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The new Spanish digital service tax; will it pass the selectivity criterion on State aid grounds?

by

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Summary

New technologies have accelerated the way we communicate and interact with each other, also creating new forms of commerce between individuals and companies. The so-called "digital economy" comprises a series of mechanisms that facilitate the interaction between users and companies that base their business models on digital platforms. The taxation of the digital economy has become extremely relevant for many countries for the challenges it brings to the international tax system.

Proposals have been developed around the world that seek to obtain higher tax revenues from the income obtained by large digital companies. In particular, the European Commission proposed a Digital Services Tax aimed to value the contributions made by users of digital platforms. However, this proposal received criticism from some Member States, so the idea of a harmonised solution at the EU level was stopped.

In response to the lack of consensus at the EU level, some Member States decided to boost their own taxes on certain digital services. Such is the case of Spain that in early 2020 approved the draft law on certain digital services. Nevertheless, the characteristics of this tax, such as the digital services it covers and the application thresholds, lead to questions about whether it complies with the legal framework of the European Union and the case law of the CJEU.

The aim of this thesis is to present a comparability analysis between the tax on certain digital services approved by Spain; article 107 (1) of the Treaty on the Functioning of the European Union and the case law of the CJEU on state aid, to determine whether the application this tax gives competitive advantages to some companies over others.

Preface

This thesis represents the grand finale for a wonderful academic year as student in the Master's Programme in European and International Tax Law at the School of Economics and Management, Department of Business Law, at Lund University, a once in a lifetime experience. I would like to thank Lund University and University of Guadalajara because, without their academic and financial support, this dream would have never been possible.

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Abbreviation list

AG	Advocate General
BEPS	Base Erosion and Profit Shifting
CJEU	Court of Justice of the European Union
Council Directive	Proposal for a Council Directive on a common system for a digital services tax on the income resulting from certain digital services COM/2018/0148 final - 2018/073
DST	Digital Service Tax
EC	European Commission
ECOFIN	Economic and Financial Affairs Council
EU	European Union
EU DST	European Union Digital Service Tax
General Court	The General Court of the European Union
MSs	Member States
OECD	Organisation for Economic Cooperation and Development
SA	State Aid
SDST	Spanish Digital Service Tax
TFEU	Treaty of the Functioning of the European Union

1 Introduction

1.1 Background

On October 19, 2018, the Spanish Government presented the Draft Law of the Tax on Certain Digital Services (SDST)[1] which is based on the Proposal for a Council Directive on a common system for a digital services tax on the income resulting from certain digital services[2], presented by the European Commission on March 2018.

Before a new consensus on multilateral tax reform within the Organisation for Economic Cooperation and Development (OECD) can be reached by the end of 2020, the mentioned Council Directive was put forward by the European Commission (EC) as a short-term remedy for the so-called, unfair taxation of digital platforms[3], a statement made and continually replicated by the EC and the OECD to justify its efforts to create a more aggressive tax framework for digital businesses.

Due to the lack of consensus at the European Union (EU) level, in March 2019 a new proposal was presented, The European Union Digital Service Tax, (‘EU DST’) that reduced the scope of the 2018 Council Directive to target only digital advertising services. Despite the changes, Denmark, Ireland, and Sweden maintained their opposition to the EU DST, forcing the EC to suspend the European solution and focus on the work developed by the OECD on the fiscal challenges presented by the digital economy.

As a result of the mentioned lack of consensus some Member States (MSs), planned to move forward with own DST proposals[4]; this is the case of the SDST mentioned above that the Spanish Government approved, on February 18, 2020.

However, the rush to obtain higher tax revenues from companies related to the supply of digital services has led to new proposals for a tax on digital services, made by different countries such as France, Italy, the United

[1] Gobierno de España; Proyecto de Ley del Impuesto sobre Determinados Servicios Digitales. http://www.congreso.es/public_oficiales/L12/CONG/BOCG/A/BOCG-12-A-40-1.PDF (last access march 29). (Translation made by the author).

[2] 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/2018/0148 final - 2018/073. https://ec.europa.eu/taxation_customs/sites/taxation/files/proposal_common_system_digital_services_tax_21032018_en.pdf (last access march 29). Herein after Council Directive.

[3] Communication from the commission to the European Parliament and the council. https://ec.europa.eu/taxation_customs/sites/taxation/files/communication_fair_taxation_digital_economy_21032018_en.pdf (last access April 29).

[4] 'Debate: Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals', (2018), 46, Intertax, Issue 6, pp. 565-572.

Kingdom or others in the world, present deficiencies that, in their application, could generate more significant problems than those they are trying to solve[5].

One of the problems these unilateral measures present is their compatibility with the current EU legal framework, among others, the compatibility between said measures and state aid rules established in article 107 (1) of the Treaty on the Functioning of the European Union (TFEU) and the criteria there mentioned to qualify a measure as state aid.

1.2 Research question and aim

This research will analyse whether the recently approved Spanish Digital Service Tax (SDST) will pass the test of the selectivity criterion on state aid grounds. Many authors have widely analysed the wording of Article 107 (1) TFEU. Therefore, this thesis has as its primary objective to analyse in-depth the selectivity criterion and its application to the mentioned SDST.

