnover (large companies)[316] are not comparable for the purpose of this tax. Therefore, the design of the Spanish DST could constitute a potential form of

[315] CJEU judgment of March 16, 2021, C-596/19 P, *Commission v Hungary*.
[316] Under article 2 of Annex I of the EU Commission Regulation 651/2014, an enterprise with more than 250 employees and with an annual turnover exceeding €50 million is considered as a large company.

State aid which distinguishes between digital service providers that exceed the set thresholds and thus fall under the scope of the tax (i.e. very large companies), and those entities that do not fall under the scope of the tax for not exceeding these thresholds (i.e. large companies, and SMEs).

As already explained, in accordance with the EU case-law interpretation of the selectivity requirement in State aid procedures, the existence of a reasonable justification or not in the different treatment provided to similar situations is what determines whether a measure can be deemed as prohibited State aid. Consequently, it is necessary to assess the justification provided in the Spanish DST Act to be able to conclude whether it is reasonable and sufficient to delimit the tax to MNEs.

In this sense, the Preamble of the Spanish DST Act justifies the €750 million threshold stating that: (i) it limits the application of the DST to entities of a certain scale, which are those which have strong market position that allow them to benefit from network effects and exploitation of big data, and thus are able to build their business models around user participation; (ii) it is the same threshold as the one established in the Country-by-Country Report which should provide legal certainty since both the STA as well as corporations will be able to determine more easily whether a company is subject to the tax or not; and (iii) due to this threshold, SMEs, as well as startups, will be excluded from this tax since, for this type of companies, the compliance cost associated with the Spanish DST could have a disproportionate effect on them.

Accordingly, the DST is intended to tax transactions whereby companies monetize the digital data generated by their users on the interface and obtain an economic benefit from it. This type of business models is mainly nourished by the network effects generated by the user's participation in the interfaces and can only be significantly exploited by large companies that have a large number of users on their interface, (i.e. large digital services providers such as Amazon, Google, or Facebook). This is the case of digital platforms that have millions of users on their interfaces that generate data which these companies are then able to exploit commercially. On the other hand, the exploitation of this type of business model (monetization of users' data) cannot be carried out by a SME that could have at most a network of hundreds of users. In this case, the exploitation of users' data may be for internal use but probably not for commercial purposes. In any case, the amount of data that SMEs obtain is most likely to be insignificant compared to the volume of larger entities, as these business models require a large number of users to generate significant network effects. Therefore, unlike digital MNEs, it is not expected that SMEs will obtain significant revenue worthy of being taxed given that the compliance cost associated with the Spanish DST could have a disproportionate effect on them, especially considering the importance of having the adequate technology in place to locate the users as explained in Chapter 2.

Lastly, as pointed out in the explanatory memorandum of the DST Directive Proposal, digital business models have a tendency towards winner-takes-most market structures due to the importance of a strong presence of network effects. In other words, this type of business model has a tendency towards monopoly or oligopoly situations because the economies of scale are so relevant that essentially a single entity or a limited number of entities control the market making it difficult for a relevant number of SMEs to exist (Cui, 2019b). This is why the companies in this sector of the economy are mainly very large MNEs.

Consequently, it is justified why SMEs are excluded from taxation and why very large MNEs with net turnovers greater €750 million fall under the scope of the tax. However, no reason is given in the Preamble of Spanish DST Act why large companies (with net turnovers between €50 and €750 million) are not taxed. The amount chosen for the turnover threshold (€750 million) cannot be justified for reasons of administrative efficiency and simplification. In all, the high threshold of the Spanish DST simply seems to serve as a mechanism to tax only MNEs. This reasoning seems insufficient to justify why large companies fall out of the scope of the tax, even though they also benefit from network effects and from economies of scale as do MNEs.

Based on these arguments, the design of the €750 million threshold does not seem to be coherent with the achievement of the objectives of the reference system. So, it can be concluded that the differentiation made by the Spanish DST based on the mentioned threshold is not justified by the nature of general structure of the reference system and that the Spanish DST likely constitutes prohibited State aid under Article 107(1) of the TFEU.

Authors such as Moreno Gonzalez (2021) consider that the CJEU ruling on the Hungarian advertisement tax gives arguments to sustain that the Spanish DST is compatible with EU State aid regulations. In the same line of reasoning, Pérez Merino (2023) defends that Spanish DST Act sufficiently justifies the use of the €750 million threshold as they limit their analysis by justifying that this threshold is reasonable for differentiating between MNEs and all other companies, and thus the tax cannot be considered as prohibited State aid. However, in this dissertation it has been argued that there are large companies with net turnovers below €750 million that do not fall under the scope of the tax but which are, nevertheless, comparable to very large companies although the Preamble of the Spanish DST Act fails to provide any reason why these companies are excluded from taxation. Other authors such as Mason & Parada (2018) consider that unilateral DSTs raise State aid issues as they are selective on the basis of size, sector, and nationality. This proves that there is not a unanimous position on this issue.

Finally, due to the €750 million turnover threshold, most of the taxpayers of the Spanish DST are US parented companies. It must be pointed out that State aid rules are applicable within the EU and a selective advantage granted to domestic entities to the detriment of third country taxpayers does not constitute an issue of state since it does not affect trade within the internal market. Consequently, as for the Spanish DST, it will have to be analyzed whether the disadvantaged group of entities has an establishment in a EU Member State. If that is not the case, State aid rules will not be infringed (Mason & Parada, 2020).

4.3.4. Implementation of the DSTs through a directive

Initially, DSTs were to be regulated through the enactment of a Directive of the EU. This never became a reality. It will now be analyzed if there is any difference regarding State aid rules when DSTs are developed unilaterally by Member States, as has occurred, or when they are introduced into domestic legislation by transposing a EU directive, as it was initially intended.

Under the *Deutsche Bahn* doctrine, a domestic tax cannot be analyzed as State aid if it has correctly transposed the provisions of a directive (Mason & Parada, 2018).[317] Consequently, a EU Directive on a DST would not be investigated for being contrary to State aid rules since the court assumes that the enactment of measures at a EU level is compliant with EU law from a State aid perspective (Pistone, Nogueira & Turina, 2021). On the other hand, unilateral DSTs enacted by Member States can be subject to a State aid investigation.

It will now be analyzed whether the Commission might initiate an investigation regarding the Spanish DST even though this tax is based on the Commission's EU DST Directive Proposal. In this sense, it must be considered that the Commission initiated investigations on other turnover-based taxes in light of the State aid rules with a similar design to the Spanish DST.

In the opinions of AG Kokott on turnover-based tax cases, it has been pointed out that the Commission seems to have different views on State aid regarding domestic taxes on the one hand, and DSTs, even though these taxes have some relevant similarities.[318] AG Kokott has used the Commission's DST Directive Proposal as an argument supporting that the Commission should not challenge other progressive turnover-based taxes on the basis of State aid rules since the Commission proposed a tax (the EU DST) that would entail more extreme distinctions between entities that could potentially be affected by the tax.[319]

The CJEU did not make any reference to the Commission's DST proposal in any of its rulings. To have done so would have been unreasonable because though there are similarities between the taxes; the objective of the rulings was not to analyze the DSTs. Even if the Commission decided not to initiate an investigation on the Spanish DST in light of a potential infringement of State aid rules, a situation that seems likely since the tax is based on their proposal, a Spanish court could make a referral to the CJEU which would have to decide on this issue (Moreno González, 2021).

[317] CJEU judgment of April 23, 2009, C-460/07, *Puffer*, para. 70; and CFI judgment of April 5, 2006, case T-351/02, *Deutsche Bahn AG v. Commission*, paras. 101-102.
[318] Opinion of AG Kokott, C‑596/19 P, *European Commission v Hungary*, para. 60; and Opinion of AG Kokott, C‑562/19 P, *European Commission v Republic of Poland*, para. 54.
[319] Opinion of AG Kokott, C‑596/19 P, *European Commission v Hungary*, para. 66; and Opinion of AG Kokott, C‑562/19 P, *European Commission v Republic of Poland*, para. 60.

4.3.5. Interim conclusions

In this section, the compatibility of the Spanish DST was analyzed in light of the State aid rules. The CJEU case-law on State aid tax matters considers that the selectivity criterion plays an essential role when assessing State aid issues. This criterion can be understood to be fulfilled if it is found that the tax measure discriminates.

It has been found the Spanish DST creates a potential State aid issue as it has been considered a discriminatory tax due to the €750 million turnover threshold, an amount which cannot be justified for administrative reasons. In addition, and also due to its tax rate structure, it does not seem to meet the objective of fair taxation as no graduation applies.

Also, it must be considered that if the DST was enacted at a EU level by a directive, as was the original intention, there would not be any State aid rule infringement.

4.4. The compatibility of the Spanish DST with Article 110 TFEU

Article 110 of the TFEU prohibits Member States from establishing protectionist taxes on goods to protect the internal market within the EU (Mason & Parada, 2020). This provision reads as follows: “No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products.”

Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products.

In other words, this article ensures that goods from EU Member States are not subject to a different tax treatment in the Member State of destination compared to domestic goods in order to attain the neutrality of competition within the EU market.[320] As explained by Károlyi (2022), it is plausible that a tax measure is considered as a prohibited tax under Article 110 of the TFEU, and also contrary to the fundamental freedoms.

[320] CJEU judgment of November 8, 2007, C-221/06, *Stadtgemeinde Frohnleiten, Gemeindebetriebe Frohnleiten*, para. 30.

This section of the chapter will analyze whether the Spanish DST might be contrary to Article 110 of the TFEU for being considered as a discriminatory tax measure against foreign goods. Nevertheless, the only taxable event relevant to be analyzed in this section is the online intermediary services in which the sale of the products is performed through the use of a multi-sided digital interface. The other digital services covered by the Spanish DST (digital advertising services, and data transmission services) are not relevant for the purposes of analyzing Article 110 of the TFEU because they are not engaged in the sale of goods.

4.4.1. Legal analysis

It is necessary to first examine whether the Spanish DST falls within the scope of Article 110 of the TFEU since it does not tax goods, but rather an economic activity that consists in the provision of digital intermediary services. According to case-law of the CJEU, Article 110 of the TFEU must be interpreted broadly in order to cover direct or indirect imposition of internal taxation of goods to ensure an equal treatment between domestic and foreign products.[321] In accordance with this broad interpretation of internal taxation of goods, the CJEU declared that Article 110 of the TFEU is applicable whenever a tax measure is likely to discourage imports of products that originate in other Member States in order to benefit domestic products.[322] Furthermore, the CJEU has also said that a tax measure that is imposed on the specific activity of an entity, and not on products as such, also falls under the scope of Article 110 of the TFEU in so far as it has an immediate effect on the cost of domestic and imported products, and indicates that this tax measure has to be applied in a way which does not discriminate against imported products.[323]

Therefore, under the CJEU case-law, the Spanish DST could fall within the scope of Article 110 of the TFEU. So, it must be analyzed whether this tax is enforced in a discriminatory manner in the sense that this tax immediately increases the costs of imported products to a grater extend than those of domestic products. As explained

[321] CJEU judgments of November 8, 2007, C-221/06, *Stadtgemeinde Frohnleiten, Gemeindebetriebe Frohnleiten*, para. 40; of December 7, 1995, C-45/94 *Ayuntamiento de Ceuta*, para. 29; of March 3, 1988, C-252/86, *Bergandi*, para. 25; and of February 16, 1977, C-20/76, *Schöttle*, para. 13.
[322] CJEU judgment of November 8, 2007, C-221/06, *Stadtgemeinde Frohnleiten, Gemeindebetriebe Frohnleiten*, para. 40.
[323] CJEU judgment of November 8, 2007, C-221/06, *Stadtgemeinde Frohnleiten, Gemeindebetriebe Frohnleiten*, para. 43.

by Károlyi (2022), the discriminatory effect would take place if the three following conditions are fulfilled: (i) foreign-owned entities suffer a higher tax burden compared to domestic entities; (ii) the products sold through the use of a multi-sided digital interface and the sale facilitated by an intermediary digital service supplier, are largely foreign; and (iii) the tax burden must be transferred, at least in part, to the user in the form of an increase in the prices of the goods so that the tax can have immediate effect.

In relation to the first condition, as concluded previously in this chapter, there are elements that demonstrate that the CJEU could rule that the Spanish DST generates discriminatory results. Thus, it is necessary to determine whether the goods sold through online digital platforms are normally foreign.

Regarding the second condition, in order to find product discrimination, foreign entities must sell or facilitate the sale of mostly foreign goods, whereas domestic entities must sell or facilitate the sale of mostly domestic goods. In the *Hervis*, *Tesco*, and *Vodafone* cases, the CJEU concluded that Article 110 of the TFEU was of no relevance because it did not appreciate that the tax being analyzed had a greater impact on goods from other Member States than on domestic goods (Mason & Parada, 2020). In relation to the *Hervis* case, AG Kokott reached the same conclusion as the CJEU. She pointed out that even if foreign-owned entities suffered a higher tax burden compared to domestic entities, it was not clear, in that given case, that foreign-owned entities sold goods mostly of foreign origin or not.[324] In other words, the origin of the entity's ownership does not necessarily have to correspond to the origin of the goods that it sells.

In order to determine whether this second condition is met regarding the Spanish DST, it is necessary to determine if the goods sold through online digital platforms are normally foreign. More precisely, it is necessary to know whether these products are imported from another Member State since Article 110 of the TFEU does not protect third country goods.[325]As concluded by AG Kokott in *Hervis* case, it is also difficult to find a link between the tax on the online intermediary service and the Member State origin of the underlying goods transferred through the platform. More than likely,

[324] Opinion of AG Kokott, C‑385/12, *Hervis Sport- és Divatkereskedelmi Kft.*, para. 28.
[325] CJEU judgment of December 18, 1997, C-284/96, *Tabouillot*, paras. 20-21, and cited cases.

most of these sales are of goods which have been imported directly from third countries.

Finally, the third condition consists in examining the direct impact of the tax on the product. It must be analyzed whether the tax is transferred to the final users by including it, or partly including it, in the price of the products when sold. According to the Spanish DST Act, the taxpayer is the entity itself which generates the revenue from the services covered by the tax. Thus, the legislature intended the tax burden to be paid by the taxpayer, especially considering that the act that governs this tax does not include any mechanism to legally pass the tax on to the user, though it does not prohibit taxpayers from doing so. Digital services providers can easily pass the tax burden, or part of the burden, on to the user by increasing the prices as already done by certain digital services providers (Salvatierra, 2021, January 20; Muñoz & Delle, 2021, March 3).[326]

4.4.2. Interim conclusion

Based on the examination carried out, it can be concluded that the Spanish DST does not infringe Article 110 of the TFEU. It is likely that this tax has an impact on the prices of the underlying sale of goods regarding online intermediary services as the digital services providers are able to pass the tax burden on to the users. However, there is no way to prove that such an impact affects goods of other Member States in a discriminatory way since, empirically, the origin of the goods mostly sold by foreign and domestic entities cannot be distinguished. In any case, it is clear that the Spanish legislature did not aim the Spanish DST at the underlying sale of goods since the focus was on the value created by the users when using an online intermediary service. Thus, it is highly improbable that a successful challenge would be raise before the CJEU on the grounds that the Spanish DST violates Article 110 of the TFEU.

4.5. The compatibility of the Spanish DST with the EU VAT Directive

Although it has been concluded in the previous chapter of this dissertation that the Spanish DST is a hybrid tax, it has been deemed appropriate to briefly analyze another possible infringement if the Spanish DST were to be considered as an indirect tax as

[326] In addition, see: https://support.google.com/google-ads/answer/9750227?hl=en; or, https://developer.apple.com/news/?id=tudh8rec.

it is in Article 1 of the Spanish DST Act. So, its compatibility with VAT will be studied.

Turnover-based taxes, such as the Spanish DST, are levied on the revenue from the goods and services on a specific business activity. Thus, as analyzed by Van Thiel, Pistone & Wathelet (2021), these taxes could have an overlapping effect with the field of application of the VAT and could threaten the fulfillment of the objectives of the EU common VAT system. If taxes are levied in parallel with the VAT and affect the prices of goods and services sold, the neutrality of the VAT system and the objective of a harmonized EU turnover tax system is put into jeopardy. To avoid this situation, Article 401 of the VAT Directive[327] was introduced so the EU VAT system would not be compromised by domestic taxes. This provision prohibits Member States from enacting turnover taxes that meet the essential characteristics of the VAT.

In this section of the chapter, an analysis will be carried out regarding the steps considered by the CJEU to determine whether a domestic tax qualifies as turnover tax under article 401 of the VAT Directive in order to conclude whether the Spanish DST infringes the VAT Directive. It must be pointed out that the term "turnover tax" is an autonomous concept in regards to EU VAT legislation and must be interpreted in accordance with article 401 of the VAT Directive.[328]

4.5.1. Legal analysis

Article 401 of the VAT Council Directive establishes:

> "Without prejudice to other provisions of Community law, this Directive shall not prevent a Member State from maintaining or introducing taxes on insurance contracts, taxes on betting and gambling, excise duties, stamp duties or, more generally, any taxes, duties or charges which cannot be characterised as turnover taxes, provided that the collecting of those taxes, duties or charges does not give rise, in trade between Member States, to formalities connected with the crossing of frontiers."

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[327] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 (2006).
[328] CJEU judgment of July 13, 1989, joined C-93/88 and C-94/88, *Wisselink and Others v. Staatssecretaris van Financiën*, paras. 15-16.

As explained by Haslehner (2019), the case-law of the CJEU has been consistent in limiting a Member State's competence to regulate a tax that has these four main features of the VAT: (i) applicable in general to goods and services, (ii) a proportionate rate to the price of these goods and services, (iii) a collection system applicable to each phase of the distribution or production processes, and (iv) the regulation of an input-tax deduction system.[329]

Based on the above, these are the elements that the CJEU uses to define the term "turnover tax" under Article 401. It is clear that only those taxes that cumulatively meet the four main characteristics of the VAT will fall within the scope of the prohibition of this article. In addition, case-law[330] of the CJEU has ruled that VAT is compatible with other domestic indirect taxes that are levied on a specific product or service, since these other domestic taxes are not a general tax as the VAT (Haslehner, 2019).