1.3 Method and material

The method used for this investigation is the legal-dogmatic[6] with the influence of the historical method and comparability analysis. The legal-dogmatic method is applied primarily to analyse legislation and cases related to EU treaties, regulations and directives, CJEU case law, and EC decisions. Although at first, this analysis may seem extensive, especially the sections related to the evolution of European state aid rules, this is necessary for the comparability analysis on state aid and the SDST.

The historical method is used to illustrate the interpretation path that the CJEU and the EC have followed concerning state aid cases and particularly the selectivity criterion. The method will be presented in a clear and illustrative manner to show how the interpretation of article 107 (1) TFEU has developed.

The comparability analysis is used to contrast the interpretation of the CJEU and the EC of the selectivity criterion framed in article 107 (1) TFEU and the wording of the SDST to clarify the interpretation that said criterion gives us about the mentioned legislation.

The material that is used to carry out this investigation consists in the aforementioned Spanish legislation, the case law of the CJEU; the EC investigations on state aid grounds and, legal doctrine such as books, articles, and opinions. However, even though taxes on digital services has caught the attention of many experts in international tax law around the

[5] Kofler, Georg & Sinnig, J. (2019). Equalization taxes and the EU's 'digital services tax'. Intertax. 47. 176-200.

[6] Douma Sjoerd, Legal Research in International and EU Tax Law, 2014 Edition, Wolters Kluwer Business, Pgs. 17 and 18.

world, little has been written (even in Spain) about the SDST, reason why the reader will find few references to articles or opinions written in Spanish.

1.4 Delimitation

This research starts from the assumption that the reader has a general knowledge of European and international tax law and has a broad knowledge of the basics of state aid law.

Therefore, the basic concepts, as well as the criteria for state aid qualification mentioned in the said treaty, are not profoundly discussed or explained in this work.

Furthermore, the base topic for analysis and comparability in this investigation will be the selectivity criterion established in Article 107 (1) (c) of the Treaty on the Functioning of the European Union. Therefore, although the other criteria there mentioned are listed and explained in this research, they are not the object of a detailed analysis.

1.5 Outline

The SDST's compatibility with state aid EU Law in the light of the selectivity criterion is the topic of this research.

First, an overview of the EC Council Directive, the base for the legislation here studied, will be described and provided. Secondly, the recently approved Spanish digital services tax will be analysed to determine its differences and similarities with the EC Council Directive. Thirdly, an in-depth study on the selectivity criterion is carried out.

This research emphasises in the characteristics that most affect the Spanish tax here studied. However, all the criteria listed in Article 107 (1) TFEU will be mentioned and explained; this investigation will focus on the analysis of the selectivity criterion mentioned above.

General development of the CJEU case law about state aid requirements is elaborated to establish the vision the Court has presented about the criterion that frame state aid. The case law of the CJEU, as well as resolutions of the European Commission in its state aid investigations, will be used to support this analysis.

Finally, through a comparability analysis between the requirements of the selectivity criterion and the SDST, will be determined if qualifies as state aid. As support for this point, aspects or characteristics of other proposals for DST presented by different MSs will enrich the analysis of this research.

2 The Digital Service Tax

The digital economy has generated, from the possibilities offered by new technologies, new business models, and the transformation of many of the existing ones, numerous benefits to companies and citizens.

However, the increase in certain digital activities has become more complicated for existing tax systems since, in some cases and according to the “official” speech (the one mentioned by the OECD in particular), companies do not pay taxes in the countries where the economic value is generated.

As indicated in the Explanatory Memorandum of the Draft Law on a tax on certain digital services (SDST)[7] presented by the Spanish Government, the new tax is needed and conceived as a solution for the current regulations’ inability to tax in Spain the income derived from new digital business models in which the contribution of Spanish users and the value of the data created by them are essential.

The term ´value creation by users´ is used in this paper as OECD, the EC and MSs have adopted it. However, the term is problematic since neither the OECD, the EC nor the MSs that use it have provided a clear definition of it or even an adequate way to measure it, but the same term will be used to stick to the line of thinking of the mentioned entities during the present analysis.

These digital businesses are often developed remotely by companies with little or no physical presence in the Spanish territory and are not taxed in Spain, nor any other MS, for the income obtained from said activities[8].

This problem is not exclusive to Spain, but rather worries at a global level, been the subject of debates at different levels for so long, and to date, a global solution has not been reached.

2.1 The OECD

Within the Organisation for Economic Cooperation and Development (OECD) and the G20, the project on Base Erosion and Profit Shifting (BEPS project)[9] have been especially relevant, specifically on the challenges of the digital economy, on its action 1.

The proposed solution consists on a revision of the concept of permanent establishment that would allow to rellocate the revenues derived from the

[7] Draft Law on the Tax on Certain Digital Services. (The Draft Law) (Proyecto de Ley del Impuesto sobre Determinados Servicios Digitales). Translation made by the author.
[8] Government of Spain, Explanatory Memorandum on the Draft Law of the tax on certain digital services, point II. (January 2019).
[9] OECD/G20 Base Erosion and Profit Shifting Project (OECD 2015).

data and contributions of the users obtained by the companies, to the country of origin or where those data and users are located.

The "Policy Note"[10] of January 23, 2019, reflects the progress made by the OECD which is structured on two pillars: the so-called "pillar one", related to the reallocation of the benefits of the digital companies, and the “pillar two”, related to a general reform of international business taxation.

For this investigation Pillar 1 is essential because its scope covers highly digital business models but goes wider by focusing on consumer-facing businesses with further work to be carried out on scope and carve-outs. Its main objectives are: The creation of a New Nexus Rule; The creation of a New profit allocation rule that goes beyond the arm’s length principle and; increases tax certainty delivered via a three-tier mechanism as follows:

Amount A – a share of deemed residual profit allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right·

Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction; and·

Amount C – binding and effective dispute mechanisms for prevention and conflict resolution regarding all proposal’s elements, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

The OECD has the intention to reach a global solution within the G20 by the end of 2020.

2.2 The EU

The European Union (EU) has been closely involved in these OECD works, which in 2019 were considered a top priority by the Council for Economic and Financial Affairs (ECOFIN)[11], establishing work teams for the evaluation of OECD proposals from different perspectives at the EU level and by holding internal preparatory debates on the implications of these proposals and their compatibility with Community law.

However, even though some advances were taking place at the OECD level and a global solution was expected, its adoption seemed complicated and time-consuming due to the great complexity of the problem. Derived from that, at the EU level, many MSs expressed interest in taking temporary unilateral measures, such as the establishment of a provisional tax that will

[10] OECD/G20 Base Erosion and Profit Shifting Project Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note (Policy note 2019). https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (last access May 24, 2020).

[11] Communication from The Commission to The European Parliament and The Council. https://ec.europa.eu/taxation_customs/sites/taxation/files/1_en_act_part1_v10_en.pdf (last access May 24, 2020).

mitigate the problem until the adoption of the final solution at the EU and the OECD level.

The European Commission responded to this appeal with the presentation, on 2018, of the Proposal for a Council Directive on a common system for a digital services tax on the income resulting from certain digital services[12], intending to regulate the taxation, in a harmonised way at the EU level, of the derived income of three types of digital services in which the user has essential participation: a) targeted advertising, b) online intermediation and c) the transmission of online obtained data.

The Commission's initial intention was that this European provisional tax to be applicable in 2020[13] and to be repealed when the final global solution was reached, with the globally coordinated reform of tax rules over these services. ECOFIN discussed the provisional measure proposed by the European Commission, however, there was no consensus between the Ministries of Finance of the MSs.[14]

Despite the broad support enjoyed by the text among many MSs, the debate revealed that some delegations kept reservations on specific aspects of the proposal and others even raised more critical objections. Thus, in March 2019, the Council of the European Union decided to start with a new draft that limited the scope of the digital advertising services tax.

Nevertheless, and due to new objections from some MSs, this latest proposal also did not obtain the necessary consensus to reach the EU level.[15] Discrepancies between MS's regarding the EC temporary solution and the progress made within the OECD towards the final solution, led the finance ministers of the member states to agree, at the ECOFIN meeting on January 21 2020, that, to avoid fragmentation and unilateral measures, the best way to move forward was to look for a global solution within the OECD, leaving for the moment the EC proposal for a provisional tax.

3 The Spanish Digital Service Tax

Throughout this time, Spain, although considered that the optimal strategy to tackle the challenge was to find a definitive solution at the global level within the OECD, in 2018 started the process to adopt a temporary

[12] Proposal for a Council Directive on a common system for a digital services tax on the income resulting from certain digital services. COM/2018/0148 final - 2018/073

[13] Article 25 of the Council Directive.

[14] Economic and Financial Affairs Council, 12 March 2019. https://www.consilium.europa.eu/en/policies/digital-taxation/.

[15] "EU finance ministers drop proposal for digital tax". MNE Tax. https://mnetax.com/finance-ministers-drop-proposal-for-eu-wide-digital-tax-32873 (last access May 24, 2020).

unilateral solution, following the path started by other countries, such as France, Italy, Germany, and the United Kingdom.

Thus, at the end of October of that year, the Spanish Government presented the Draft Law of the SDST. Three months later, after the corresponding process of observations, the Council of Ministers of January 18, 2019, approved the referral of the Draft Law to the Congress of Deputies for processing to approve it for 2019. According to the Explanatory Memorandum of The Law, the delay in adopting an internationally agreed regulation, either at the global level (OECD) or at the EU level, justified such action.[16]

However, the SDST, which was a replica of the 2018 EC proposal once the thresholds had been adapted and with some other differentiating nuance, was then presented by the Spanish Administration as the first MS's proposal to adapt to the future EC provisional tax structure, indicating that it would adapt to the regulation of said tax as soon as it was approved.