The Spanish DST is levied on the revenues that arise from certain digital services. This tax has a single flat tax rate; though it is applicable only if the revenue of the taxpayer exceeds certain thresholds. Once the threshold is exceeded, the entirety of the revenue becomes taxable, and not only the amount that exceeds the threshold.

The interpretation of the term "turnover tax" by the CJEU is so restrictive that the DSTs will clearly not fall within its scope (Haslehner, 2019; Ismer & Jescheck, 2018; and Kofler, Mayr & Schlager, 2017; Pistone & Ullmann, 2021). The Spanish DST is levied on the turnover of only certain digital services, not being applicable, in general, to all supplies of services. Thus, it is beyond a shadow of a doubt that the first criterion is not met.

4.5.2. Interim conclusion

As the Spanish DST complies with the characteristic of being imposed only on revenues from specific services of a digital nature and is not deemed to be a general

[329] Haslehner (2019) mentions as case-law of the CJEU the following cases: *EKW & Wein & Co* (C-437/97), *KOGAZ & Others* (C-283/06 and C-312/06), and *Krawczyn´ski* (C-426/07).
[330] As an example, CJEU judgment of July 13, 1989, joined cases C-93/88 and C-94/88, *Wisselink and Others v Staatssecretaris van Financiën*.

tax on all goods and services, then it will be compatible with EU harmonized legislation on VAT.

4.6. Conclusions

This chapter has argued that there are arguments which sustain that the Spanish DST infringes EU law that prohibit nationality discrimination, and more specifically it has been found that it violates fundamental freedoms as well as State aid rules. Case-law of the CJEU provides strong arguments that the court might accept these claims in a potential claim against the Spanish DST. However, no violation of this tax is found in regard to Article 110 of the TFEU and with the VAT Directive.

After having analyzed whether the Spanish DST infringes EU law, the following chapter will address the third hypothesis which calls to examine relevant issues that the Spanish DST faces with tax principles covered under Spanish law. This will be the third of the three chapters which address the hypotheses drawn as described in Chapter 1.

CHAPTER 5: THE COMPATIBILITY OF THE SPANISH DST WITH TAX PRINCIPLES AND DOMESTIC LAW

5.1. Introduction

This chapter will analyze from a legal perspective the most relevant controversies regarding tax principles and Spanish law that have been found in the previous sections of this dissertation when analyzing the Spanish DST.[331] It has been considered interesting to analyze whether the Spanish DST could infringe the prohibition of arbitrariness (Section 5.2), the generality principle (Section 5.3), the equality and the non-discrimination principles (Section 5.4), the ability to pay principle together with the non-confiscatory principle (Section 5.5), as well as the non-double taxation principle that derives from the non-confiscatory principle (Section 5.6), and the legal certainty principle and the prohibition of retroactivity (Section 5.7), all of them principles protected by the Spanish Constitution. The chapter will also provide an analysis of the issues regarding the concept of targeted advertising used in the Spanish DST Act (Section 5.8). At the end, conclusions will be drawn (Section 5.9).

5.2. The prohibition of arbitrariness

This first section will analyze whether the Spanish DST infringes the principle of prohibition of arbitrariness of the public authorities. This legal principle is set forth in Article 9.3 of the Spanish Constitution under which the entire Spanish legal system must be interpreted.

Precisely, Article 9.3 of the Spanish Constitution establishes that the Spanish Constitution guarantees the principle of legality, the hierarchy of norms, the publicity of legal enactments, the non-retroactivity of punitive measures that are unfavorable to individuals or which restrict individual rights, legal certainty, as well as the accountability of the public authorities and the prohibition against arbitrary action of the public authorities.[332]

[331] According to Aguallo Avilés (2001) tax law, together with criminal law, are the areas where the rights of citizens are most limited or compromised.

[332] Rozas Valdes (2010) considers the prohibition of arbitrariness to be essential for the correct functioning of the tax system. In this sense, the mentioned author recognizes the need to establish control mechanisms to limit arbitrariness of the tax authorities so a unanimous criterion within the administration can exist, and also with regards to the courts of justice.

Therefore, the principle of the prohibition against arbitrariness binds all public authorities. No branch of government (legislative, executive, and judicial) may act arbitrarily in the exercise of the powers entrusted to them (Roca Trías, 2013).

In relation to this principle, the Spanish Constitutional Court considers that the constitutional control of laws cannot impose undue constraints on the legislative branch, insofar as the laws are an expression of the will of the people as these have been passed by their democratically elected representatives (Roca Trías, 2013). Therefore, the Spanish Constitutional Court recognizes in its judgments of March 14, 2000 (judgment 73/2000), and of April 13, 2000 (judgment 104/2000), that to rule that a law is arbitrary requires that the constitutional review must be carried out with caution to not impose undue restrictions on the legislature and must always respect its policy choices.[333] However, the Spanish Constitutional Court in its judgment of October 6, 2016 (judgment 167/2016) does not exclude the possibility of such control when the law can be considered arbitrary because it is capricious, inconsistent, incoherent, or creates inequality.[334]

As can be perceived, the prohibition of arbitrariness is an indeterminate legal concept, which must be analyzed in each given case as done by the Spanish Constitutional Court which has been specifying when the legislative branch can incur in arbitrariness when enacting laws. Settle case-law of the Spanish Constitutional Court[335] has analyzed the prohibition of arbitrariness from a double perspective: (i) A law can be deemed arbitrary when it establishes unjustified discrimination or unequal treatment; and (ii) a law can be deemed arbitrary when it is not justified or lacks a rational explanation, or is based on erroneous assumptions, or generates effects contradictory to those intended.

Considering this second perspective, the Spanish Constitutional Court analyzes the principle of the prohibition of arbitrariness as a limit to the discretion of the legislature. The idea is that when the exercise of power is arbitrary, it can result in an unfounded,

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[333] Though it is reasonable that a constitutional court cannot impose undue restrictions on the legislature and must respect its policy choices, Sánchez Serrano (1997) strongly criticizes the Spanish Constitutional Court for acting in certain tax cases as a legitimizer of the governmental authority instead of acting as a court of constitutional guarantees should.

[334] This conclusion has also been reached by the Spanish Constitutional Court in the judgments of March 14, 2020 (judgment 73/2000); of December 16, 1999 (judgment 233/1999); of December 17, 1992 (judgment 239/1992); of November 29, 1988 (judgment 227/1988); and of June 11, 1987 (judgment 99/1987).

[335] See Spanish Constitutional Court judgments of September 19, 2018 (judgment 98/2018); of October 6, 2016 (judgment 167/2016); of April 13, 2000 (judgment 104/2000); of June 13, 1996 (judgment 108/1996); and of April 5, 1990 (judgment 65/1990).

contradictory, or counterproductive decision (Roca Trías, 2013). Thus, the court must examine the reasonableness of a law according to the specific circumstances of each case.

Atienza Rodríguez (1987) indicates that reasonableness is a central concept in the theory and practice of legal reasoning. In addition, Adinolfi (2009) points out that the concept of reasonableness plays a prominent role whenever a balancing approach and a cost-benefit analysis is required. Though, as explained by Adinolfi (2009), it is hard to establish a single and comprehensive definition of such a concept as it takes meanings and purposes that can vary depending on the contexts in which it is invoked, reasonableness can be said to be an interpretative criterion and a general principle of law that legislatures must respect.[336] For instance, it might be necessary to weigh the demand to develop industry against the call for environmental protection. In this case, the recourse to reasonableness provides the courts and the legislatures with a criterion that transcends a legal solution, as the interests of the different actors will have to be assessed and balanced (Adinolfi, 2009).

From this point of view, the judgment of the Spanish Constitutional Court of June 6, 1991 (judgment 130/1991) has associated arbitrariness with irrational or absurd conduct on the part of the lawmaker.[337]

In the case of the Spanish DST, there are several elements that indicate that the configuration of this tax can be considered as arbitrary.

Therefore, the goal of this first section is to analyze whether there was arbitrariness on the part of the legislature while designing the Spanish DST since constitutional principles might have been infringed and the tax could be based on erroneous or biased justifications that altogether generate unwanted effects.

[336] Atienza Rodríguez (1987) also considers that reasonableness applied in the legal field is a notion of a variable content and must therefore be understood from both a historical or social point of view (what is seen as reasonable depends on temporal and territorial circumstances), and from a logical point of view (what is to be understood as reasonable depends on the specific field to which this notion is applied). Thus, as specified by the mentioned author, though it is a historically and socially variable notion, it can refer to a plurality of possible solutions that can all be reasonable. That said, legal decisions cannot, or should not, ever be unreasonable (Atienza Rodríguez, 1987).

[337] In the same sense, see judgments of the Spanish Constitutional Court of June 14, 2022 (judgment 74/2022); of December 17, 2012 (judgment 238/2012); of December 13, 2011 (judgment 196/2011); and of July 29, 1986 (judgment 108/1986).

The Preamble contains the justifications of the thresholds to determine what entities are taxpayers. The first threshold (€750 million threshold) limits the application of this tax to large companies by using the amount established in the Country-by-Country Report. The justification used is to avoid taxing SMEs. The Preamble also reasons that only large companies are the ones that can benefit from the digital business model. By establishing such a high threshold, many large companies, meaning companies with turnover above €50 million according to EU legislation, fall outside of the scope of the tax and are also able to benefit from the digital business model. In all, by establishing such a high threshold, many large companies are left out of the scope of the tax without justification.

The second threshold (€3 million threshold) is justified by the Preamble for limiting the application of this tax to situations in which there is a significant digital footprint of the taxpayer in Spain regarding the digital services taxes. However, the Preamble does not offer any explanation as to why this amount is established and not another to determine that an entity has a significant presence in Spain. Furthermore, its configuration as a threshold that separates taxation from non-taxation generates results that could be described as irrational and discriminatory. In effect, a single euro of difference (that would be the difference between revenue of covered services of €3,000,000 and of €3,000,001) is sufficient to determine if an entity's total amount of revenues of covered services obtained in Spain becomes taxable or not.

This arbitrary decision of establishing this threshold violates the idea set forth behind the provision contained under Article 56.3 of the Spanish GTA, according to which the total tax liability must be reduced ex officio when the application of the tax rates shows that an increase in the tax base corresponds to a portion of the tax liability that is greater than such increase. Though the mentioned provision refers to a tax rate structure, there is a clear intention of the Spanish GTA to reduce a disproportionate tax liability, a situation that is not met in the case of the Spanish DST.

In addition, the €3 million threshold can make large traditional companies that form part of important groups, such as airlines or newspapers that obtain relevant revenues from digital advertising on their websites fall under the scope of this tax, though the tax does not intend to target traditional sectors. Thus, this threshold could be raised as will be argued further along in this chapter.

The levy is not equitable and creates evident contradictions between its objectives and the results obtained. In summary, the contradictions contained in the Preamble of the Spanish DST Act that tries to justify the need for the established thresholds, the unjustified discrimination created between economic operators, the disconnection between the objective pursued and the result obtained that lead to illogical situations, mean that the establishment of the Spanish DST meets the requirements that the case-law of the Spanish Constitutional Court established to determine infringement of Article 9.3 of the Spanish Constitution for arbitrariness on the part of the legislature.

5.3. Infringement of the generality principle

The Spanish DST could infringe the generality principle under Article 31.1 of the Spanish Constitution that establishes that everyone shall contribute to the support of public expenses in accordance with their ability to pay.

In addition to this constitutional provision, the Spanish GTA also calls for this principle under Article 3 that establishes the principles of the tax system. This article considers that the tax system is based on the ability to pay of the persons obliged to pay taxes and on the principles of justice, generality, equality, progressiveness, equitable distribution of the tax burden, and non-confiscation.

Under the principle of generality, everyone must contribute to the tax system. This principle establishes a general obligation that prohibits taxes designed for specific persons and must be interpreted in accordance with the principles of equality (Articles 14 and 31.1 of the Spanish Constitution), ability to pay (Article 31.1 of the Spanish Constitution), and the prohibition of arbitrariness (Article 9.3 of the Spanish Constitution).

It is true that Spanish case-law has accepted that the lawmakers have a wide margin of discretion to configure taxable events and to define who the taxpayers are. Discussions on the scope of the generality principle in tax rules have mainly taken place in the field of environmental taxation. In this regard, the Spanish Supreme Court judgment of November 25, 2015 (judgment 5001/2015) is an example. In this ruling, it was established that the fact that certain activities have been chosen by the lawmakers as the object of taxation does not imply an infringement of the equality and generality principles. This ruling admits that a margin of discretion must be given to the lawmakers that allows them to decide what events should or should not be taxed. In addition, this ruling recognized that the generality principle cannot be infringed if the tax effects are the same to all those who find themselves in identical situations.

This ruling is consistent with the judgment of the Spanish Constitutional Court of April 25, 2002 (judgment 96/2002) which admits that the lawmakers have a wide range of liberty when it comes to taxing an economic activity that can cause a risk of deterioration on the environment as it is seen as a legitimate reason under Article 45 of the Spanish Constitution. This ruling recognized that a tax cannot be deemed as arbitrary if the legislature selects to tax, from among all activities carried out in a region or that put the environment at risk of deterioration, those that are potentially more harmful to the environment.

However, the reasons that allowed the Spanish Constitutional Court to validate the adequacy of the generality principle in the cases analyzed do not seem to concur with the Spanish DST. Firstly, because the goal of environmental taxes is to protect the environment, and as stated in Article 45 of the Spanish Constitution, everyone has the right to enjoy a suitable environment for the development of the person as well as the duty to preserve it. This circumstance is not present in the Spanish DST tax, whose only purpose is to provide greater resources to the treasury to finance its expenses.

Secondly, because in the case of the Spanish DST, the parameters for establishing who is a taxpayer are based on the level of global turnover and on the amount of revenues obtained in Spain from the covered services. It could be considered arbitrary that, among all the companies that carry out an economic activity with the objective of obtaining revenues, the lawmakers have established a tax on only very large corporations that obtain revenues from the provision of specific digital services. Based on the mentioned case-law, it can be concluded that, from the parameter of contributing to public expenses, all legal entities that have the same ability to pay shall be subject to an equivalent tax burden.

Calvo Ortega & Calvo Vérgez (2022) indicate that the purpose of this general call that everyone must contribute to finance the public expenditures under the generality principle is to avoid discrimination or privileges in favor of certain persons. These authors point out that the generality principle is key for achieving equality in taxation as a tax system can only be fair and the distribution of the tax burden equitable if all those with an equivalent ability to pay are treated equally. It is not possible for a certain group to be exempt from paying taxes while another group in the same situation is not (Calvo Ortega & Calvo Vérgez, 2022).

As established in the Spanish Constitutional Court judgment of July 22, 1996 (judgment 134/1996), the equality and generality principles are infringed when the criterion used for distributing public charges lacks any reasonable justification and, therefore, is incompatible with the objective of a fair tax system under article 31 of the Spanish Constitution.

Menendez Moreno (2019) argues that the Spanish DST might infringe the generality principle as it only taxes certain digital services, leaving other digital services untaxed. However, as indicated in the Preamble of the Spanish DST Act and analyzed in Chapter 2 of this dissertation, the digital services covered are those for which the participation of the user is essential in the value creation process of the provider of the services, and through which the provider is able to monetize the user contributions. As explained in Chapter 2, the possibility for the service providers to monetize the data of the users might not be possible in all digital services, but it is possible with regards to the three digital services that fall under the scope of the tax (online advertising services, online intermediary services, and data transmission services). As expressly mentioned in the Preamble, the services covered are those that could not exist without the participation from the users that provide their data to the service providers, this being the true essence of this tax. Thus, the possible violation of the generality principle should not be based on the perspective of whether all digital services are covered by the tax, but on whether there are any digital services not covered by the tax in which the participation of the users with their data is essential to provide this service. Consequently, it can be concluded that there is no infringement of the generality principle as it is believed that there are no other digital services apart from the ones covered that are entirely dependent on the users' data that do not fall under the scope of the tax without justification.[338]

[338] It could be claimed that online streaming of music or video could fall under the scope of the tax as users are the ones that upload content. Nevertheless, these services are potentially taxed under the category of online advertising services. Therefore, online streaming of music or video without charge for the user because it is remunerated by targeted advertising posted on the platform for the user to see will fall under the scope of the DST (e.g. free Spotify), while the exact same service with no advertising but in which the user must pay for the service, will not fall under the scope of the DST (e.g. Spotify Premium). Consequently, it seems reasonable to exclude online streaming of music or video based on its remuneration model. In addition, it must be said that paid online streaming of videos

Furthermore, it must be pointed out that if the legislature had not delimited the scope of the tax to the revenues of certain specific digital services, the taxable event could be qualified as a generic taxable base. Sainz de Bujanda (1966a) explains that if the taxable event is generic, the tax obligation will arise whenever an event occurs that is included in the general taxable event configured by the law, which generates a certain level of legal uncertainty as it might not be clear what events are taxed and what events fall out of the scope of the tax. Consequently, the lawmakers did well on delimiting the scope of the tax to certain types of digital services that have in common the dependency on the user's data in order to avoid a generic taxable event that could have generated a higher level of legal uncertainty if all digital services were to be taxed, specially taking into account that new digital services appear on a regular basis.

In addition, as described by Manzano Silva (2021), the principle of generality is interpreted from a subjective perspective, and from an objective perspective. As the generality principle entails the subjection of everyone to the tax system to contribute to the support of public expenses, the subjective exemptions, and not the objective exemptions, might come into conflict with this principle as these exemptions are based on the particular characteristics of the subjects (Manzano Silva, 2021). In other words, the generality principle might be infringed because certain entities are excluded from being subject to the Spanish DST (i.e. subjective exemption), not because certain services are subject to taxation while others are not (i.e. objective exemption).