Likewise, Spain would repeal its tax as soon as a permanent solution is reached at the OECD level, which is recognised by the fourth final provision of the Draft Law. In this way, and after the Bill was put on hold due to various political issues in Spain, on February 18, 2020 the Council of Ministers approved the referral of the Draft Law of the SDST back to the Congress of Deputies.

However, the political context marked by global trade and economic tensions has led the Government to propose that, exceptionally, this first year the payment of the tax be made at the end of 2020 instead of quarterly. According to the Ministry of Finance, "this measure aims to give greater scope to negotiations at the international level, with the idea of reaching a global consensus in the coming months".[17]

It is important to recall that some countries have taken the step of approving this kind of tax. Perhaps the most discussed case has been that of France, which delayed the application of its DST until the end of this year due to the warning from the United States to establish tariffs on some of the main French products as a consequence of the effects the French DST would have on North American companies [18].

[16] Explanatory Memorandum. Op. Cit. Part II.

[17] Ministry of Finance. Memory of the Analysis of the Normative Impact of the Draft Law Xx / 2018, Xx De Xx, Of the Tax on Certain Digital Services (Memoria Del Análisis Del Impacto Normativo Del Anteproyecto De La Ley Xx/2018, De Xx De Xx, Del Impuesto Sobre Determinados Servicios Digitales). Translation made by the author.

[18] Report on France's Digital Services Tax Prepared in the Investigation under Section 301 of the Trade Act of 1974, Robert E. Lighthizer, December 2, 2019. https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf (last access April 24, 2020).

Furthermore, from the controversy over the timing for the adoption of this unilateral measure in relation with the current EU position and the progress that is taking place within the OECD towards a definitive solution, the configuration of the SDST proposal raises numerous technical difficulties, some of which have already been pointed out by various MSs, which supported their rejection of the EC version of the tax[19].

To these considerations, the latest events generated by the global health crisis must be added, given that they may change the perspective on the SDST, possibly expanding the coverage of said tax to all digital companies, not only those which provide online advertising. Specially given the economic consequences and the relevant role acquired in this situation by digital service companies, which can navigate through uncertain economic times better than other traditional sectors of the economy.

Below, the most relevant elements of the tax, and some of its most controversial aspects are analysed.

The Spanish DST, defined in the Draft Law as an indirect tax, taxes certain digital services in which users located in Spanish territory contribute significantly to the value creation process. It is essential to mention that the main idea of the SDST, is to tax those services in which the intervention (participation) of the user located in Spain is essential for the value creation of the company that provides the services and through which the company monetises those user contributions. In other words, the services the SDST contemplate are those that, according to the Draft Law itself, could not exist in their current form without users' involvement.

An example of this type of digital services is the case of internet search engines, which capture user's data, once the user has given their consent, and subsequently, transfer said data to third parties or include advertising explicitly directed to the user based on said data (for example, based on previous searches made by the user).

3.1 The taxable event.

The new SDST tax the following services:[20]

a) Targeted advertising: the inclusion, in a digital interface (program, website, or application that allows online communication), of advertising directed to the interface users.

b) Online intermediation: making available multi-sided digital interfaces that a) allow users to locate and interact with each other or b) facilitate the delivery of underlying goods or services directly between users.

[19] MNE Tax. Op cit.
[20] Article 4. Of the draft Law.

c) Transmission of data obtained online: transmission, including the sale or transfer, of the users' data that have been generated by activities carried out by the latter on digital interfaces.

Concerning the first service (targeted advertising), the rule clarifies that, in cases which the entity that includes advertising does not own the digital interface, the taxable person will be the provider of the advertising service to the said entity, and not the entity that owns the interface.

In this way, the rule seeks to avoid possible chain effects or double taxation (it is understood that part of the income obtained by the entity that includes the advertising of a client will be paid to the owner of the digital interface in the one that will appear the advertisement, in exchange for the rental of digital space in that interface).

3.2 Exclusions

Following the purpose of the tax (services in which the user's participation in a digital activity constitutes an essential contribution for the company and thanks to which it can obtain income), the sale of goods or services contracted online through the website of the provider of those goods or services (which may involve what is commonly called "electronic commerce") are excluded from the scope of the SDST, since, for the retailer, the value creation resides in the goods and services provided. The digital interface is used only as a communication channel.

For the same reason, the delivery of underlying goods or services that take place between users in the framework of an online intermediation service also falls outside of the scope of the Spanish DST. Likewise, online intermediation services, when the only or central purpose of said services provided by the entity that makes a digital interface available is to supply digital content to users or provide communication services or payment services, are excluded.

As stated in the explanatory statement of the EC Council Directive on which the SDST proposed by the Spanish Government is based, some providers of digital content through a digital interface may authorise a certain form of interaction between the recipients of said content and, therefore, they could be considered to be included within the definition of multi-sided digital interfaces that provide intermediation services.[21]

However, in such circumstances, it is understood that the interaction between users remains ancillary concerning the supply of digital content[22], in which the sole or central purpose of the user is to receive the digital content from the entity that makes the digital interface available. For

[21] Council Directive. Op. cit. page 9.
[22] Ibid, page 8.

example, the delivery of a video game by an entity to a user through a digital interface will constitute a supply of digital content by the said entity and falls outside the scope of the SDST, regardless of whether the user in question can play with other users and, therefore, some form of interaction between them is performed. It is the same case with communication and payment services, in which value creation resides in development and sale of programs that allow interaction and where user participation provides less value.

The supply of digital content to users through a digital interface outside the scope of the Spanish DST should be distinguished from the provision of a multi-sided digital interface through which users can upload and share digital content with other users, or the provision of an interface that facilitates the underlying supply of digital content directly between users.

Precisely these latter services constitute by the entity that makes available the multi-sided digital interface that falls within the scope of the Spanish DST an intermediation service, regardless of the nature of the underlying operation. Hence, the wording of the Draft Law emphasises that the supply of digital content excluded from the scope of the SDST must be carried out by the entity that provides the digital interface through which the digital content is provided, and not by the users of said interface to other users.

The provision of financial services provided by regulated financial entities, as well as the provision of data transmission services performed by said entities are also excluded from the scope of the SDST.[23] Multi-sided digital interfaces where users can receive information regarding the existence of order execution services, investment services, or investment analysis, such as those provided by the entities mentioned above, often involve user interaction. However, as stated in the explanatory statement of the EC Council Directive, the basis for the SDST, the user does not play a central role in creating value for the entity that makes such digital interface available.[24] Instead, the value lies in the entity's ability to bring together financial products, buyers, and sellers under specific and distinctive conditions that would not otherwise occur (compared, for example, to operations concluded outside of such interfaces directly between counterparties). This kind of services goes beyond the mere facilitation of financial operations among interface users.

Specifically, regulated services excluded from the scope of the Spanish DST seek to provide a safe environment for financial operations, determining the specific conditions under which such operations are carried out, guaranteeing elements such as the quality of execution operations, market transparency and fair treatment for investors.

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[23] Article 6 of the draft law.

[24] Council Directive. Op. cit. page 8.

Finally, the supply of digital services between entities that are part of a group with direct or indirect participation of 100% is also excluded from the Spanish DST. The exclusion, provided for by the 2018 EC Council Directive, but not established in the Draft Law presented by the Government in 2018, was contemplated when considering the observations made during the hearing process and was finally included in the Draft Law here studied.[25]

3.3 Application thresholds.

The SDST's taxpayers will be companies that, at the beginning of the taxable period, exceed the following thresholds: a) the net amount of their turnover in the previous calendar year exceeds 750 million euros and b) the income derived from the supply of digital services to users located in Spanish territory, for the previous calendar year, exceeds 3 million euros.[26]

The first threshold aims to limit the application of the Spanish DST to large companies, which are those capable of supplying digital services based on data and users' contribution, and which based its business model on extensive users' networks, in massive data traffic and the exploitation of a solid position in the market[27]. The second threshold aims to limit the application of the tax to cases in which there is a significant digital footprint in Spain concerning the types of digital services within scope[28].

However, special rules for entities that belong to a group exists. To determine whether an entity exceeds the thresholds and is therefore considered as taxable person, the entire group turnover will be considered. If the group exceeds the said thresholds, all the entities within the group would be considered as taxpayers, to the extent that they carry out the taxable event, regardless of the amount of income derived from the benefits of digital services subject to the tax obtained in Spain that correspond to them.

For the SDST, a company that exceeds the two thresholds mentioned above will be considered as taxable person regardless of whether or not it is established in Spain.

3.4 Place of taxation

The SDST intends to tax those digital services which value lies in the intervention (participation) of users located in Spain. This is precisely the link that justifies the existence of the tax; the Draft Law establishes that only those services that can be considered linked to Spain are subject to the tax.

[25] Government of Spain, Ministry of Finance, "Document submitted for public information processing" 23 October 2018. (Documento sometido a trámite de información pública) https://www.hacienda.gob.es/Documentacion/Publico/NormativaDoctrina/Proyectos/Tributarios/ANTEPROYECTO%20LEY%20IDSD.pdf
[26] Article 8(1)(b) of the draft law.
[27] Explanatory Statement of the Draft Law on the Tax on Certain Digital Services, paragraph 5.
[28] Ibid, paragraph 5.

The previous shall be understood as such when there are users of said services located in Spanish territory.

This approach responds to the reasoning that users participation in the digital activities of a company is what generates the value for the latter, which may not necessarily entail a payment by the user (for example, in the case of users who sees advertisings on a digital interface); or which may imply payment by some users exclusively (for example, multi-sided digital interfaces where some users pay to access the interface, while the rest has some limited free access). Therefore, the SDST will accrue in Spain when the user is located in Spain, regardless of whether or not they have contributed financially to the generation of the company's income.[29]

To consider that users are located in the application territory, specific rules for each digital service taxed exists, which are based on the place where the devices of those users have been used, located, in general, from their internet protocol addresses (IP) or other means of proof, in particular, geolocation of the devices.[30] Thus, in cases of targeted advertising, the number of times that an advertisement appears on the user's device during the tax period in Spain is considered.[31]