The law must indicate those liable to pay the tax in an abstract and impersonal manner and must ensure that it does not treat taxpayers differently without justification and, therefore, in an arbitrary and discriminatory manner as set forth by the Spanish Supreme Court in its judgment of June 2, 1986 (judgment 10524/1986). Although the Spanish DST Act as it is drafted does not contain specific designations to particular entities, it apparently aims to tax an economic sector (digital services providers), and within this, very large groups of digital services providers due to the established thresholds. As the tax has been configured, it exclusively affects companies that are world leaders in providing digital services. Moreover, it is relevant to point out that in Spain the Spanish DST is colloquially known as the Google tax (or "*tasa Google*" in Spanish).

(e.g. Amazon Prime Video, Netflix, etc.) is more likely related to movies or series made by professionals rather than videos uploaded by users.

The subjection of specific taxpayers to the Spanish DST can be against the generality principle provided for in Article 31.1 of the Spanish Constitution. Nevertheless, in order to conclude if this infringement takes place, it is necessary to analyze this tax under the equality principle as both principles are highly interconnected, being necessary to examine whether a different treatment between economic operators is justified.

5.4. Infringement of the equality and the non-discrimination principle

It must be examined whether the Spanish DST infringes the equality and non-discrimination principles. These principles regard the duty to contribute to the support of public expenditure (Article 31.1 of the Spanish Constitution) as well as the principle of prohibition of arbitrariness (Article 9.3 of the Spanish Constitution).

The prohibition of discriminatory treatment is established in general terms under Article 14 of the Spanish Constitution in which it is stated that all Spanish citizens are equal before the law. This article also sets out that no discrimination may take place on the grounds of birth, gender, opinion, race, religion, or any other personal or social condition or circumstance.[339]

Consolidated case-law of the Spanish Constitutional Court[340] has declared that the analysis of unequal taxation must be placed within the scope of Article 31.1 of the Spanish Constitution, a provision that connects equality with the principles of generality, ability to pay, justice, and progressiveness.[341]

The Spanish Constitutional Court[342] has stated that if the discrimination or difference in treatment occurs due to subjective reasons (e.g. gender, race, religion, etc.), the infringement of the right to equality must be analyzed under Article 14 of the Spanish

[339] The prohibition of any type of discrimination is also found in EU law, in particular under Article 21 of the Charter of Fundamental Rights of the EU, and also under Article 14 of the Convention for the Protection of Human Rights and Fundamental Freedoms (also known as the Rome Convention).
[340] Among other judgments of the Spanish Constitutional Court, see judgments of October 11, 2006 (judgment 295/2006); of February 27, 2006 (judgment 54/2006); of February 13, 2006 (judgment 33/2006); of March 14, 2005 (judgment 57/2005); of January 20, 2005 (judgment 10/2005); of December 23, 2004 (judgment 233/2004); of February 14, 2000 (judgment 46/2000); of March 16, 1998 (judgment 55/1998); and of July 22, 1996 (judgment 134/1996).
[341] Mata Sierra (2009) states that the equality principle is infringed when unacceptable differences are introduced between persons, which violate the concept of justice, understood as what should be deemed as fair.
[342] Among other judgments of the Spanish Constitutional Court, see judgments of February 27, 2006 (judgment 54/2006); February 13, 2006 (judgment 33/2006); of March 14, 2005 (judgment 57/2005); and of November 4, 2004 (judgment 193/2004).

Constitution, and it can be appealed for constitutional protection of fundamental rights before the Spanish Constitutional Court (appeal for *amparo*, in Spanish), receiving the highest level of legal protection as a fundamental right. If the difference in treatment occurs due to objective reasons (e.g. different tax treatment) the infringement of the right to equality under tax matters must be analyzed in accordance with the ability to pay principle under Article 31.1 of the Spanish Constitution, and it cannot be appealed for *amparo* (Rodríguez Bereijo, 2011).

Thus, as determined by Lucas Durán (2016), if the difference in treatment is due to a tax measure in which different taxpayers that have the same ability to pay are taxed differently, this tax measure might be potentially infringing the tax equality under Article 31.1 of the Spanish Constitution that does not fall within the catalog of fundamental rights, being the reason why it cannot be appealed for *amparo*.

In relation to Article 31.1 of the Spanish Constitution, it must be borne in mind that this provision is binding not only on citizens but also on the public authorities as ruled by the Spanish Constitutional Court in its judgments of November 4, 2004 (judgment 193/2004) and April 26, 1990 (judgment 76/1990). Consequently, citizens are obliged to contribute in accordance with their ability to pay for the support of public expenditure, and the public authorities are obliged to demand this contribution from all taxpayers whose situation shows an ability to pay susceptible to taxation, avoiding any unjustified or disproportionate difference in treatment.

According to the Spanish Constitutional Court,[343] the equality principle imposes on the lawmakers the duty to provide equal treatment to those in equal situations, prohibiting any inequality which lacks a reasonable justification. So, for the difference in treatment to be in accordance with the Spanish Constitution, the legal consequences deriving from such a distinction must be proportionate to the purpose pursued, to avoid excessively burdensome or disproportionate results.

[343] Among other judgments of the Spanish Constitutional Court, see judgments of May 29, 2014 (judgment 83/2014); of October 11, 2006 (judgment 295/2006); of January 20, 2005 (judgment 10/2005); of December 23, 2004 (judgment 255/2004); of November 4, 2004 (judgment 193/2004); of July 17, 2003 (judgment 152/2003); of January 15, 2001 (judgment 1/2001); and of April 26, 1990 (judgment 76/1990).

In all, consolidated case-law of the Spanish Constitutional Court[344] has established that Article 31.1 of the Spanish Constitution prohibits lawmakers from taxing identical manifestations of wealth differently, unless there is reasonable justification.

Also, it must be pointed out that the prohibition of arbitrariness relates to the principle of equality when there is a lack of reasonable, objective, and proportional justification in the selection of the addressees of a rule, as decided by the Spanish Constitutional Court in its case-law.[345]

The analysis of arbitrariness must be carried out from double perspectives, that is from the point of view of equality as well as from the point of view of the rationality of the rule, as a rule may not be arbitrary from the former but it may be arbitrary from the latter, as recalled by the case-law of the Spanish Constitutional Court.[346]

The Spanish DST could potentially infringe the equality principle as not all entities that carry out an economic activity fall under the scope of this tax. Thus, the tax grants a different treatment from a double perspective: (i) From the point of view of the type of economic activities that are being taxed, the Spanish DST being a sectoral tax that refers to digital services; and (ii) from the point of view of digital services providers, the tax affecting only providers of certain types of digital services from which the revenues generated fall above certain financial thresholds.

The parameters for proving that an inequality of treatment is discriminatory and contrary to Articles 14 and 31.1 of the Spanish Constitution have been established by the case-law of the Spanish Constitutional Court. For instance, the judgment of the Spanish Constitutional Court of February 9, 2022 (judgment 20/2022) summarizes the process to be followed to analyze whether a given tax measure infringes the equality principle. In this sense, it establishes that first it is necessary to specify that the situations to be compared are equal; second, once it has been specified that the situations are comparable, it must be proven that there is an objective and reasonable purpose that legitimizes the unequal treatment of those equal situations; and, third, it must be demonstrated that the

[344] Among other judgments of the Spanish Constitutional Court, see judgments of February 15, 2012 (judgment 19/2012); of October 11, 2006 (judgment 295/2006); of February 13, 2006 (judgment 33/2006); and of March 14, 2005 (57/2005).
[345] See Spanish Constitutional Court judgments of October 6, 2016 (judgment 167/2016); and of June 23, 2016 (judgment 122/2016).
[346] See Spanish Constitutional Court judgments of May 9, 2013 (judgment 111/2013); and of February 15, 2012 (judgment 19/2012).

legal consequences that lead to the unequal treatment are reasonable, because there is a proportionality between the means employed and the purpose pursued, avoiding particularly burdensome or disproportionate results.

These are what is known as comparability, reasonableness, and proportionality tests that the Spanish Constitutional Court carries out to determine whether a measure infringes the equality principle. Likewise, the Spanish Constitutional Court has pointed out that to analyze whether the measure is reasonable and proportionate, it is necessary to examine the reasons given by the legislature in the Preamble of the act that governs the measure or even the arguments raised during the parliamentary debates.[347]

5.4.1. The comparability test

The comparability test consists of analyzing whether the situations to be compared are equal. To determine whether the Spanish DST complies with the equality principle, three different comparisons can be drawn. Each one of the comparisons is between two groups which include those entities that are taxpayers of the Spanish DST and those that are not since this tax provides different treatment to each of the potentially comparable groups in each one of the scenarios.

The first comparison to be analyzed is between digital service providers and non-digital service providers that carry out a similar activity but in a traditional form, that is offline. The second comparison is between digital service providers that reach the thresholds established and those digital service providers that do not reach such thresholds. Finally, the third comparison is between digital service providers that supply covered services and those digital service providers that supply non-covered digital services.

An analysis will be performed to determine whether the situations of each of these groups are comparable or not. There is no place for an unequal treatment if the groups are comparable.

5.4.1.1. Traditional vs. online services

In relation to the first scenario, an analysis is to be made to determine whether a traditional offline service supply is similar to the same service provided digitally and, if that is the

[347] See Spanish Constitutional Court judgments of November 4, 2004 (judgment 193/2004); and of January 20, 2000 (judgment 15/2000).

case, whether the different treatment given by the Spanish DST is justified due to their differences. For example, a reader of a newspaper could choose to go to a news stand and buy a printed version of a newspaper or to read the online version for free, though some content might be only available for subscribers that pay a monthly fee. These two provisions of services can be regarded as similar from the point of view of the consumer, so they can be considered as competitors since the main difference between both services is in relation to the form (offline or online) in which the service is provided. Nevertheless, there is a key difference between both services.

To illustrate these differences between offline and online services, the following hypothetical example is explained. A person situated in Spain wants to spend a weekend in New York City. This person introduces words like “Hotels in New York City” in an online search engine. Without any cost, the search engine displays different hotel options in New York City, some of which are cheaper, and others which are more expensive. This person decides to click on a specific hotel from a well-known hotel chain. For the search engine service provider, the data that it has collected from this person based on their choices is information that it will be able to monetize to provide its service for no cost to the user. It is likely that when this person visits an online newspaper to read the news, the website of this newspaper displays an advertisement from the same hotel chain that this person has selected, or for hotels of a comparable chain as the one selected, or even advertisements for airlines that fly to New York, or for tours of the city, etc. In all, advertisements will be displayed which this person may decide to click on, or at least take a look at, since they might have an interest in the services advertised.

In sum, digital platforms are able to obtain vast quantities of data from their users that is highly valuable. This data is then analyzed through sophisticated algorithms that enable them to precisely target users. Traditional services are not able to collect and use this data as digital services providers do. For instance, in a traditional newspaper, the advertising displayed is for all types of readers; it cannot be tailored to a specific reader. In contrast, the online version is able to display customized advertisements on the user’s device. Therefore, users’ data is highly valuable, and it is understandable why market jurisdictions such as Spain could be interested in taxing users’ participation in these digital platforms.

In addition, traditional service providers need to have some sort of physical presence in a territory to reach customers. So, the revenue obtained by traditional services providers will be subject to taxation through the CIT. However, digital services providers are able to perform their economic activity without having a physical presence in the jurisdiction where their users are located. Considering that the current international tax system is based on physical presence, it might be fair to say that a new nexus based on where the users are located could be implemented in order to tax value where it is created. In all, it is reasonable to say that offline and online services providers are not comparable. Therefore, it should not be deemed discriminatory that traditional providers are not subject to the Spanish DST, while digital services providers are.

5.4.1.2. Above vs. below the thresholds

The second scenario refers to the comparability of digital service providers that reach the thresholds established and, consequently, become taxpayers of the Spanish DST, and those digital service providers that do not reach such thresholds. Under Article 8 of the Spanish DST Act, taxpayers of the Spanish DST are those legal entities that exceed two thresholds: a) The net turnover must have been of over €750 million during the previous calendar year; and b) the total revenue from the provision of the services that are subject to the Spanish DST must have been of over €3 million during the previous calendar year.

As stated in Section V of the Preamble of the Spanish DST Act, the first threshold (€750 million threshold) limits the application of this tax to very large companies, while the second threshold (€3 million threshold) limits the application of this tax to situations in which there is a significant digital footprint of the taxpayer in Spain in relation to the digital services taxed.

Under the current tax design, large digital service providers that benefit from a strong market position but which are not subject to the Spanish DST are comparable to very large entities that do fall under the scope of the tax. In other words, the €750 million threshold leaves comparable entities both in and out of the scope of the tax. In addition, due to the tax rate structure, when an entity becomes a taxpayer of the Spanish DST, it will be taxed according to all the revenues obtained in Spain from covered services at a 3% tax rate, while an entity that falls short of the threshold will not be taxed at all. It is hard to justify this situation as fair treatment between comparable entities.

5.4.1.3. Covered vs. non-covered digital services

The third scenario compares digital service providers that supply covered services and those digital service providers that supply non-covered digital services. The Spanish DST taxes a narrow scope of revenue since the services covered are online advertising, online intermediation, and data transmission. There are many digital services in which an industry-wide carve-out seems to apply where specific services are exempt. As an example, the digital content exemption under Article 6.c of the Spanish DST Act applies to online streaming services of music and videos, or platforms that facilitate online payments and financial transactions.

The Spanish DST covers the same digital services as the DST Directive Proposal. As pointed out by Hufbauer & Lu (2018) it must be kept in mind that there are some European market leaders that provide services that are exempt from this tax such as the Swedish Spotify (online music streaming), the British Skrill (online payments), and the Finish Supercell (online gaming). Consequently, this cherry-picking of digital services excluded from the scope of the DSTs could be seen as a form of protectionism (Mason & Parada, 2020). However, revenue generated by these services could fall within the scope of the DSTs under the category of online advertising services. For instance, services for online streaming of music or video which can be offered without charge for the user because it is remunerated by advertising posted on the platform for the user to see will fall under the scope of this tax. Nevertheless, the exact same service with no advertising but for which the user must pay, will not fall under the scope of the DST. Understandably, this can explain why online streaming of music or video is considered as an exemption as their activity will be taxed by online advertising services. For example, YouTube relies on monetizing user content through online advertising services which represents approximately 83% of its revenue (Kim, 2020).

To determine the discriminatory effect, it must be analyzed whether the covered digital services are comparable to the non-covered ones while taking into consideration the justification for the exclusion. This justification is based on the idea that, for covered services, the user plays a key role in the creation of value for the entity. As explained in Chapter 2, it is coherent to use this criterion to select digital services to be taxed. Thus, the digital services covered and those that are not covered are seen as non-comparable. Therefore, there is no discrimination.

From the above examination regarding the comparability of the three possible scenarios analyzed, it can be concluded that in only one case are the two groups comparable but subject to differentiation caused by the thresholds. Consequently, there is discrimination against entities that exceed the thresholds which receive an unfavorable treatment due to the application of the Spanish DST because other entities, such as large companies that do not reach the thresholds but benefit from a strong market position and from the economies of scale, are comparable to them in light of the objective of the tax, but nevertheless, fall out of the scope of the tax.

Consequently, in order to determine whether the Spanish DST infringes the equality principle, it is also necessary to consider the reasonableness, and the proportionality tests as done by the Spanish Constitutional Court.

5.4.2. Reasonableness test

The reasonableness test requires analyzing whether there is an objective and reasonable purpose that legitimizes unequal treatment.[348]

First, in relation to the €750 million turnover threshold, though the Preamble of the tax justifies it by using the same amount as the Country-by-Country Report, and thus making it easier to identify what groups would be liable to fall under the scope of the tax, it is inconsistent with the objective of the tax as many large companies do not fall under its scope. As explained in Chapter 4, according to EU law large companies are considered to be those with turnover over €50 million. Consequently, it would have been reasonable for the legislature to use the €50 million threshold if the goal was to tax large digital services providers.

Second, as also explained in Chapter 4, there is no justification as to why the legislature established such a non-progressive tax rate structure. A taxpayer of the Spanish DST will be taxed according to all the revenue obtained in Spain from covered services at a 3% tax rate, while an entity that just falls short of the threshold will not be considered as a taxpayer. This situation is not reasonable as comparable entities (those with revenue just

[348] See judgments of the Spanish Constitutional Court of May 8, 2012 (judgment 100/2012); and of April 25, 2002 (judgment 96/2002).

above and below the threshold) are treated completely differently without any justification from the legislature.

5.4.3. Proportionality test

The proportionality[349] of a measure entails that even though consequences of a measure lead to unequal treatment, these consequences are reasonable since the measure pursues a constitutionally legitimate purpose in a coherent manner, avoiding particularly burdensome or disproportionate results.[350]

As explained, the existence of the €750 million threshold and the tax rate structure create a disproportionate situation that is unjustifiable. As argued in the USTR report, if a €50 million threshold were to be applied, more domestic companies would fall under the scope of the tax without affecting foreign entities so disproportionately. Also, in relation to the tax rate structure, it is entirely disproportionate that a single euro of difference (that would be between revenue of covered services of €3,000,000 to €3,000,001) is sufficient to determine if an entity's total amount of revenues of covered services obtained in Spain becomes taxable at 3% or is not taxed at all. As will be explained, there is the possibility to apply a more reasonable threshold and tax rate structure that would avoid such disproportionate results between comparable entities.

Therefore, the comparability, reasonableness, and proportionality tests lead to the conclusion that the Spanish DST infringes the equality and non-discrimination principles derived from a joint interpretation of Articles 14 and 31.1 of the Spanish Constitution, as the tax establishes an unequal treatment between entities in terms of the tax burden to be borne by taxpayers that does not carry an objective, reasoned, and proportionate justification.

[349] Alexy (1989) introduced the correctness thesis that is based on the idea that the law necessarily raises a claim to correctness, and that, therefore, there is a connection between law and morality; in essence, justice is seen as correctness. As indicated by the mentioned author, in order for a norm to be correct, it has to be the result of an argumentative procedure. As explained by Serrat Romaní (2017), proportionality plays a key role in Alexy's thesis as an instrument to achieve correctness, since proportionality entails an equilibrium that is necessary to obtain a fair application of the law. In order to seek such an equilibrium, different factors will have to be assessed and balanced to reach the fairest solution to a conflict.

[350] See judgments of the Spanish Constitutional Court of May 8, 2012 (judgment 100/2012); and of July 1, 1986 (judgment 88/1986).

5.4.4. Proposed measures to comply with the equality principle

In this section, ideas will be proposed to amend the tax to put it into accordance with the equality principle.

As explained in Chapter 4, Annex I of the EU Commission Regulation 651/2014 of June 17, 2014, declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, sets the definitions of micro enterprises and SMEs. Under article 2 of Annex I of this regulation, a medium-sized enterprise is an enterprise with fewer than 250 employees, with an annual turnover not exceeding €50 million, and/or an annual balance sheet that does not exceed €43 million. Therefore, if an enterprise exceeds the mentioned thresholds, it is considered a large company. Based on this provision, it can be proposed to decrease the current €750 million turnover threshold to a €50 turnover threshold. Though it will still affect mostly foreign or foreign-parented companies, it would be more coherent with EU law since it is in accordance with its definition of large companies. In any case, there would be fewer reasons to claim a discriminatory intent on part of the Spanish legislature as it could be defended that the thresholds are in accordance with EU law and proportionally more domestic companies would be taxed. It could also then be claimed that the result of more foreign or foreign-parented entities falling under the scope of the tax could be a consequence of the structure of the Spanish digital services market that is dominated by foreign owned corporations, and clearly not a discrimination intent. In addition, it must be mentioned that in the CJEU rulings on *Bachmann* (C-204/90) and *Commission vs Belgium* (C-300/90) it was first recognized that discriminatory domestic measures could be justified if proven that they were coherent with the tax system. As reasoned, the proposed measure is coherent with the purposes that the Spanish DST pursues, which is to tax large digital services providers as these are the ones that are able to benefit from the user's value creation, and not only very large entities in accordance with the definition of large companies found in EU legislation.

A special mention also needs to be made regarding the second threshold that limits the application of the Spanish DST to situations in which there is a significant digital presence in the territory of application of this tax. As explained in Chapter 2, the €3 million revenue threshold of covered services generated in Spain is similar to the threshold established in the Italian DST (€5.5 million), but much lower than the Austrian and French DSTs (€25 million) or the UK's DST (£25 million). Also, as indicated in Chapter 2, it is reasonable to consider that entities that form part of a large group of companies whose main activity is not that of a digital services provider might be affected by this tax, as would be the case of large airlines or news media groups that can obtain revenue from digital advertising on their websites.

No reason has been found for why the Spanish lawmakers established the amount of €3 million to consider that those entities with revenues of covered digital services obtained in Spain above this amount are deemed to have a significant digital presence in the territory of application of this tax. As the relevant criterion to determine digital presence is highly correlated with the number of users (population in a given territory), an objective criterion to use would be based on the Spanish population. First, it would be necessary to obtain the proportion that the Spanish population in 2018 (year in which the DST Directive Proposal came to light) represents relative to the EU population in the same year. The use of the population as a criterion could be seen as a relatively stable factor as it would be compared in proportion to the EU. It is reasonable to believe that if the Spanish population increases or decreases, the EU population as a whole could experience proportionally similar changes.

Second, the population of Spain in proportion to the rest of the EU would then be used as a function to calculate the threshold of covered services revenue generated within Spain relative to that generated within the rest of the EU. The proportion (9.1%)[351] would have to be multiplied by 50 million as this was the threshold of covered services revenue obtained in the EU established by the DST Directive Proposal. By doing so, we would obtain a threshold of €4,550,000, which for practical purposes could be rounded up to €5 million.

This amount is almost 67% higher than the one established by the Spanish legislature and it represents an objective way to set this threshold in line with the DST Directive Proposal. By implementing the mechanism based on the population of each country, Austria[352] should apply a threshold of €850,000, France[353] of €6,550,000, and Italy[354] of €5,900,000, in order to determine the significant digital presence in each of these countries. It must be

[351] EU (2018, July 10). Eurostat. *EU population up to nearly 513 million on 1 January 2018.*
[352] Proportion of Austrian population in relation to EU population in 2018: 1.7%.
[353] Proportion of France population in relation to EU population in 2018: 13.1%.
[354] Proportion of Italy population in relation to EU population in 2018: 11.8%.

taken into account that the Austrian DST only covers online advertising services (Garcia Prats, 2022), though the Commission's DAT Directive Proposal also considered the €50 million threshold of revenue of covered services obtained in the EU even though the scope of the services was limited.

Consequently, based on the data obtained, it can be reasonable to suggest that the second threshold should be increased from €3 million to €5 million in order to avoid traditional business from falling under the scope of the tax.

It must be borne in mind that the Spanish DST does not include any sort of graduation. If an entity meets the €750 million threshold but the covered revenues stay below the €3 million threshold, the entity will not be a taxpayer of this tax. Nevertheless, if both thresholds are exceeded, the entire amount of the covered digital revenues becomes taxable and not only the exceeding part. This design is hard to defend in light of the objective of fair taxation as it potentially treats entirely different taxpayers with a similar level of covered revenue, meaning those that are just below and above the €3 million (or €5 million) threshold.

In order to design a mechanism to solve this issue, it must be considered that the turnover thresholds are calculated based on the total group figures in the case of those entities that form part of a group. That complicates a potential solution.

As foreseen in Article 9.2 of the DST Directive Proposal, in a case of a group of entities among which at least two meet the requirements to be considered as taxpayers, it is permitted to nominate an entity of that group for the purposes of paying the DST, and this entity will then be the one responsible to comply with this obligation. However, as stated in Article 9.1 of the DST Directive Proposal, the taxpayers are the entities that meet the threshold. The designated entity responsible to perform the payment may or not be a taxpayer of the DST.

Thus, the author of this dissertation would propose the incorporation of a similar provision in the Spanish DST Act. To this effect, one entity of the group would have to file the tax form of the Spanish DST and pay the aggregated tax liability. This way, it is possible to apply a tax graduation based on the thresholds established.

In order to solve the different treatment above mentioned, the author of this dissertation would propose to introduce a dual tax rate structure of 0% tax rate for an aggregated tax base of up to €3 million (or €5 million), and a 3% tax rate for the exceeding part of the aggregated tax base. It must be pointed out that the revenue threshold is established in accordance with Article 10 of the Spanish DST Act that sets out the rules for determining the tax base.

Another possibility would be to establish an exemption of €3 million (or €5 million if the amount proposed by this author is applied) on the aggregated tax base (or on the tax base for stand-alone entities).

In relation to the tax forms, the mentioned information for each entity that is a taxpayer will have to be provided including its individual tax base. However, the tax bases will be aggregated in order to apply the tax graduation scheme.

5.5. Infringement of the ability to pay and the non-confiscatory principles

In this section it will be analyzed whether the Spanish DST infringes the ability to pay and non-confiscation principles that are established under Article 31.1 of the Spanish Constitution.

This article establishes that everyone shall contribute to sustain public expenditure in proportion to one’s financial means, and that the tax system shall in no case have a confiscatory nature.[355]

Article 2.2.c of the Spanish GTA provides a definition of taxes and within its definition, the expression *ability to pay* is included. This provision defines taxes with the consideration that the taxable event is constituted by transactions, acts, or events which reveal the taxpayer's ability to pay.

[355] Palao Taboada (2018) interprets that the prohibition of confiscation does not apply to individual taxes, but to the tax system as a whole. However, Herrera Molina (1998) defends that when Article 31.1 of the Spanish Constitution establishes that the tax system shall in no case have a confiscatory nature, it entails that confiscation may not only derive from isolated taxes, but also from the sum of the different taxes that form part of the tax system.

In this sense, Article 3.1 of the Spanish GTA enumerates the principles upon which the tax system is founded and includes the ability to pay of the persons obliged to pay taxes as one of the core principles on which the tax system must be based.[356]

In all, the ability to pay principle is fundamental to interpreting and applying the tax system (Sainz de Bujanda, 1963). Over the years, the Spanish Constitutional Court has created extensive case-law defining the scope of the ability to pay principle.

Gorospe Oviedo & Herrera Molina (2007) describe how at first, the Spanish Constitutional Court considered the ability to pay principle to be part of the right to equality in tax matters, thus it treated the ability to pay principle as one that had to be protected as a fundamental right.[357] However, as portrayed by these authors, this position was left behind by the Spanish Constitutional Court in favor of the current distinction between the right to equality under Article 14 of the Spanish Constitution (subjective dimension of equality), and the right to tax equality under Article 31.1 of the Spanish Constitution (objective dimension of equality), in accordance with what has been explained under the infringement of the equality and non-discrimination principle of this chapter.

The judgment of the Spanish Constitutional Court of November 4, 2004 (judgment 193/2004), ruled that the ability to pay principle prevents the legislature from establishing taxes whose taxable event does not constitute a real manifestation of wealth. In the same line of reasoning, the judgment of the Spanish Constitutional Court of November 16, 2000 (judgment 276/2000), sustains that "the taxable event must constitute a manifestation of wealth",[358] and the judgment of July 19, 2000 (judgment 194/2000), states that "taxes cannot be based on situations that are not expressive of the ability to pay".[359] In addition, the judgment of the Spanish Constitutional Court of October 28, 1997 (judgment

[356] Sainz de Bujanda (1963) considers the ability to pay principle as a principle that inspires a tax system based in the idea of justice, in the sense that the distribution of the tax burden must be fair. As explained by this author, a tax must not only be in accordance with the law, but it also ought to be fair.
[357] Judgments of the Spanish Constitutional Court of February 20, 1989 (judgment 45/1989), and of November 10, 1988 (judgment 209/1988).
[358] Translated by the author. Original wording in Spanish: *"el hecho imponible tiene que constituir una manifestación de riqueza".*
[359] Translated by the author. Original wording in Spanish: *"la prestación tributaria no puede hacerse depender de situaciones que no sean expresivas de capacidad económica".*

182/1997), states that "the tax, by imperative of article 31.1 of the Constitution, can only be levied when the ability to pay exists, and in accordance with the ability to pay".[360]

Time after that, in the order of February 26, 2008 (order 71/2008), the Spanish Constitutional Court nuanced its previous judgments to a certain extent. The court still considers that the ability to pay principle constitutes the basis of taxation, stating that a tax is legitimate if it covers "a taxable event that reveals the ability to pay without allowing for a need to rely on situations that are not expressive of a manifestation of wealth".[361] However, it refines this statement by adding that the ability to pay can be expressed as wealth or as potential income, and also adds that "the principle is only infringed when the ability to pay is virtual, non-existent, or fictitious".[362] This nuance established the new doctrine of the Spanish Constitutional Court on the ability to pay principle that is still currently being used in its judgments.[363]

It is also interesting to point out that the Spanish Constitutional Court in its judgment of December 11, 1992 (judgment 221/1992) established the idea that the ability to pay principle constitutes a limit to the legislature as it considered that the duty to contribute to the support of public expenses according to the ability to pay of each taxpayer configures a mandate that binds both public authorities and citizens.[364] In this same line of reasoning, the Spanish Constitutional Court in its judgment of February 14, 2000 (judgment 46/2000) indicated that the ability to pay principle is infringed if those with a lower economic capacity bear a greater tax burden than those with a higher capacity.

In all, the ability to pay principle acts as a limit to the legislature in tax matters. Although the legislature has a wide margin of discretion when legislating, it must respect the limits

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[360] Translated by the author. Original wording in Spanish: *"el tributo, por imperativo del artículo 31.1 de la Constitución, sólo puede exigirse cuando exista capacidad económica y en la medida –en función- de la capacidad económica"*
[361] Translated by the author. Original wording in Spanish: *"Lo que legitima al tributo es que recaiga sobre un hecho imponible revelador de capacidad económica, sin que se pueda hacer depender de situaciones que no sean expresivas de una manifestación de riqueza"*
[362] Translated by the author. Original wording in Spanish: "*basta con que dicha capacidad exista como riqueza o renta potencial, de manera que el principio solo quiebra cuando la capacidad económica gravada por el tributo sea virtual, inexistente o ficticia".*
[363] In the same sense, see judgments of the Spanish Constitutional Court of January 20, 2005 (judgment 10/2005); of December 22, 2004 (judgment 209/1988); and of April 25, 2002 (judgment 96/2002).
[364] Palao Taboada (2004) points out that Article 31.1 of the Spanish Constitution establishes the duty to contribute to the support of public expenses and recalls that such duty arises historically as an ethical or moral obligation that implies that all citizens have to contribute to the support of public expenses as members of a community and, in a certain way, as an exchange for the fundamental rights that are recognized and guaranteed by the public authorities.

that derive from this constitutional principle, which is breached in those cases in which the ability to pay is non-existent or fictitious. Consequently, the principle of economic capacity implies that a tax must: (i) tax real or potential income, that is, it must not be non-existent or fictitious income, and (ii) be levied equitably among taxpayers.[365]

The Spanish Constitutional Court has recently had the occasion to rule on the ability to pay principle in relation to the IIVTNU (in Spanish, *Impuesto sobre el Incremento del Valor de los Terrenos de Naturaleza Urbana*). Until now, the IIVTNU regulations established an objective method to calculate the tax base. Consequently, the tax was levied on the transfer of urban land even when the transferor had not obtained an increase in the value of the transferred property. Due to this situation, in recent years several questions of unconstitutionality were raised before the Spanish Constitution Court that have led to several different rulings.

The Spanish Constitutional Court judgment of May 11, 2017 (judgment 59/2017) declared that the method for calculating the tax base of the IIVTNU was unconstitutional in situations where it could not be proven that the value of the urban land had increased during the period in which the taxpayer owned it. The court considered that the IIVTNU taxed situations that did not express the ability to pay of the taxpayer infringing Article 31 of the Spanish Constitution.[366]

Years after, the Spanish Constitutional Court of October 31, 2019 (judgment 126/2019) declared the regulation of the tax base to be unconstitutional in those situations in which, though the value of the property increased, the amount to be paid for the IIVTNU exceeded the capital gains of the transfer of property obtained by the taxpayer. According to the Spanish Constitutional Court, taxing these situations infringed the ability to pay principle and the prohibition of non-confiscation since it taxed income that did not exist.

[365] As pointed out by Sánchez-Archidona Hidalgo (2021), horizontal equity entails that two taxpayer with the same ability to pay should experience the same tax burden, while vertical equity entails that the taxpayer with a higher ability to pay should experience a greater tax burden.
[366] Palao Taboada (2017) criticized the first Constitutional Court rulings on the IIVTNU as he argued that the rules for calculating the tax base of the IIVTNU had to be deemed unconstitutional under all circumstances because they infringed the ability to pay principle as they taxed situations that did not express the ability to pay of the taxpayer.

Finally, the Spanish Constitutional Court in its judgment of October 26, 2021 (judgment 182/2021) declared that the method for calculating the tax base of the IIVTNU was unconstitutional under all circumstances because it considers that the maintenance of the objective and compulsory system for determining the taxable base does not consider the situation of the real estate market and the economic crisis and, therefore, it does not consider the ability to pay of the taxpayer. Thus, it infringes the ability to pay principle.

The ability to pay principle is closely related to the prohibition of non-confiscation, which entails the incorporation of the logical requirement that taxable wealth should not be exhausted under the pretense of the duty to contribute to sustain public expenses. Hence, the maximum limit of taxation is imposed by the Spanish Constitution in the form of prohibiting taxation with a confiscatory scope, as established by the Spanish Constitutional Court in its judgment of October 4, 1990 (judgment 150/1990).

The Spanish Constitutional Court has not yet decided on the threshold above which a tax, or a combination of taxes, can generate an unconstitutional confiscatory effect. In this respect, as done so by the Spanish Constitutional Court judgment of October 4, 1990 (judgment 150/1990), this court has only stated that a confiscatory effect in taxation occurs when the tax burden exhausts the taxable wealth.

Academics have interpreted that the taxable wealth has been exhausted by means of a tax burden when, after paying the tax, the wealth left for the taxpayer is equal to or less than what it had been prior to carrying out the taxable event, or is insufficient for the taxpayer to cover their vital needs for maintaining a reasonable standard of living and being compensated for the costs, risks, and efforts involved in obtaining its wealth (García Dorado, 2002). Based on this interpretation of the non-confiscatory principle, it can be concluded that this principle calls for: (i) that those who lack sufficient wealth to develop a reasonable standard of living are exempt from taxation; and (ii) that the tax system cannot undermine the wealth generated by economic activity. In relation to the Spanish DST, it is the second of these conclusions of the non-confiscatory principle that must be analyzed. As can be seen, academics provide an abstract criterion to determine whether a tax that is confiscatory must be assessed in a case-by-case scenario.

Regarding the possibility of establishing a fixed threshold as a criterion to determine whether or not a tax is confiscatory, Agulló Agüero (1982) considers that it is an issue that depends on the historical-social awareness of what is understood to be fair in each period of time. In a similar line of thought, Moreno Fernández (2019) defends that constitutional courts cannot set a maximum limit of taxation to determine when a tax is confiscatory. According to the mentioned author, this limit can only be established by the legislative branch, unless the constitution clearly allows constitutional courts to establish this threshold if there are called to do so.

As explained by Moreno Fernández (2020), the Supreme Court of Argentina considers a tax to have confiscatory effects when the taxed wealth exceeds 33% of the generated wealth, while the German Constitutional Court ruled that a tax burden cannot exceed 50% of the taxpayer's income based on the idea that the private and public interest must be divided in half, though as established by this court this is not an absolute requirement, but a relative limit to avoid overburdening the taxpayer in paying taxes. The mentioned author also indicates that the French Constitutional Council follows the same criterion as the German Constitutional Court.

In Spain, the non-confiscation principle is related to the right to property under Article 33 of the Spanish Constitution which recognizes the right to private property under which no one may be deprived of their possessions without a justified cause of public interest. This same right to property is recognized under Article 17 of the Charter of Fundamental Rights of the EU and under Article 1 of the of the Protocol to the ECHR.

Article 17(1) of the Charter states that:

> "Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest."[367]

In addition, Article 1 of the of the Protocol to the ECHR reads as follows:

[367] Though it is an aspect out of the scope of this dissertation, it is relevant to point out that the public interest exception under Article 17(1) of the Charter implies that the right to property is not deemed as an absolute right under EU law (Debelva, 2019).