As regards the supply of multi-sided digital interfaces in cases where they involve the facilitation of underlying operations (delivery of goods or services) the allocation to Spain of taxable income is carried out based on the number of users who conclude such operations during the tax period using a device in Spain.[32]

However, when the intermediation service does not entail the facilitation of underlying operations, to attribute taxable income to Spain, the number of users who have an account that allows access to the interface and the said account had been opened using a device in that country are considered, regardless of whether the creation of the account took place during that fiscal year or in a previous one.[33]

As regards the transmission of users' data collected, the allocation of taxable income to Spain considers the number of users who have generated the data transmitted in the tax period as a result of the use of a device in said country.[34]

As can be seen, in determine the place where the supply of digital services has been carried out, the place where the delivery of goods or underlying services are carried out in cases of intermediation online services will not be

[29] Explanatory statement. Op. cit. point VII.
[30] Ibid, point VI.
[31] Article 7(2)(a) of the draft law.
[32] Article 7(2)(b) of the draft law.
[33] Ibid.
[34] Article 7(3) of the draft law.

considered, nor the place from which any payment related to digital service is made.[35]

3.5 Taxable base and Tax rate.

The taxable base of the SDST will be the amount of income, excluding value added tax or other equivalent taxes, obtained by the taxpayer for each of the digital services provided in Spain during the taxable period.[36]

Rules are established to calculate the tax base and to be able to tax exclusively the part of income corresponding to users located in Spain concerning the total number of interface users, following the allocation rules of each of the taxable events described in the previous section. Likewise, the rule clarifies that, in the provision of digital services between entities of the same group, the tax base will be its reasonable market value.[37]

Lastly, the text provides that, if the amount of the tax base is not known during the taxable period, the taxpayer must provisionally fix it applying well-founded criteria, without prejudice to its subsequent regularisation when the said amount is known.[38] The tax rate to be applied will be 3%, in line with the EC Council Directive. The accrual will occur for each taxed service provision, and the taxable period will be quarterly.[39]

3.6 Formal obligations and sanctioning regime

The SDST foresees a series of formal obligations, among which is, on the one hand, the keeping of specific registers of taxable operations, and, on the other, the establishment of systems that allow determining the location of users' devices in the territory where the tax is applied.[40]

In the event of non-compliance with the last obligation, the sanctioning system foresees a monetary fine of 0.5% of the net amount of turnover for the previous calendar year, with 15,000 euros as the minimum and 400,000 euros as the maximum, for each calendar year.[41]

After the analysis made to the SDST, the main differences between this and the EC Council Directive are evident. In both legislations, the threshold of the net worldwide amounts to be considered as a taxpayer is 750 million euros in the previous calendar year. However, the EC Council Directive establishes a threshold of 50 million euros on EU revenues meanwhile the SDST states a 3 million euros revenues obtained in Spain, being this, as well as the sanctioning system, the main differences between both proposals.

[35] Article 7(3)(a) of the draft law.
[36] Article 10(1) of the draft law.
[37] Ibid.
[38] Article 10(3) of the draft law.
[39] Article 11 of the draft law.
[40] Article 13 of the draft law.
[41] Article 15(1) and (2) of the draft law.

4 State Aid

The question arises as to whether the Spanish legislation is aligned with the EU's legislative framework, in particular, concerning state aid, since, if not, its proper application to digital companies operating in Spanish territory will be compromised.

According to Article 107(1) of the TFEU, will be incompatible with the internal market "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States".

That means that for a particular measure to be classified as state aid, and fall within the scope of Article 107(1) of the TFEU, it must fulfil the following criteria[42]:

First: State Origin; whether the aid is of public origin.

Second: Advantage; whether an economic benefit has been obtained. In this case, according to CJEU's case law, to constitute an advantage, it is not necessary that the aid involves the direct transfer of the state's resources, being this one form of state aid, but that the tax scheme places the recipients in a financial position more favourable than that of other taxpayers also constitutes an advantage within the framework of state aid under Article 107(1) TFEU[43].

Third: Effect on trade and competition; whether the economic activity distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods and only insofar as it affects trade between MSs.

Fourth: Selectivity; whether the public aid grants an advantage in a particular way to certain undertakings or categories of undertakings or specific economic sectors.

This last element is, according to AG Juliane Kokott[44], the decisive criterion to determine if a measure constitutes or not state aid because the other conditions are almost always satisfied.

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[42] European Commission. Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU. https://eur-lex.europa.eu/legal-content/EN/LSU/?uri=CELEX%3A52016XC0719%2805%29 (last access May 2020).

[43] See for example Judgment of 15 March 1994, *Banco Exterior de España*, C-387/92, EU:C:1994:100, paragraph 14; Judgment of 15 November 2011, *Gibraltar*, Joined cases C-106/09 P and C-107/09, EU:C:2011:732, paragraph 72, and; Judgment of 9 October 2014, *Ministerio de Defensa and Navantia*, C-522/13, EU:C:2014:2262, paragraph 23.

[44] Opinion of 16 April 2015, AG Kokott, *Finanzamt Linz v. Bundesfinanzgericht*, Case C-66/14, EU:C:2015:242, para. 114.