> "1. Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."[368]

An issue that must be addressed is whether taxation falls within the scope of the right to property. In this sense, the second paragraph of Article 1 of the Protocol to the ECHR can provide some guidance as it establishes that the provision that guarantees the protection of property cannot in any way impair the right of the state to secure the payment of taxes or other contributions or penalties. The tax carve-out contained in this provision appears to grant extensive taxing power to the states, though as noted by Peeters (2008), all tax measures are subject to scrutiny under the right to property since they must comply with the proportionality principle. From this provision it can be concluded that taxation is covered under the scope of the right to property as otherwise there would have been no reason to expressly include the carve-out to secure the payment of taxes (Kokott & Pistone, 2022). Consequently, tax measures might be reviewed in light of the right to property though there are very few taxation cases analyzed through the prism of the right to property by the CJEU and the General Court due to the limited scope of the Charter (Peeters, 2008, and Debelva, 2019). In this sense, the CJEU in the *Berlington Hungary* case indicated that when a tax measure infringes a fundamental freedom, its conformity with fundamental rights must be analyzed in the justification phase, even though the court in that case did not analyze the compatibility of the concerned tax with the right to property which, according to the applicants, was the fundamental right that the domestic legislation infringed.[369] Also, the CJEU in the *Pfleger* case stipulated that in order for a restriction to be admissible, it must respect the essence of the underlying fundamental rights.[370]

As explained by Kokott & Pistone (2022), initially the ECtHR dismissed the claims that taxation infringed the taxpayer's right to property. Nevertheless, as noted by these authors, from the beginning of the twenty-first century the ECtHR changed the approach

[368] Article 52(3) of the Charter establishes that in the case that the Charter contains rights which also correspond to rights guaranteed by the ECHR, as it is the case to the right of property, the meaning and the scope should be the same as those laid down by the ECHR. As identified by Perrou (2021), the ECHR functions as minimum standard for the meaning and the scope of the rights contained in the Charter.
[369] CJEU judgment of June 11, 2015, C-98/14, *Berlington Hungary and Others*, para. 113.
[370] CJEU judgment of April 30, 2014, C-390/12, *Pfleger and Others*, para. 58.

and began interpreting the right to property by setting certain standards for the design of taxes. The ECtHR ruling on the *Gáll v Hungary* case recognized that when tax measures are tested against the right to property, these are subjected to a proportionality test to check whether they amount to an excessive financial burden for the taxpayer though states enjoy a wide margin of discretion to design their taxes.[371] In the *N.K.M v Hungary* case, the ECtHR ruled on a case in which a taxpayer received a compensation on which a 98% tax rate was applied to the part exceeding HUF 3.5 million, while the amount below this limit was taxed at a rate of 16%, representing an overall tax burden for the taxpayer of approximately 52% on the entirety of the severance. In this case, the ECtHR considered the 52% tax burden as excessive and disproportionate, and as expressly mentioned by the court, the taxpayer suffered a substantial deprivation of income and, lastly it held that there had been a violation of Article 1 of the Protocol to the ECHR.[372]

As seen, it is not clear how to determine the confiscatory nature of a tax by the use of a threshold. As stated by Kokott & Pistone (2022), only those taxes that qualify as confiscatory (i.e. taxes that eat up the income generated from the economic activity carried out) are prohibited under the fundamental right to property.

Therefore, a tax or an aggregation of taxes (i.e. in cases of double taxation) that generates a confiscatory effect would also infringe the right to property recognized under Article 33.1 of the Spanish Constitution and EU law.[373]

That said, it must be examined whether the Spanish DST infringes the ability to pay and the non-confiscatory principles. The doctrine of the Spanish Constitutional Court on the IIVTNU could be used to substantiate a claim stating that the Spanish DST infringes the ability to pay and the non-confiscatory principles since this tax is levied even if the taxpayer has no profits.

It must be pointed out that chances are that the Spanish legislature believed that since the tax targets very large digital services providers, the taxpayer will have profits.[374]

[371] ECtHR judgment of June 25, 2013. case *Gáll v Hungary*, Application No. 49570/11, para. 64.
[372] ECtHR judgment of May 14, 2013, case *N.K.M. v Hungary*, Application No 66529/11, paras. 70 and 71.
[373] Palao Taboada (2018) points out, that a confiscatory tax should be understood as equivalent to contrary to the principle of property.
[374] Moreno Fernández (2020) indicates if norm is in accordance with the Spanish Constitution in the generality of cases, it does not mean that its application to the specific case might be unconstitutional, and since the citizen does not have the legal duty to support the application of an unconstitutional

However, it must be taken into account that the thresholds applied to determine who is a taxpayer apply the total figures of a group. Therefore, the taxpayer could be an entity, large or small, with losses. In such cases, a clear confiscatory effect is produced by taxing, as stated in the Spanish Constitutional Court case-law, fictitious or non-existent wealth.[375]

Consequently, if the Spanish legislature had opted for establishing a rule that stipulated that the tax would not be levied if the taxpayer had losses, the tax would be in accordance with the ability to pay and non-confiscatory principles.

5.5.1. Proposed measures to comply with the ability to pay and non-confiscatory principles

The Spanish legislature could have had the possibility to implement measures in order to comply with the ability to pay and the non-confiscatory principles regulated under the Spanish Constitutional, but in this case, decided otherwise to follow the DST Directive Proposal that does not allow those taxpayers that have losses to be exempt from the tax. To this extent, this dissertation proposes the following amendment to the Spanish DST in order to make it compliant with the ability to pay and the non-confiscatory principles.

A profitability threshold should be applied stipulating that the tax cannot be levied if the taxpayer has losses in the calendar year the tax is accrued to not infringe the ability to pay and the non-confiscatory principles. Thus, if the entity has losses, its tax base should not be considered for the purposes of calculating the aggregated tax base. In the case of a stand-alone entity that does not form part of the group, if it has losses, it will not have to file the tax form as it would not have the consideration of being a taxpayer.

norm, not even in a specific case, the solution would be the non-application of the norm to that specific case.

[375] Moreno Fernández (2020) explains that in order to analyze whether a tax is confiscatory, the Spanish Constitution Court applies the "generality of cases" test, according to which it is sufficient that the wealth intended to be taxed exists in the generality of the cases contemplated by the legislature so that, if in marginal cases, the amount of the tax would be higher than the taxed wealth, would not make the tax unconstitutional, as the analysis of the constitutionality of the norms must be made taking into consideration the normal case and not the possible exceptions to the rule. In the case of the Spanish DST, though the generality of taxpayers might not have losses and, therefore, this tax does not create a confiscatory effect in the generality of cases, the act that regulates the tax faces constitutional issues for not providing a remedy for this foreseeable situation in a similar manner in which the method for calculating the tax base of the IIVTNU was declared unconstitutional under all circumstances for not considering the ability to pay of the taxpayer by the Spanish Constitutional.

An issue can arise if the taxpayer’s fiscal year does not coincide with the calendar year. Therefore, it will be up to the taxpayer to provide evidence if they decide to apply this benefit before the STA if required to do so. A rule could be established that states that for fiscal years in which the entity has had losses, the revenues obtained in Spain from covered services during the months of that fiscal year do not count for the purposes of the tax.

In addition, the tax levy of the Spanish DST cannot be higher than the profits obtained after taxes in order to comply with the non-confiscatory principle. Thus, for entities whose calendar year does not coincide with their fiscal year, the profits obtained in a fiscal year after the CIT, or equivalent tax on profits, could be divided monthly in order to allocate the profits per calendar year. Once again, this is a mechanism to be used if the taxpayer wants to claim that they are not subject to taxation due to losses or low profits and is not mandatory to all taxpayers.

It could not be sustained that by introducing this mechanism, the Spanish DST should then be considered as an income tax for considering the taxpayer’s ability to pay as the introduction of this new threshold is for the purposes of not infringing constitutional principles with which all taxes must comply.

5.6. Potential existence of improper double taxation

Preventing double taxation is a core principle in any tax system to ensure fair taxation. To achieve this goal in the international framework, DTCs have the objective to allocate taxing rights between jurisdictions, and to provide for the elimination of double taxation when possible (Simmonds, 2019).

The revenues from digital services covered by the Spanish DST will be subject to taxation (i) by the Spanish DST, and (ii) possibly by the CIT of the country of tax residence of the digital services providers. Therefore, there is a risk that the revenue taxed by the Spanish DST could be subject to taxation twice.

It must be noted that the term "double taxation" can be used for expository purposes to refer to situations in which the same income is taxed by two different taxes. However, from a technical point of view, this term should only be used when these taxes are identical or analogous in nature (Egea Perez-Carrasa, 2020). That said, double taxation would only occur if the Spanish DST were defined as a direct tax as the CIT. This dissertation concluded that the Spanish DST should be considered as a hybrid tax as it has characteristics of both direct and indirect taxes, thus it is impossible for the Spanish DST to create double taxation from a theoretical point of view.

DTCs tend to cover only income taxes as states tax income obtained by resident taxpayers on a worldwide basis, and also tax income obtained by non-resident taxpayers on a territorial basis (Hohenwarter, Kofler, Mayr & Sinnig, 2019). So, income with a cross-border component will potentially be taxed twice by two different states and by two different income taxes. This explains why DTCs cover income taxes. On the other hand, as in the case of turnover/sales taxes such as the VAT and the DSTs, these are levied on a destination basis, thus only the state where the consumption or use of a services has taken place has the capacity to tax the revenue (Hohenwarter, Kofler, Mayr & Sinnig, 2019). Therefore, as concluded by these authors, it is theoretically impossible that international double taxation arises with regards to DSTs.

However, the double burden between an income tax (i.e. CIT) and the DSTs can also arise in domestic situations with no cross-border component when the taxpayer is a tax resident in a jurisdiction were a DST is levied. Though, as explained, from a technical point of view, this internal double burden between the CIT and the DSTs is irrelevant since both taxes are of different nature, so it does not trigger double taxation issues.

That said, it is rather interesting that in paragraph 27 of the Preamble of the DST Directive Proposal, it was expressly mentioned that to avoid possible cases of double taxation in situations in which the same revenues were subject to the domestic CIT and to the DST, it was expected that Member States would allow entities to deduct the DST tax fee paid as a cost from the CIT base, irrespective of whether both taxes were paid in the same or in different Member States. It must be specified that the Preamble in no way imposes an obligation to do so.

Though the Spanish DST Act does not make any reference to the possibility of deducting the tax debt paid for the purposes of the Spanish CIT, it does not say that it should not be deductible either. So, given that, from an accounting point of view, the tax debt paid is considered as an expense since the Spanish DST is a non-recoverable tax, and it is also not included in the cases of non-deductibility under Article 15 of the Spanish CIT Act, it is reasonable to consider it as a deductible expense under Spanish law.

The described mechanism for deducting the Spanish DST debt paid as an expense from the Spanish CIT base would only reduce the internal double tax burden since the Spanish DST debt paid would only be deducted at an amount of 25% (current Spanish CIT rate).[376] The only way to eliminate the internal double tax burden would be to directly deduct the entire amount paid for the Spanish DST from the Spanish CIT debt. However, the Spanish legislature did not contemplate this possibility either in the CIT regulation nor in the Spanish DST Act, being coherent with its definition of the Spanish DST as an indirect tax since double taxation does not occur between the Spanish DST (an indirect tax, or a hybrid tax), and the Spanish CIT (a direct tax).

Consequently, it would not be recommended to include the above-mentioned mechanism to eliminate the effect of this double tax burden since, from a tax policy perspective, the Spanish DST does not give rise to any double taxation issues. By including such a mechanism, a relation can be established between the Spanish CIT and the Spanish DST, and that would be negative for defending that the Spanish DST is not an income tax, especially taking into account that one of the arguments to defend this position is that there is no relation between both taxes. In any case, and as concluded, the Spanish DST can be deducted from the Spanish CIT according to the existing rules, without needing the regulations of this tax to make express mention of it.

5.7. Infringement of the principle of legal certainty and the prohibition of retroactivity

It should also be analyzed if the Spanish DST infringes the legal certainty principle established under Article 9.3 of the Spanish Constitution. This principle has the objective of guaranteeing the certainty of the legal system and the protection of legitimate expectations.

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[376] For example, an entity that has as an accounting result of 1,100 (not considering the Spanish DST paid) and has paid a Spanish DST debt of 100 will have a CIT base of 1,000. The CIT debt will be of 250 (that is, 25% of 1,000). However, if the Spanish DST debt would be able to be deducted directly from the CIT debt the result would be as follows: CIT base of 1,100, and CIT debt of 175 [(1,100 x 25%) - 100]. The difference of 75 is because in the first case it was only possible to deduct 25% of the total Spanish DST debt paid, while in the second case it was possible to totally neutralize the effect of this tax.

Legal certainty requires that the rules and decisions are made in accordance with the legal system and must be respected by all public authorities, including the legislature, as established in the Spanish Constitutional Court judgment of December 12, 2012 (judgment 234/2012).

As indicated by consolidated case-law of the Spanish Constitutional Court, legal certainty entails the need for the legal rule to be known or to be able to be known by everyone in the sense that any subject of law is in a position to foresee the legal consequences of their own acts (García Novoa, 2019). Therefore, it protects the right of citizens to be fully aware of the decisions of the public authorities sufficiently in advance to be able to plan their activities in accordance with the law and to be able to adapt to the new legal framework.[377]

As defined by the Spanish Constitutional Court case-law, legal certainty requires, on the one hand, that rules do not generate doubts to its addressees as to what is required of them and, on the other hand, that it does not cause uncertainty as to the legal effects of the rules (García Novoa, 2019). Citizens and companies should have a reasonable period of time to be able to adapt to the new legal framework, which is incompatible with the enactment of sudden regulatory changes that prevent the addressees from reacting and adapting to their new obligations.

In the Spanish Constitutional Court judgment of October 31, 1996 (judgment 173/1996) on the complementary levy of the tax on gambling, the Spanish Constitutional Court considered the measure as unforeseeable, which led the court to classify the regulation as unconstitutional. Likewise, the Spanish Constitutional Court considered that the legitimate expectations of the taxpayers had been affected because they were not previously aware of the tax consequences deriving from their activity of operating gaming machines. In that case, a regulation was passed in June that taxed gaming machines in operation on January 1 of the same year. So, the tax was accrued to situations in which the rule was not yet in force.

In the case of the Spanish DST, the Spanish DST Act was passed on October 15, 2020, and the law went into force on January 16, 2021. The issue could be raised that for the

[377] See Spanish Constitutional Court judgments of December 13, 2012 (judgment 234/2012); of April 20, 2009 (judgment 90/2009); of January 31, 1986 (judgment 15/1986); and of July 20, 1981 (judgment 27/1981).

first calendar year in which the tax was applicable (i.e. 2021), the magnitudes of the first threshold to determine who a taxpayer is had to be set on December 31, 2020, a moment in which the law was not yet in force.[378] It could be argued, though, that the law was passed as of December 31, 2020, and that the addresses already knew that for the calendar year of 2021, it was necessary to consider the financial data of the indicated date to determine who was a taxpayer.

Nevertheless, the Spanish DST Regulation was approved by Royal Decree 400/2021, on June 8, 2021. This establishes the rules on the location of users' devices, and regulates the formal obligations relating to this tax, and the form to settle the tax (form 490) was approved by Order HAC/590/2021, on June 9, 2021. As the first payment of the Spanish DST regarding the first quarter of 2021 had to be performed on or before April 30, 2021, it was established that the tax returns of the first and second quarter of 2021 had to be filed jointly in July 2021. As can be seen, the Spanish DST Regulation has a retroactive effect because it regulates situations that took place prior to their being passed.[379]

In addition, it must also be pointed out that the Spanish DST Act considers the amounts of the thresholds regarding the previous year from when the tax is accrued, and that can be deemed inconsistent. So, the Spanish DST is levied four times in one year (e.g. calendar year 2024) based on definitive and consolidated economic situations on December 31 of the previous calendar years (e.g. December 31, 2023). It is found that the financial data used to determine who is a taxpayer is not that of the period in which the tax is accrued, but of a previous one.

It is evident that the retroactive effects of a rule are against legal certainty; the citizen's ability to know the effects of its actions is incompatible with the existence of norms whose

[378] As explained in Chapter 2 under Section "2.10. Taxpayer", for year 2021, as there was no preceding year in which the tax was in force, to calculate if an entity met the significant digital footprint threshold, the STA established that the revenues of covered digital services were considered from the beginning of each of the four quarterly settlement periods until the end of each of them, though these quarterly amounts were estimated over a one-year period to determine if the €3 million threshold was met or not with regards to each quarter.

[379] The Opinion of the Spanish Council of State of May 5, 2021, on the Spanish DST Regulation, shows its concerned regarding the fact that the tax was levied before the Spanish DST Regulation had been passed and, as a result, many aspects were not duly specified in the regulatory framework once the tax was levied. Though the Spanish Council of State acknowledges that the second final provision of Spanish DST Act empowers the Government to approve as many provisions as may be necessary for its implementation without any time limit, it also points out that for an effective protection of the legal certainty principle, it is necessary a legal and regulatory regime as complete as possible and well defined, for when the tax is levied for the first time.

validity extends to a conduct prior to their enactment, making the non-retroactivity principle key in tax law (García Novoa, 2019).

The doctrine on the non-retroactivity principle is found among others, in the judgments of the Spanish Constitutional Court of June 23, 2016 (judgment 121/2016), and of October 20, 2016 (judgment 181/2016) in which the court indicates that, despite the fact that there is no constitutional prohibition of retroactive tax legislation, since tax rules do not have a punitive nature, Article 9.3 of the Spanish Constitution demands the protection of the legitimate expectations of the citizens so they can adapt their economic decisions against the normative changes that are not reasonably foreseeable.