Nevertheless, the line between general measures and state aid is not always clear; this problem becomes more acute in the case of fiscal and social policy measures[45].

It is evident the example according to which a tax exemption that is applied in favor of a specific company constitutes a state aid under article 107(1) of the TFEU. In contrast, a reduction of the current corporate tax rate applicable to all companies without distinction by sectors or activities in a particular MS, is a general measure that does not fall within the scope of said article. However, in other cases, the distinction is not that obvious, and much more in-depth analysis is needed to determine what type of measure is being faced.

In recent years, a substantial advance on the interpretation of the selectivity criterion by the EC has been observed, especially concerning fiscal measures. This evolution will be analysed below based on the Commission's publication of the “Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union”, in 2016[46], which is the interpretation framework that EC itself has given. The adoption of this notice responds to the fulfilment of the commitment assumed by the EC on its Communication COM(2012) 209 final EU State Aid Modernisation (SAM). It aims to “provide further clarification on the key concepts relating to the notion of state aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, to contribute to an easier, more transparent and more consistent application of this notion across the Union”[47].

4.1 Selectivity, according to the criteria applied.

The EC and the CJEU have traditionally interpreted the concept of selectivity, understanding that a measure is general when it benefits any company, sector, or region of a Member State[48]. By contrast, material selectivity is configured when a measure applies only to certain companies or certain sectors of a MS’s economy.

According to the AG Bobek’s idea that the selectivity test is merely a discrimination test[49], the CJEU has established two different dimensions of

[45] Quigley, Conor. Direct taxation and State aid: Recent Developments Concerning the Notion of Selectivity. INTERTAX, Volume 40, Issue 2. 2012.
[46] 2016 Notice.
[47] European Commission. Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union. (July 2020).
48 European Commission (1998) Commission Notice on the application of the State aid rules to measures relating to direct business taxations.
[49] Opinion of 21 April 2016, AG Bobek, *Kingdom of Belgium v Commission,* case 270/15 P, EU:C:2016:289, paragraph 29.

this criterion[50]. De jure-selectivity requires a derogation from a reference system of taxation, giving rise to a different treatment of undertakings that are in a legal and factual comparable situation in light of the reference system objective. On the other hand, De facto-selectivity can be understood as an example of the obligation also to adhere to specific external consistency standards.

However, those are not the only criteria for determining whether a measure falls within the scope of Article 107 (1) TFEU as state aid. The CJEU has established that the selectivity of a measure should, in principle, be assessed employing a three-step analysis[51].

4.2 System of Reference.

The first step is identifying the reference system, as stated by the CJEU in the judgment *Portugal vs Commission*[52] "…The determination of the reference framework has particular importance in the case of tax measures, since the very existence of an advantage may be only established when compared with 'normal' taxation. The 'normal' tax rate is the rate in force in the geographical area constituting the reference framework."

Nevertheless, the CJEU also has stated that "the concept of state aid does not refer to State measures which differentiate between undertakings and which are, therefore, *prima facie* selective where that differentiation arises from the nature or the general scheme of the system of which they form part"[53], so we can understand that consistency of the reference system also must be examined.

It is essential to mention that the proper establishment of the reference system is vital for the success of state aid controversies.[54]

4.3 Derogation.

Subsequently, once the reference system has is established, is necessary to evaluate and determine if any advantage granted by the tax measure in question is selective, demonstrating that the measure derogates the "normal" regime[55].

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[50] Ismer, Roland & Piotrowsk, Sophia (2018). *Selectivity in Corporate Tax Matters After World Duty Free: A Tale of Two Consistencies Revisited*. Intertax. 46, Issue 2.

[51] See, for example, Judgment of 8 September 2011, *Commission v Netherlands*, Case C-279/08, EU:C:2011:551; Judgment of 8 November 2001, *Adria-Wien Pipeline*, Case C-143/99 EU:C:2001:598; Judgment of 8 September 2011, *Paint Graphos and others,* Joined Cases C-78/08 to C-80/08, EU:C:2011;550.

[52] Judgment of 06 September 2006, *Portugal vs Commission,* Case 88/03, EU:C:2006:511, paragraph 56.

[53] *Gibraltar,* Op. cit., paragraph 145.

[54] See 4.5 below.

[55] *Gibraltar,* Op. cit., paragraph 36.

A measure is understood to derogate from the "normal" regime when differentiates (discriminates) between economic operators who, in light of the fundamental aim of that system, are in a comparable factual and legal situation.[56]

While it is true that this “rule-and-exemption” approach has been criticised[57], it is also true that the CJEU has tried to give light to this issue through its case law, by mentioning, for example, that "case-law does not make the classification of a tax system as ‘selective’ conditional upon that system being designed in such a way that undertakings which might enjoy a selective advantage are, in general, liable to the same tax burden as other undertakings but benefit from derogating provisions, so that the selective advantage may be identified as being the difference between the normal tax burden and that borne by those former undertakings"[58].

All this, as Lang mentions[59], of using "normal taxation" and deviation from it as the basis, which is not preferred by the CJEU, is the effort to determine the rule and identify the exception to it.