As established by the Spanish Constitutional Court in its judgment of May 8, 2012 (judgment 100/2012), among others,[380] the retroactivity of tax rules may be considered harmful from a constitutional point of view when it infringes any of the principles contained in Article 9.3 of the Spanish Constitution, in particular, the legal certainty principle. If it is disregarded by a given tax rule, it is necessary to analyze, on the one hand, the degree of retroactivity of the challenged rule and, on the other, the specific circumstances of the case. In this sense, the Spanish Constitutional Court has traditionally distinguished between authentic retroactivity (or proper retroactivity or of a maximum level), and improper retroactivity (or of a medium level).[381]

As indicated by Herrera Molina & Macho Pérez (2010), improper retroactivity exists when a rule aims to have an effect on current legal situations that have not concluded, while authentic retroactivity exists when a rule aims to have an effect on situations that happened prior to the enactment of the law.

These authors point out, based on the case-law of the Spanish Constitutional Court, that if the tax rules are modified at the beginning of the current fiscal year, it would be a case of improper retroactivity that is permitted only if it does not infringe the legal certainty principle. Thus, the legality of the improper retroactivity will depend on the circumstances of each case, and it will have to be examined the various reasons that could

[380] Spanish Constitutional Court judgments of June 23, 2016 (judgment 122/2016); of December 13, 2012 (judgment 234/2012); of November 11, 1996 (judgment 176/1996); of October 4, 1990 (judgment 150/1990); and of July 16, 1987 (judgment 126/1987).
[381] Among others, see Spanish Constitutional Court judgment of July 16, 1987 (judgment 126/1987).

justify the modification of the tax law, as well as the purpose of the measure, its foreseeability, its quantitative effects, or other similar factors.

As the Regulation of the Spanish DST, but not the act that governs this tax, was enacted after the tax was accrued regarding the first and second quarter of 2021, it would be a case of medium level retroactivity. Legal certainty was affected as the taxpayer did not have the entire information on how they had to calculate the tax base once the tax was accrued. Thus, though it might not be considered unconstitutional as the Spanish DST Act had already been enacted, the Administration could have chosen not to levy the tax for the first two periods of 2021 so the taxpayers would have more time to adapt to the new regulations for the sake of legal certainty.

On the other hand, in cases in which the authentic or proper retroactivity occurs, the prohibition of retroactivity generally applies as only the concurrence of circumstances that could be qualified as for the common good or for the general interest of the public would justify the unlawfulness of the provision.[382]

In relation to the Spanish DST, who is a taxpayer in a given calendar year (e.g. 2024) is determined based on certain economic magnitudes on December 31 of the previous calendar year (e.g. December 31, 2023). Thus, entities that exceed the established threshold will be subject to taxation (e.g. from January 1 to December 31, 2024).

Therefore, although the levy is established for a given calendar year, magnitudes from previous years are taken as a base for the thresholds. This is evidence that the rule in this respect grants a level of retroactive effects as it refers to situations that have already concluded; it might not be unconstitutional, but could be avoided.[383] Though the calendar year does not have to coincide with the fiscal year of entities, it seems reasonable to establish a correlation between the year in which the tax is accrued and the year in which the magnitudes to determine who must pay taxes is considered.[384]

[382] See Spanish Constitutional Court judgments of October 20, 1997 (judgment 182/1997); of October 31, 1996 (judgment 173/1996); of November 19, 1992 (judgment 197/1992); of October 4, 1990 (judgment 150/1990); and of July 16, 1987 (judgment 126/1987).

[383] Macho Pérez (2006) defends that the infringement of the prohibitions of retroactivity cannot be appealed for *amparo* as it cannot be considered as a fundamental freedom.

[384] The delimitation of who is taxpayers depends on the compliance with certain characteristics referring to previous years might not be unconstitutionality per se from the perspective of the principle of legal certainty, though it can be reasonable to avoid this situation.

5.7.1. Proposed measures to comply with the legal certainty and the prohibition of retroactivity

Drawing from the above, the author of this dissertation proposes that the thresholds must be based on the amounts of the net turnover and revenues of covered services on December 31, of each given year, as it is currently regulated. However, the tax form and payment of the tax will have to be filed and performed only once a year, six months after the closing of the calendar year in order to establish a correlation between the determination of the magnitudes of thresholds and the calendar year in which the tax is accrued. For example, for year 2024, the tax will be accrued from January 1 to December 31, 2024. However, the filing of the relevant tax form and the payment of the Spanish DST for year 2024 should be done during July 2025 in accordance with this proposal. A period of six months is sufficient for the taxpayers to have obtained all the relevant information to be able to calculate the tax.

To sum up, to comply with the legal certainty principle and the prohibition of retroactivity, as well as with the ability to pay principle, a temporal correlation should exist between the moment in which the tax is accrued and the moment in which the magnitudes of the thresholds to be used are determined.

5.8. Issues regarding the concept of targeted advertising

This section will address the issues presented by the concept of targeted advertising that result from an inconsistent and incoherent decision of the Administration, and thus arbitrary and contrary to Article 9.3 of the Spanish Constitution.

The Spanish DST is levied on the provision of three types of digital services: (i) online advertising services, (ii) online intermediary services, and (iii) data transmission services. Of special importance to this section are online advertising services that consist of the inclusion in a digital interface of advertising targeted to the users of that specific digital interface, as defined in Article 4.6 of the Spanish DST Act.

Article 4.10 of the Spanish DST Act defines “targeted advertising” as any form of commercial digital communication with the objective of promoting a brand, product, or service, aimed at users of a digital interface based on the data obtained from such users. In addition, it specifies that, unless proven otherwise, all advertising will be deemed as targeted advertising. Thus, if it is proven that the advertising is not targeted, it will not fall under the scope of the tax.

The Spanish DGT resolution on the DST states that the concept of targeted advertising requires that the user's data must be considered when determining the advertising to be displayed on the digital interface. The Spanish DGT resolution on the DST includes some remarks on the data to be considered as described as follows.

According to the Spanish DGT, the data does not need to be obtained from the use of digital interfaces; it can be collected previously or through the user's browsing history. So, the relevant data to consider the online advertising as targeted can be data provided by the users upon registration or when signing up to use the platform, or at any other time as will be explained, as well as data acquired from third parties.

The Spanish DGT resolution on the DST indicates that the user's data can be, among other things: (i) geographic location (country, city, IP address, geolocation, etc.); (ii) socio-demographics: age, gender, etc.; (iii) individual preferences or interests; (iv) search words; and (v) user profile, which as mentioned in the Spanish DGT resolution on the DST, the profile of the user may be obtained by data collected at registration or when signing up to use the platform, or by surveys done by phone, or by data collected from the activity of the users on various digital interfaces, or by any other means by which data can be obtained. For the purposes of this section, it should be noted that the Spanish DGT resolution on the DST identifies the IP address as relevant data for classifying advertising as targeted.

Finally, the Spanish DGT resolution on the DST establishes that the use of a single type of data from the user will be sufficient to consider online advertising as targeted. This is a relevant precision since according to the Spanish DGT, the use of the IP address of the user's device to aim advertising at those users that access a digital interface through a Spanish IP address would be sufficient data to consider this type of advertising as targeted for the purposes of the Spanish DST. Consequently, if the type of advertising only depends on the IP address of the user's device, even if no other type of data is taken into account, it will be considered as targeted advertising.

It is reasonable to believe that certain online advertising campaigns that have a general scope might be limited to an audience with devices that have a Spanish IP address (i.e. an online campaign limited to an audience localized in Spain) and might not include any other parameter to target its advertising to any other specific audience.

5.8.1. Analysis of the administrative criterion on the concept of targeted advertising

The aim of this section is to analyze possible issues regarding the administrative criterion for interpreting the concept of targeted advertising. Arguments will be discussed to conclude if the administrative criterion which establishes that the single use of the IP address is sufficient to consider the existence of targeted advertising under the Spanish DST Act.

5.8.1.1. The use of the IP address in accordance with the Spanish DST Act

Under Article 4.10 of the Spanish DST Act, targeted advertising is defined as commercial digital communication directed to users based on data obtained from them. This definition found in the act that governs the tax does not determine what kind of data it refers to. Consequently, the Spanish DGT has been able to perform a broad interpretation of the term *data* and has understood that an advertising campaign that only uses the IP address to aim a given advertisement at an audience located in Spain is sufficient to conclude that the advertisement is targeted.

Article 4.2 of the Spanish DST Act defines the concept of IP address as a code assigned to interconnected devices that allows them to communicate over the Internet. This is relevant as the Spanish DST Act does not define the IP address as data, but as code. It must be pointed out that no link is found in the Spanish DST Act between the IP address and the concept of targeted advertising. In addition, the term IP address defined in Article 4.2 of the Spanish DST Act is only used once more in the provisions that govern the Spanish DST, and that is in Article 7.4 of the Spanish DST Act in order to determine the location of the provision of digital services. Article 7.4 of the Spanish DST establishes that it will be assumed that a user’s device is located in the place determined by its IP address, unless it can be established that the real location is different by using other means of evidence, specifically, the use of alternative geolocation technology.

The Spanish DST Regulation refers in its Article 2.1 to the term IP address but only for the purposes of Article 7.4 of the Spanish DST Act. Article 1.2 of the Spanish DST Regulation specifies alternative means to the IP address for locating user’s devices.

Specifically, it states that geolocation based on network identification may be used (such as Wi-Fi, Ethernet, or others), or physical geolocation by satellite (such as the Global Positioning System, GLONASS, Galileo, or BeiDou), or through information provided by wireless terrestrial communications systems (such as the Global System for Mobile Communications, or the Lower Power Wide Area Networks), or also by beacons (such as Wi-Fi, or Bluetooth). The precept finishes by indicating that it is also possible to use a combination of current or future technologies for locating the users' devices.

In addition, Article 5.3 of the Spanish DST Regulation refers to the IP address of the device as data. However, the IP address is referred to as data associated with the location of the device but not as the personal data of the user.

Consequently, the IP address is defined by the Spanish lawmakers as code, not as data, that makes it possible to locate the users in the territory of application of the tax and, therefore, to be able to tax digital services when the users are located in Spain. Hence, the lawmakers do not associate the use of the IP address with the concept of online advertising.

5.8.1.2. The importance of the value created by users

Article 1 of the Spanish DST Act establishes that the scope of this tax is the provision of certain digital services in which users that participate are located in the territory of application of the tax. Section III of the Preamble of the Spanish DST Act refers to the importance of the role that the users play in the digital services that fall under the scope of this tax in the following terms:

> "Specifically, these are digital services in relation to which there is user participation that constitutes a contribution to the value creation process of the company that provides the services, and through which the company monetizes those user contributions. That is to say, the services contemplated by this tax are those that could not exist in their current form without the involvement of users. The role played by the users of these digital services is unique and more complex

> than that traditionally adopted by a customer of an offline service." [Translation by the STA].[385]

When drafting the Spanish DST Act, the Spanish legislature was clearly inspired by the DST Directive Proposal, in which the explanatory memorandum of such proposal, as can be seen below, also establishes the key role of the users in very similar terms as in the Preamble of the Spanish DST Act:

> "The services falling within the scope of DST are those where the participation of a user of a digital activity constitutes an essential input for the business carrying out that activity and which enable that business to obtain revenues therefrom. In other words, the business models captured by this Directive are those which would not be able to exist in their current form without user involvement. The role played by the users of these digital services is unique and more complex than that traditionally adopted by a customer. (…) However, what is subject to taxation are the revenues obtained from the monetization of the user input, not the user participation in itself." [DST Directive Proposal. p. 7].

Consequently, the Spanish DST is levied on the revenues from the supply of certain services in which the user's participation is key to the value creation process of the providers of digital services. It is important to note that the Spanish legislature justifies the right of Spain to tax the revenue on the provision of certain digital services as it considers that the value is generated in Spain since this is where the users are located. In this sense, reference should be made to Section II of the Preamble of the Spanish DST Act that justifies the creation of this tax:

> "The long period of time that has passed since the international debates on this issue began without reaching a possible solution in this regard, along with social pressure, tax justice and sustainability of the tax system, make it necessary to adopt, following the path initiated by other countries, a unilateral solution that allows Spain to immediately exercise taxation rights that legitimately correspond

[385] See: STA (n.d.). *Law 4/2020, of 15 October on the Tax on Certain Digital Services* (Translation by the STA).

to it in its territory, as this is where the data and user contributions that generate value for the company come from." [Translation by the STA].[386]

In the Preamble of the Spanish DST Act it is indicated that the role that the users play for the digital services covered by this tax is unique and more complex compared to the role that customers have traditionally played for offline services. However, it must be pointed out that if an online advertising service is considered to be targeted advertising just because it uses the IP address to locate the device and, consequently, falls under the scope of the Spanish DST because the device used to access the digital interfaces that includes such advertising is located in Spain, it cannot be overlooked the fact that the role of the user is exactly the same as in offline broadcasting services such as radio or television.

When an advertisement is broadcasted in Spain through offline radio or television services, the role of the users is limited to listening to or viewing a device that is located in Spain. It is clear, in this case, that the user does not contribute to the value generation process since they do not provide any data to the providers of such services. Likewise, just as offline broadcasting services of radio and television, the providers of such services do not have any information about their audience, the same could be said of providers of online advertising in which the location of the device is the only information used to include a specific advertisement on a digital interface. Therefore, it can be concluded that an online advertisement that only targets users based on the location of the user's devices should not fall under the scope of the Spanish DST as the users do not contribute to the value creation process.

5.8.1.3. The rebuttable presumption under the localization rules and under the definition of targeted advertising

Article 4.10 of the Spanish DST Act establishes a rebuttable presumption when defining the concept of targeted advertising by specifying that, unless proven otherwise, all advertising will be considered as targeted advertising. So, the legislature implicitly recognizes that there may be online advertising that is not targeted advertising.

Article 7.4 of the Spanish DST Act also establishes a rebuttable presumption in relation to the location of the device determined by its IP address. Thus, the legislature foresees

[386] See: STA (n.d.). *Law 4/2020, of 15 October on the Tax on Certain Digital Services* (Translation by the STA).

that the location of the device may be different from the one determined by its IP address. It must be borne in mind that the user can modify the IP address (i.e. by using the VPNs as explained in Chapter 2). This could explain the reason why the legislature has established a rebuttable presumption in relation to the localization rules since the provider of the digital services is the taxpayer and will be the one that will have to ultimately prove the location of the user if it decides to apply other technologies different from the IP address to locate the user's devises.

However, the rebuttable presumption established under the Spanish DST Act in relation to targeted advertising can be seen as an opportunity given by the legislature to allow taxpayers to claim what is not targeted advertising. Thus, a taxpayer could argue, based on the arguments presented, that the single use of the IP address in an online advertising campaign cannot be deemed as sufficient to consider such advertising as targeted.

5.8.2. Mismatch between the legislature and the administrative criterion

As has been explained, it does not seem consistent with the Spanish DST Act, and thus contrary to Article 9.3 of the Spanish Constitution, that the administrative criterion established in the Spanish DGT resolution on the DST considers that the single use of the IP address can be deemed as sufficient to determine targeted advertising.

Article 12.3 of the of the GTA enables the Ministry of Finance to issue clarifying or interpretative resolutions of tax laws and other tax regulations. In any case, an administrative criterion cannot contradict the tax law it interprets.

Consequently, it would be suggested that a new Spanish DGT resolution be issued in which it would expressly mention that the single use of the IP address (or any other data to locate a device) is not sufficient to consider an advertisement as targeted for the reasons above-mentioned and thus, it should not fall under the scope of the tax. The use of the IP address in a digital advertising campaign must be combined with some other data different from the data used to locate a device to call it targeted advertising and, therefore, as online advertising which falls under the scope of the Spanish DST.

5.9. Conclusions

This chapter has examined, from a legal perspective, the most relevant issues regarding tax principles covered under Spanish law. It has been found that the current wording of the Spanish DST Act presents relevant challenges in regards to: (i) the prohibition of arbitrariness, (ii) the generality principle, (iii) the equality and non-discrimination principles, (iv) the ability to pay and the non-confiscatory principles, and (v) the legal certainty principle and, the prohibition of retroactivity. However, this chapter has proposed some measures to make the Spanish DST compliant with such principles. It has also been found that the Spanish DST does not face any challenges with regards to double taxation.

The chapter has also provided an examination of the issues regarding the concept of targeted advertising under the Spanish DST and concluded that that the single use of the IP address (or any other data to locate a device) in an online advertising campaign is insufficient to consider online advertising as targeted, and therefore, such advertising should not fall under the scope of this tax.

After having analyzed whether the Spanish DST infringes the principles of tax law under Spanish legislation, the following chapter will address a topic which transcends the European view of the issues discussed in this dissertation: The 2022 ruling made by a judge of the Anne Arundel County Circuit Court who struck down the Maryland DAT. The goal is to call attention to the especially interesting parallelism that can be drawn between legality issues under EU law and the constitutionality issues that arise among state legislations within the US, broadening the scope of this dissertation.

CHAPTER 6: THE INVALIDATION OF THE MARYLAND DIGITAL ADVERTISING TAX

6.1. Introduction

In the US, Maryland was the first and only state to enact a DST and it limits its scope to digital advertising services. However, other states such as Arkansas, Connecticut, Indiana, Massachusetts, Montana, New York, Texas, Washington, and West Virginia, have contemplated some sort of tax on digital services (Walczak, 2021, May 10).

The Maryland Digital Advertising Gross Revenues Tax, also known as Maryland DAT, was challenged before entering into force on January 1, 2022 in federal court (the case is Chamber of Commerce of the United States of America, et. al., v. Peter Franchot, case number 1:21-cv-410-DKC]),[387] and in state court (the case is Comcast Cable Communications Management, et. al., v. Comptroller of the Treasury of Maryland, case number C-02-CV-21-000509).

This chapter comments on the state court ruling of October 17, 2022, that struck down the Maryland DAT on the grounds that it infringed the Commerce Clause of the US Constitution, the First Amendment to the US Constitution, and the federal ITFA.[388] This chapter is organized as follows: First, the Maryland DAT will be described (Section 6.2). Second, the litigation proceeding and the main arguments used by the plaintiffs to request the annulment of the DAT will be discussed (Section 6.3). Third, the bench ruling and the order of the state court that resolves the Maryland DAT case will be analyzed (Section 6.4). Finally, the conclusions reached will be outlined (Section 6.5).

[387] As of the day this chapter was drafted, the federal challenge of the Maryland the DAT initiated by four trade groups, among those the US Chamber of Commerce, was dismissed by the US District Court decision of December 2, 2022, though the challenge has been resuscitated as the trade groups have appealed this decision to the Fourth Circuit (Chittiappa & Zagorski, 2023, January 13).

[388] This chapter is based on the article written by Pownall Montoya (2023). The information provided in this chapter on the Maryland DAT, and on the litigation carried out, unless expressly indicated otherwise, was obtained from: (i) the plaintiffs' writs dated on September 10, 2021, and on April 5, 2022; (ii) the defendant's opposition writ dated on April 29, 2022; (iii) the transcript of the hearing that took place on October 7, 2022; and (iv) on the order granting the plaintiffs' the motion for summary judgment dated on October 20, 2022. These documents where provided by Evan Hamme, partner in the New York office of Pillsbury Winthrop Shaw Pittman.

6.2. The Maryland Digital Advertising Tax

On February 12, 2021, the Maryland legislature enacted the Maryland DAT after overriding the veto of Maryland Governor Larry Hogan.

The DAT is imposed on any person with at least $100 million in global annual gross revenues, and $1 million in gross revenue from digital advertising services in Maryland. It must be pointed out that non-digital forms of advertising services are not taxed in Maryland. Therefore, under the Maryland DAT, digital advertising conducted online is taxed, while non-digital advertising, such as billboards, magazines, and newspapers, as well as any other printed media, are not subject to taxation.

This tax is levied on the taxpayer's revenue derived from digital advertising services in Maryland at a graduated tax rate, which goes from a minimum rate of 2.5% to a maximum rate 10% of these revenues. Surprisingly, the tax rate is determined by the taxpayer's annual gross revenue derived from all activities, and regardless of where the revenue is acquired.

The tax rate is of 2.5% for taxpayers with global revenues between $100 million and $1billion; of 5% for taxpayers with global revenues between $1 billion and $5 billion; of 7.5% for taxpayers with global revenues between $5 billion and $15 billion; and of 10% for taxpayers with global revenues above $15 billion. So, the tax rate is increased in accordance with the global annual gross revenues of the taxpayer, considering neither the annual gross revenues obtained from digital advertising nor how much revenue is obtained in Maryland. The act that governs the tax does not regulate a method on how to establish the taxable revenues earned in Maryland since it is the Comptroller who regulates this specification.

The DAT was intended to be affective at the beginning of fiscal year 2021. However, legislation enacted on April 12, 2021, delayed the application of the tax to fiscal year 2022 and amended some relevant articles of the law. The corrective legislation established that for purposes of the DAT, the term "digital advertising services" expressly does not include, and therefore, exempts those advertisement services on digital interfaces owned or operated by or on behalf of a broadcast entity or news media entity. Also, it is relevant to point out that the law that governs the tax prohibits taxpayers from passing the DAT on to a consumer by incorporating a separate fee, line-item, or surcharge.

6.3. Case litigation

On April 15, 2021, subsidiaries of Comcast Corporation, as well as a subsidiary of Verizon Communications Inc., filed a lawsuit in the Circuit Court of Anne Arundel County, a Maryland state court, challenging the validity of the DAT. The objective of the plaintiffs was that the state court declared the illegality of the DAT. In March 2022, the court considered that the case could continue as it concluded that the companies did not have to exhaust the administrative proceedings before filing the lawsuit in a state court. The companies then submitted a motion for summary judgment, requesting the court to rule on several counts of their complaint for a declaratory judgment. The counts of the plaintiffs' complaint can be summarized as follows, that the DAT infringes: (i) the Supremacy Clause of the US Constitution, and ITFA; (ii) the Commerce Clause of the US Constitution; and (iii) the First and Fourteenth Amendments to the US Constitution.

The case was brought before the Circuit Court of Anne Arundel County, seat of the state capital, Annapolis, and the Comptroller's base; tax cases can often be brought before the courts where the agencies that administer taxes are located. In this case, the Comptroller is the Maryland state agency that administers the tax. Consequently, the controversy exists between the plaintiffs and the Comptroller.

While this commentary will not focus on the formal issues of the litigation,[389] it must be noted that the defendant argued that the lawsuit was improperly submitted in a state trial court since the plaintiffs did not exhaust all the administrative proceedings. As explained, the court decided that the companies did not have to exhaust the administrative proceedings before filing the lawsuit at a state court.

The main arguments of the plaintiffs are that the DAT infringes the ITFA, the US Constitution Commerce Clause, as well as its First and Fourteenth Amendments. Below, a more detailed analysis of the main arguments is provided.

6.3.1. The plaintiffs claim that the DAT infringes the ITFA

ITFA was enacted by the US Congress in 1998 and bans taxes that discriminate against electronic commerce by taxing transactions of business models conducted over the Internet while not taxing similar transactions of more traditional business models

[389] For further discussion of this case, see: Grant Thorton (2022, November 22).

conducted offline. Under the DAT, digital advertising conducted online is taxed, while non-digital advertising, such as billboards, magazines, and newspapers, as well as any other printed media, are not subject to taxation. Therefore, according to the plaintiffs, the DAT infringes ITFA as it is a discriminatory tax targeted at Internet-based transactions.

6.3.2. The plaintiffs claim that the DAT infringes the US Constitution's Commerce Clause

The US Constitution's Commerce Clause bans taxes that discriminate against interstate commerce. According to the plaintiffs, since the DAT's tax rate is based on the global revenues rather than on the revenues earned only in Maryland, and since the tax exempts those businesses with global revenues of less than $100 million, a local business that obtains all its revenue in Maryland will not be taxed or will pay less tax than an out-of-state business that obtains revenue from Maryland as well as from elsewhere. As described by the plaintiffs, during the legislative debates on the creation of the DAT, it was clear that the intention was to tax a small number of large technological corporations all located outside of Maryland. The DAT provides a commercial advantage to local businesses infringing, therefore, the Commerce Clause which was meant to guard against these local protectionist measures. The plaintiffs conclude that the DAT infringes the Commerce Clause as it has a discriminatory effect on out-of-state companies and that there is a legislative intent to discriminate against them.

The plaintiffs also raised the issue that the DAT infringes the Commerce Clause since it is not fairly apportioned. The fair apportionment requirement entails that in an interstate transaction, a state must only tax the portion that reflects the taxpayer's activities in that given state, eliminating therefore a possible risk of double taxation. For a tax to comply with the fair apportionment requirement, it must be internally consistent. The US Supreme Court internal consistency doctrine under the Commerce Clause establishes that a state tax must be regulated so that if every state imposed the exact same tax, commerce carried out between states would not be affected worse than commerce carried out within each state.

According to the plaintiffs, the DAT infringes the internal consistency test because of the process by which the tax is calculated. This tax is assessed on a tax base that is determined by the taxpayer's annual revenues from digital advertising services in Maryland. To calculate this amount, and according to the law, a taxpayer ought to multiply its total revenues from digital advertising services by an “apportionment fraction”, the numerator being the annual gross revenue from digital advertising services in Maryland, and the denominator being the annual gross revenues from digital advertising services in the US. The law does not state any rules on how to determine the revenues from digital advertising services obtained in Maryland. However, the law delegates to the Comptroller the duty to adopt regulations that determine which revenues from digital advertising are obtained in Maryland. In the opinion of the plaintiffs, the subjectivity in this scheme fails the internal consistency test. If the same rule was passed in every state, there would be a very probable risk of multiple taxation as the head of the department of revenue of each state could adopt a different criterion. For example, one state might base it on the location of the audience that viewed the advertising while another might consider an estimate based on the proportion of the US population living in that state. Consequently, the same digital advertising revenue could be taxed in multiple states. In Maryland, the Comptroller established that to determine from which state the revenues from digital advertising were obtained, taxpayers must use the criterion of the location of the device on which the advertising is shown. The Comptroller has listed the information to use to determine the location of a device: IP, geolocation data, cookies, device registration, industry standard metrics, or any other comparable information. However, the Comptroller has not established what information should be used first and has not described the consequences if the information obtained is different depending on the source used (that is, what should prevail if the IP shows a different device location from the glocalization data). It can be concluded that this scheme has established a very subjective rule and that if every state adopted the same rule, there could be a high risk of multiple taxation as states might reach distinct outcomes depending on what criterion is used to determine the location of the device. So, the plaintiffs conclude that the internal consistency rule is infringed and therefore, deem the DAT invalid.

6.3.3. The plaintiffs claim that the DAT infringes the US Constitution’s First Amendment and the Fourteenth Amendments.

The First Amendment prohibits regulations that violate freedom of speech and bans a different tax treatment of speakers according to the content of a taxpayer’s speech, while the Fourteenth Amendment enables the First Amendment’s freedom of speech clause to be applicable against States. As explained by the plaintiffs, the DAT is applicable to all digital advertising providers excluding news media entities, so this tax provides for a content-based distinction, which is not admissible under the First Amendment. The DAT does not apply to digital advertising provided by a news media entity that is defined by the law that governs this tax as “an entity engaged primarily in the business of newsgathering, reporting, or publishing articles or commentary about news, current events, culture, or other matters of public interest.” As pointed out by the plaintiffs, this is an exemption that provides an explicit content-based distinction as businesses that are “primarily engaged” in providing “articles or commentary” on “current events, culture, or other matters of public interest” are exempt from taxation, while businesses that provide other content are not. Consequently, according to the plaintiffs, this tax specifically targets entities based on the kind of content they provide. As defended by the plaintiffs, a regulation that allows the government to discriminate according to the content of a message infringes the First Amendment.

The plaintiffs also consider that the DAT’s pass-through prohibition infringes the First Amendment. The pass-through prohibition forbids taxpayers from passing the tax cost on to consumers by means of a surcharge, separate fee, or line-item on the invoice. Nevertheless, taxpayers can pass the tax cost on to the consumer by increasing the price of the digital advertising services, but the amount of the tax cannot be displayed on the invoice. According to the plaintiffs, the pass-through prohibition prevents the taxpayers from communicating to their customers about the DAT and the reason for the increase in the price of the services if they decide to cover the tax cost of the DAT by increasing the price of its services. The plaintiffs sustain that courts have considered that these types of pass-through prohibitions are an unconstitutional restriction of speech.

The defendant opposes all the arguments raised by the plaintiffs. It must be pointed out that an interesting debate was carried out during the hearing in which the defendant argued that online advertising is entirely different from offline advertising. The defendant raised the point that in online advertising, the providers of such services can collect data from the users that show their preferences, an aspect that cannot be found in traditional advertising. Overall, the defendant argued that digital advertising services are not sufficiently similar to offline advertising and, therefore, that the Maryland DAT does not discriminate against electronic commerce under ITFA. Nevertheless, the defendant's arguments did not seem to convince the judge.

6.4. Court decision

On October 17, 2022, after a two-hour hearing, Anne Arundel County Circuit Associate Judge Alison L. Asti ruled from the bench, rather than providing a written decision, in favor of the plaintiffs. In this case, as it is common in trial cases, the judge decided to rule from the bench "in the interest of time and brevity". Consequently, a written decision supporting the conclusions of the judge will not be issued.

First, with respect to ITFA, the state court decided that the DAT infringed ITFA because other forms of advertising are not taxed in Maryland and, for ITFA purposes, online and offline advertising are alike. From the court's point of view, the DAT treated online and offline services differently, infringing, therefore, ITFA which prohibits taxes that discriminate against electronic commerce. Specifically, with respect to ITFA, the judge stated that "And advertising is advertising. […]. And no one taxes advertising in any other manner in the state".

Second, in relation to the US Constitution's Commerce Clause arguments, the court agreed with the plaintiffs that the DAT evidently targets against out of state companies, excluding from its application local and in-state business. Therefore, it was found that the DAT discriminated against interstate commerce. The state court considered relevant the argument raised by the plaintiff's that the DAT only focused on the taxpayers' global revenues to determine the applicable tax rate, and not on the revenues obtained in Maryland nor those earned from providing advertising services. In particular, the judge established that "[…] violates the commerce clause particularly the manner in which the taxes calculated in this case. Which has nothing to do with even advertising […]".

Finally, the court ruled that the DAT infringed the First Amendment as it exempts traditional broadcast and news media, while applying to comparable Internet speech. The court considered that the provision that exempts news media sources from the DAT infringed the freedom of speech protected under the First Amendment of the US Constitution.

On October 20, 2022, three days after the bench ruling, the state court provided a two-page order that granted the plaintiff's summary judgment. In this order, the state court concluded that the DAT: (i) infringes the Supremacy Clause of the US Constitution and ITFA as it "constitutes a discriminatory tax"; (ii) infringes the Commerce Clause of the US Constitution since it "discriminates against interstate commerce"; and (iii) infringes the First and Fourteenth Amendments to the US Constitution since "it singles out the Plaintiffs for selective taxation and is not content-neutral".

6.5. Conclusions

The tax challenges brought about by the digital economy have stirred the interest of lawmakers to propose new taxes in Europe as well as in the US in the form of DSTs. As analyzed, these new taxes may present some illegalities that the courts will eventually have to resolve. [390]

The Circuit Court for Anne Arundel County invalidated the Maryland DAT as it considered that the tax infringed ITFA, the Commerce Clause of the US Constitution, and the First Amendment to the US Constitution. Though Maryland appealed such ruling before the State Supreme Court (Bologna, 2022, November 23), other states that might have been interested in enacting similar taxes could decide to postpone their proposed legislations to see the outcome of the Maryland DAT.[391]

As analyzed in this dissertation, the Spanish DST could be ruled contrary to the fundamental freedoms under the TFEU for being a discriminatory tax for targeting large foreign MNEs in a similar manner as the Maryland DAT was ruled to infringe the US Constitution Commerce Clause as this tax targets mainly out of state companies. It is interesting to highlight this parallelism between both legal bodies.

It must be pointed out that since the initial article by Pownall Montoya (2023), the Maryland Supreme Court on May 9, 2023, vacated an order issued by the Circuit Court of Anne Arundel County that, as explained, had stricken the Maryland DAT.[392] The State

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[390] For further discussion on the Maryland DAT court ruling, *see* Simonetti, Hamme, Chittiappa & Koester (2022, October 21), *Maryland Court Invalidates Maryland's First-of-Its-Kind Digital Ad Tax*.
[391] Some authors defend the enactment of DSTs in the US, such as Kim & Shanske (2022).
[392] Order issued on May 9, 2023 by the Maryland Supreme Court, No. SCM-REG-0032-2022, *Comcast of California/Maryland/Pennsylvania/Virginia/West Virginia, LLC v. Comptroller of the Treasury of Maryland*.

Supreme Court held that the circuit court had no jurisdiction over this case as the plaintiffs did not exhaust their administrative remedies though the substantive arguments concerning the legality of the tax were not addressed. Consequently, the Maryland DAT is in effect for the 2022 tax year and thereafter though subject to the potential challenges by taxpayers that could, in the course of time, exhaust their administrative remedies.[393]

[393] For further discussion on the current status of the Maryland DAT after the order of May 9, 2023 by the Maryland Supreme Court, see: Grand Thorton (2023, May 18).

CHAPTER 7: CONCLUSIONS AND PROPOSALS

7.1. Introduction

This dissertation has analyzed one research question: Is the Spanish DST contrary to law? The hypotheses drawn from this research question are that the Spanish DST infringes on (i) DTCs, (ii) EU law, and (iii) tax principles under domestic legislation. The goal of the dissertation is to answer the research question by confirming or rejecting these hypotheses, and if deemed necessary, propose measures to amend the Spanish DST so it can be compliant with the current legal framework.

In this final chapter, the main findings of the research will be summarized together with the proposals to amend the Spanish DST to make it compliant with the current legal framework that have resulted from the analysis carried out in this dissertation.

7.2. Overview of the Spanish DST

This dissertation has shown that digital service providers, due to the characteristics of digitalization, are providing their services in certain jurisdictions without contributing to the treasury of those jurisdictions. This is because they are able to provide digital services without the need for physical presence in the source states. As a result, under the current DTCs rules that are based on physical presence, there is no applicable tax nexus between the revenues obtained from the provision of digital services and the states in whose territory these services are provided.

The OECD has proposed a two-pillar solution to address the tax challenges of the digitalization of the economy. While the OECD's Pillar Two intends to guarantee a 15% effective tax rate for corporate groups with a turnover greater than €750 million, the OECD's Pillar One would involve a reformulation of the international tax system with respect to MNEs with a turnover greater than €20 billion and a profitability of more than 10%. Thus, the OECD's multilateral solution does not target only digital companies but also other very large MNEs. As noted in this dissertation, digital service providers are generally MNEs. However, not all MNEs necessarily have to provide digital services, nor do all digital companies exceed the thresholds established in the OECD Pillar One. Consequently, the OECD Pillar One does not seem to be a sufficient response to the lack of taxation of digital service providers in the source states, as the OECD Pillar One only taxes very large MNEs regardless of their business activity. Therefore, the OECD Pillar One might be a solution to the conflict of the distribution of tax sovereignty between states of residence and source states, but it does not directly solve the taxation problems that a digitalized economy generates.

The DSTs are the response of certain states, including Spain, to tax digital companies in the jurisdictions in which they provide digital services. These states used the EU's DST Directive Proposal as a model. However, the failure to indeed enact the DST Directive Proposal as a harmonized response by the EU has led to significant differences between the domestic DSTs. As a matter of example, the threshold of subjection to the tax based on the significant digital presence in Spain was established at €3 million while in Italy it was set at €5.5 million, and in Austria and France at €25 million; or the types of digital services covered, for instance the Spanish DST covers three different types of digital services while the Austrian DST only covers one digital service (online advertising). The applicable tax rate also differs between the DSTs. For instance, the Spanish, French, and Italian DSTs apply a 3% tax rate, while the Austrian DST applies a 5% tax rate; or the restrictive criterion adopted by the Spanish DST for the non-taxation of intra-group transactions requiring a direct or indirect participation of 100%, which is a criterion that is not required by the French DST nor by the Italian DST.

The Spanish DST taxes value created by users participating in services that fall under the scope of this tax. It subjects three types of digital services to taxation: (i) online advertising services, (ii) online intermediary services, and (iii) data transmission services. What these services have in common is that the role the users play is key, and the location of a user in Spain is the nexus to allocate a provision of a digital service in Spain. Taxpayers of the Spanish DST are those legal entities that exceed two thresholds: a) The worldwide net turnover must have been of over €750 million during the previous calendar year; and b) the total revenue obtained in Spain from the provision of the covered services must have been of over €3 million during the previous calendar year. As stated in the Preamble of the Spanish DST Act, the €750 million threshold limits the application of this tax to very large companies, while the €3 million threshold limits the application of this tax to situations in which there is a significant digital footprint of the taxpayer in Spain.

The Spanish DST has been designed with a legislative technique that could be improved, as has been demonstrated in this dissertation. For example, the lack of precision in the delimitation of taxable revenues (e.g. second and successive transmissions of a user's data), or the issues raised in relation to the events not subject to taxation, or regarding the definition of "targeted advertising", are all examples in which it is necessary to make interpretations on how to calculate the taxable base making it necessary to resort to non-legal texts such as the DST Directive Proposal or interpretative resolutions from the Spanish DGT and the STA. This imprecision in the delimitation of the tax generates significant legal uncertainty that will most likely lead to a great deal of litigation, since many of the aspects mentioned in this dissertation will depend on the interpretation made by the STA while conducting administrative verifications regarding this tax.

After having summarized the context in which the Spanish DST was enacted and some issues found in the regulation of this tax, the following sections of this chapter will compile the conclusions reached in each of the hypotheses drawn. As a high-level conclusion, it can be said that the compatibility of the Spanish DST with DTCs does not face any legal issues prima facie. However, this tax is found to be problematic with regards to the current legal frameworks of the EU, as well as in regards the tax principles protected under domestic law.

7.3. Compatibility with DTCs

The first hypothesis states that the Spanish DST is contrary to DTCs. Based on the analysis carried out, this hypothesis must be rejected. In this dissertation, stronger arguments have been presented which demonstrate how the Spanish DST is not covered by the DTCs signed by Spain. This tax is considered by the Spanish legislature as an indirect tax under the intention that to state or to treat DSTs as indirect taxes automatically excludes them from the possibility that they could be considered an income tax and, therefore, places them beyond the scope of DTCs. However, the indirect nature of the tax could be contested. It has been concluded that the Spanish DST is a hybrid tax as it presents elements of direct and indirect taxes. Nevertheless, the terms "direct tax" or "indirect tax" themselves are not precise according to the commentaries of paragraph 1 of Article 2 of the OECD MTC and therefore are not used to define the taxes that fall under the scope of application of the DTCs.

The Spanish DST will be covered by DTCs if it can be argued that it is a tax on total income or on an element of income in accordance with Article 2 of the OECD MTC. The OECD MTC does not provide a description of what constitutes income or an element of income. Nevertheless, relevant arguments favor a broad interpretation of the meaning of income, including taxes that are calculated on a gross basis. In any case, the definition of taxes on income (or on elements of income) is clearer for taxes that are calculated on profits as they have a stronger connection with what is classically known as an income tax.

Though the Spanish DST is calculated based on the revenue (turnover) from certain digital services, this does not exclude it from falling within the scope of DTCs. However, this, in conjunction with other design features of the Spanish DST such as the fact that it has no connection with the CIT, does not allow for a deduction of most of the expenses, and the fact that it taxes the use of the user's data, or more precisely, that the tax revenue represents the quantification of the value created by the use of the user's data, makes it evident that the Spanish DST is essentially not a tax on income (or on an element of income) and falls out of the scope of DTCs.

It must also be pointed out that in accordance with Article 2 OECD MTC, the Spanish DST could also be covered by a DTC if it can be considered as a tax substantially similar to a tax which is already covered. However, the unique characteristics of the Spanish DST makes it unlikely that DTCs will include similar taxes.

On the other side of the spectrum, it could be defended that the Spanish DST does fall under the scope of application of certain DTCs by taking into account (i) the purpose for which it is introduced, to supplement the CIT, and (ii) the three defining elements that could lead to identify it as a tax on income. First, it is a tax on revenue which is an element of income. Second, it is a tax that considers the economic capacity of the supplier. Thirdly, it is a tax on the supplier that does not include any mechanism to legally pass the tax on to the user. These arguments are deemed weaker especially considering the way in which it could be defended; that the tax considers the economic capacity of the provider through the thresholds that determine who is a taxpayer. These thresholds are clearly not set to consider the specific ability to pay of the taxpayer.

Though better arguments speak against the consideration of the Spanish DST as a tax on income, the debate addressed in this dissertation does not have a clear solution; the courts will have to define whether the Spanish DST is covered by the DTCs. However, under Article 25 of the OECD MTC, contracting states could resolve doubts on the interpretation of a DTC if a MAP was initiated.

This dissertation has examined the criteria for a tax to fall under the scope of the DTCs as well as the characteristics of the Spanish DST. It can be concluded that the Spanish DST meets the characteristics not to be defined as a tax on income and, therefore, does not fall under the scope of DTCs signed by Spain. However, it is not implausible that a court might rule that it is a tax on income. If that were the case, the Spanish DST could fall under the scope of a DTC that contained the four sections of Article 2 of the OECD MTC. Under this interpretation, the STA would not have the taxing powers to collect this tax in accordance with Article 7 of the OECD MTC.

Finally, it must be borne in mind that Article 24 of the OECD MTC establishes the prohibition to discriminate between contracting states. As explained in Chapter 1 of this dissertation, this provision is not relevant in this case as this article is only breached when a domestic provision targets only non-nationals or foreign ownerships, but this is not the case of the Spanish DST.

7.4. Compatibility with EU law

The second hypothesis states that the Spanish DST is contrary to EU law. The compatibility with EU law has been analyzed in four parts including from the perspectives of fundamental freedoms, of State aid rules, of Article 110 of the TFEU, and of the VAT Directive. It has been found that while the Spanish DST does not infringe on Article 110 of the TFEU and on the VAT Directive, it does infringe on fundamental freedoms and State aid rules. Overall, the analyses carried out have demonstrated the validity of this hypothesis.

7.4.1. Compatibility with fundamental freedoms

The first part of this second hypothesis addressed the compatibility of the Spanish DST in light of fundamental freedoms, especially with regards to the freedom to provide services. It has been demonstrated that large digital services providers which meet the

€750 million turnover threshold and those which do not can be perfectly comparable. To this extent, it has been proven that the Spanish lawmakers intended to discriminate between domestic and foreign (or foreign parented) entities when establishing this threshold.

This threshold distinguishes between digital service providers that exceed the set thresholds and thus fall under the scope of the tax (i.e. very large companies that tend to be foreign or foreign-parented), and those entities that do not fall under the scope of the tax for not exceeding these thresholds (i.e. large companies and SMEs that tend to be domestic). Large companies that have a strong market position but with a turnover just below this threshold are not subject to the Spanish DST. These entities, however, are comparable to the very large entities that do, indeed, fall under the scope of the tax. So, while the tax is imposed on entities which exceed the €750 million threshold, comparable entities are left out of the scope of the tax.

There are many relevant differences between the Spanish DST and the Hungarian turnover-based business taxes examined by the CJEU in the *Vodafone* and *Tesco* cases in which it ruled that no discrimination occurred. As explained, in the case of the Spanish DST there is a direct relation between the design of the €750 million worldwide turnover threshold and foreign MNEs that leads to indirect discrimination. Therefore, in a potential judicial case against the Spanish DST, the *Vodafone* and *Tesco* rulings should not be applied automatically.

Furthermore, the Spanish DST Act establishes that for entities that form part of a group, the global figures of the group are taken into account toward the threshold. This rule is similar to the one examined under the *Hervis* case in which the CJEU concluded that it resulted in discrimination. Therefore, the *Hervis* case should be considered in a future challenge to the Spanish DST.

Potentially, the Spanish DST discriminates mostly against US companies. For the purposes of these companies claiming that EU law has been infringed, it is necessary for them that the taxpayer be a subsidiary in a Member State so the entity has standing to invoke a violation of EU law.

7.4.2. Compatibility with State aid rules

The second part of the second hypothesis addressed the compatibility of the Spanish DST under the scope of State aid rules. In accordance with the CJEU case-law on the application of State aid rules in tax matters, the selectivity criterion plays a relevant role. The selectivity test consists of a three-step process: (i) identifying the reference framework, (ii) analyzing whether a discriminatory treatment takes place between comparable entities, and (iii) examining whether the discriminatory treatment can be justified by the nature or the general structure of the tax system.

In relation to the correct reference framework, it is delimited by the sector to which the Spanish DST applies (i.e. providers of online advertising services, online intermediary services, and data transmission services).

As mentioned in the fundamental freedoms section, the €750 million threshold could constitute a derogation from the reference framework since, as proven, this threshold generates a de facto discrimination, as comparable entities are treated differently. Moreover, for entities that become taxpayers for meeting the thresholds, the entire amount of revenue from digital services obtained in Spain becomes taxable at a tax rate of 3%, meaning that different treatment is provided between those entities that barely meet the thresholds and those that fall short of meeting them. Thus, these two elements of the Spanish DST favor certain entities (entities that do not fall under the scope of the tax) in relation to others which are comparable (entities that fall under the scope of the tax), creating a differential treatment that is not accordant with the objective of the Spanish DST Act, that being the reference system.

As argued, the design of the €750 million threshold and of the tax rate structure does not seem to be consistent with the achievement of the objectives of the reference system, which is to tax the value created by the users that is monetized by entities that have a strong market position and benefit from scale economies. This threshold only considers very large companies while leaving large companies that also hold a strong market position out of the scope of the tax. In addition, the use of this very high threshold can hardly be justified by administrative reasons of feasibility and simplicity as intended by the Spanish legislature. Consequently, it can be concluded that the differentiation made by the Spanish DST based on these thresholds and on the tax rate scheme are not justified by the nature of the general structure of the reference system, that is, of the Spanish DST Act and of the Spanish tax system as a whole. The bottom line is that the Spanish DST infringes State aid rules.

7.4.3. Compatibility with Article 110 TFEU

The third part of the second hypothesis examined the compatibility of the Spanish DST from the perspective of Article 110 of the TFEU. It is unlikely that the Spanish DST will raise issues under Article 110 of the TFEU as the discriminatory nature of the tax affects foreign services providers and not foreign goods. In addition, it is not possible to establish that the goods of other Member States are treated in a discriminatory way as it is not possible to distinguish the origin of the goods mostly sold by foreign and domestic entities.

7.4.4. Compatibility with the VAT Directive

The fourth part of the second hypothesis examined the compatibility of the Spanish DST under the scope of Article 401 VAT Directive. This Directive, which prohibits the enactment of other turnover taxes, is interpreted by the CJEU in a narrow way. Accordingly, though the Spanish DST complies with the characteristics of being a tax on revenue (turnover), it is imposed only on very specific services of a digital nature. Consequently, it is not a general tax on goods and services, thus it should be deemed compatible with the EU harmonized legislation on VAT.

7.5. Compatibility with tax principles under domestic legislation

The third hypothesis states that the Spanish DST is contrary to the tax principles covered under Spanish law. The analysis carried out has confirmed this hypothesis. It has been found that the current wording of the Spanish DST Act presents relevant challenges in relation to different principles.

The contradictions contained in the Preamble of the Spanish DST Act that tries to justify the need for the established thresholds, the unjustified discrimination created between economic operators, and the disconnection between the objective pursued and the result obtained that leads to illogical situations, are all indicators that this tax is arbitrary infringing Article 9.3 of the Spanish Constitution.

The subjection of specific taxpayers to the Spanish DST can infringe the generality principle provided for in Article 31.1 of the Spanish Constitution. Nevertheless, to conclude whether this infringement takes place, it was necessary to examine this tax under the equality principle as both principles are highly interconnected. Hence, it was necessary to analyze whether a different treatment between economic operators is justified.

Thus, subjecting the Spanish DST to the comparability, reasonableness, and proportionality tests that the Spanish Constitutional Court carries out to determine whether a measure infringes the equality and non-discrimination principles leads to the conclusion that the Spanish DST infringes these principles, as the tax establishes an unequal treatment between comparable entities in terms of the tax burden to be borne by taxpayers which does not carry an objective, reasoned, and proportionate justification.

The Spanish DST is levied even if the taxpayer has losses, this being a clear indicator that the tax potentially infringes the ability to pay and non-confiscatory principles. In addition, magnitudes from previous years are taken as a base for the thresholds to determine who is a taxpayer, though it seems reasonable to establish a correlation between the year in which the tax is accrued and the year in which the magnitudes to determine who is a taxpayer is considered. This is evidence that the Spanish DST grants a level of retroactive effects as it refers to situations that have already concluded, potentially infringing the principle of legal certainty and the prohibition of retroactivity.

In all, it can be concluded that the Spanish DST presents relevant challenges regarding: (i) the prohibition of arbitrariness, (ii) the generality principle, (iii) the equality and non-discrimination principles, (iv) the ability to pay and the non-confiscatory principles, and (v) the legal certainty principle and the prohibition of retroactivity. Nevertheless, it has also been found that the Spanish DST does not face any challenges with regards to double taxation with the CIT since both taxes are of different natures.

7.6. Proposals

This dissertation proposes the following amendments to the Spanish DST to make it compliant to the current legal framework.

First, a profitability threshold should be applied stipulating that the tax cannot be levied if the entity has losses in the calendar year the tax is accrued to not infringe the ability to pay and the non-confiscatory principles. Thus, if the entity has losses, their tax base should not be considered for the purposes of calculating the aggregated tax base. In the case of a stand-alone entity that does not form part of the group, if they have losses, they will not have to file the tax form as they would not have the consideration of being a taxpayer.

An issue can arise if the taxpayer's fiscal year does not coincide with the calendar year. Therefore, it will be up to the taxpayers to provide evidence if they decide to apply for this option before the STA if required to do so. A rule could be established that states that for fiscal years in which the entity has had losses, the revenues obtained in Spain from covered services during the months of that fiscal year do not count for the purposes of the tax.

In addition, the tax levy of the Spanish DST cannot be higher than the profits obtained after taxes in order to comply with the non-confiscatory principle. Thus, for entities whose calendar year does not coincide with their fiscal year, the profits obtained in a fiscal year after the CIT, or equivalent tax on profits, could be divided monthly in order to allocate the profits per calendar year. Once again, this is a mechanism to be used if the taxpayer wants to claim that they are not subject to taxation due to losses or low profits and is not mandatory for all taxpayers.

Second, the thresholds must be based on the amounts of the net turnover and revenues of covered services on December 31 of each given year. However, the tax form and payment of the tax will have to be filed and performed only once a year, six months after the closing of the calendar year in order to establish a correlation between the determination of the magnitudes of thresholds and the calendar year in which the tax is accrued. For example, for year 2024, the tax will be accrued from January 1 to December 31, 2024. However, the filing of the relevant tax form and the payment of the Spanish DST for year 2024 should be done during July 2025 in accordance with this proposal. A period of six months is sufficient for the taxpayers to have obtained all the relevant information to be able to calculate the tax base.

Third, decrease the current €750 million turnover threshold to a €50 million turnover threshold so large domestic companies fall under the scope of the tax; and increase the threshold of covered services obtained in Spain from €3 million to €5 million to avoid traditional (or offline) business from falling under the scope of the tax.

Fourth, in a case of a group of entities among which at least two meet the requirements to be considered as taxpayers, it is permitted to nominate an entity of that group for the purposes of paying the DST, and this entity will then be the one responsible to comply with this obligation. To this effect, one entity of the group would have to file the tax form of the Spanish DST and pay the aggregated tax liability. This way, it is possible to apply a tax graduation since the thresholds refer to the aggregated amounts of the group.

Fifth, introduce a dual tax rate structure of 0% tax rate for an aggregated tax base of up to €3 million (or €5 million as proposed), and a 3% tax rate for the exceeding part of the aggregated tax base. Another possibility would be to establish an exemption of €3 million (or €5 million as proposed) on the aggregated tax base (or on the tax base for stand-alone entities). In relation to the tax forms, the mentioned information for each entity that is a taxpayer will have to be provided including its individual tax base. The tax bases will be aggregated to apply the tax graduation scheme.

7.7. Outlook

The goal of the dissertation is to provide an answer to the research question that consisted in analyzing the compatibility of the Spanish DST with the current legal framework. Three hypotheses were proposed which considered that the Spanish DST infringes on (i) DTCs, (ii) EU law, and (iii) tax principles.

In relation to the hypothesis of the DTCs, this must be rejected as stronger arguments suggest that the Spanish DST does not infringe DTCs. The other three hypotheses as concluded in this section have been confirmed.

Policy makers are struggling to redesign the international tax system in order to adapt it to this digitalized economy. Digital business models carry out their activities with little or no physical presence and are highly reliant on intangibles and users' data.

The Spanish DST is a tax that targets certain digital services (online advertising services, online intermediary services, and data transmission services) and allocates taxing rights based on the location of the users as it taxes the value that users generate for providers of the covered services.

The analysis carried out in this dissertation has revealed that the Spanish DST successfully targets services that rely heavily on users' data and uses an interesting nexus to allocate taxing rights where the users are located, thus providing a solution to the challenges of taxing the digital economy as it provides a remedy for market jurisdictions to impose a levy on revenues obtained within their borders. As it taxes the value generated by the users, it is logical that it is a tax on revenue and due to this characteristic, it cannot be considered as a tax on income and thus does not fall under the scope of DTCs avoiding many difficulties since if it were to be considered a tax covered by DTCs, its application could be very limited. Nevertheless, the Spanish DST can be considered to be a discriminatory tax due to the high revenue threshold as well as its tax rate structure. As a result, it presents serious issues with regards to EU law, and tax principles covered by domestic law.

To conclude, the DSTs are an interesting solution to solve the tax challenges of the digital economy. While a comparison with other policy options to tax the digital economy is out of the scope of this dissertation, the DSTs should not be dismissed as a possibility to successfully address the tax challenges of the digital economy within the OECD two pillar approach solution that intends to redefine international taxation.

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