4.4 Justification.

Once the two previous points are established, the next is to assess whether said derogation is justified by the nature or the general scheme of the system[60].

In the same way, the EC, on its 2016 Notice listed potential justifications for derogations mentioned above, those are (i) The need to fight fraud or tax evasion; (ii) Specific accounting requirements; (iii) Progressive nature of the system, and; (iv) Need to avoid double taxation.

The *A-Brauerei* case[61] illustrates one of the mentioned justifications. This case deals with a non-exemption on property transfer tax, granted by German law on transfers in ownership of property occurring as a result of restructuring procedures carried out involving only companies of the same group, linked by a shareholding of at least 95% during a minimum, uninterrupted period of five years before that procedure and of five years thereafter, while in cases where the restructuring does not involve companies from the same group, the exemption was granted.

[56] Judgment of 8 November 2001, *Adria-Wien Pipeline,* Case 143/99, EU:C:2001:598, paragraph 41.
[57] Opinion of 7 April 2011, AG Jääskinen, *Gibraltar,* Joined cases C-106/09 P and C-107/09, EU:C:2011:215, paragraph 184.
[58] *Gibraltar*, Op. cit. paragraph 90.
[59] Lang, Michael. State aid and Taxation: Selectivity and Comparability Analysis. 2016. Springer. pgs. 34.
[60] *Portugal vs Commission*, Op. cit. paragraph 81.
[61] Judgment of 19 December 2018, *A-Brauerei*, case C-374/17, EU:C:2018:1024.

In its judgment, the CJEU found that even though a derogation from the general tax system exists since "that exemption introduces a distinction between undertakings which are, in the light of the objective pursued by the legal system at issue, in comparable factual and legal situations" said derogation was justified because "it seeks to avoid double taxation and stems, to that extent, from the nature and general scheme of the system of which it forms part".[62]

Furthermore[63], non-fiscal reasons can also justify different treatment for comparable economic operators, as was acknowledged, for example, in *ANGED*[64] concerning environment and town and country planning reasons in connection with a tax on the retail sales area.

This case is about a regional tax on large commercial establishments introduced by the Autonomous Community of Catalonia to offset the potential impact of those large retail establishments on the territory and the environment.

Said measure tax the use of sales areas equal to or greater than 2 500 square meters, by individual large retail establishments. However, large individual retail establishments which pursue the business of a garden centre or selling vehicles, construction materials, machinery or industrial supplies and collective retail establishments are exempt from that tax.

The purpose of the tax, according to the authority of Catalonia, was to "tax … on the exceptional financial capacity of large retail establishments which, on account of their large sales area, may acquire a dominant position and produce adverse effects on the territory and the environment, the cost of which they do not bear."[65]

Setting aside those unsubstantiated claims such as the relationship between financial capacity and the size of the establishment[66], CJEU's reasoning focused on the nature of the legislation, making clear that "the environmental impact of retail establishments is largely dependent on their size. The larger the sales area, the higher the attendance of the public, which results in greater adverse effects on the environment"[67], thus a measure as such is not capable of constituting state aid.

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[62] Ibid, paragraph 52.

[63] From this point on, I will analyse the justifications presented by the CJEU or the EC in cases that I consider relevant for the development of the investigation carried out in this work.

[64] Judgment of 26 April 2018, *ANGED*, C-233/16, EU:C:2018:280.

[65] Ley 16/2000 del Parlamento de Cataluña del impuesto sobre grandes establecimientos comerciales (Law 16/2000 of the Parliament of Catalonia on the tax on large retail establishments) of 29 December 2000.

[66] Who can say for sure that a company operating in a vast area of 5000 square meters is financially more capable than a company operating in small 100 square meters office based simply on their size?

[67] *ANGED*, Op. cit., paragraph 53.

However, the CJEU determined that the tax did constitute state aid to the extent that it exempts collective large retail establishments with a surface area equal to or greater than 2 500 square meters since these also have "an adverse effect on the environment and town and country planning as the others."[68]

4.5 Selectivity and State aid: the EC's view

Two relevant cases for this research, due to the similarities presented between these cases, the SDST, and the EC's reasoning about them are analysed below.

The first case concerns the tax on the retail sector entered into force in Poland in September 2016. The measure was a progressive tax, based on turnover. The basis of assessment was a monthly turnover of more than 17 million Polish zlotych (PLN) (approximately € 4 million). The tax rates applied to the monthly turnover were 0.8% from PLN 17 million to 170 million inclusive and 1.4% beyond PLN 170 million.[69]

In its investigation, the EC followed the three-step analysis established by the CJEU to assess if the measure was selective. With that regard, the EC set out that the single (flat) tax rate on retail sales of all undertakings involved in the retail market in Poland was the reference system against which the progressive retail tax should be compared.[70] Then, the EC determined that the measure derogates the application of the reference rules in favour of specific companies that was in a similar factual and legal situation in light of the objective of the reference system.

The above mentioned due to the fact the measure imposed discriminated between retailers based on their level of turnover and thus on their size, because undertakings with high levels of turnover are subject to both substantially higher marginal rates and to substantially higher average tax rates as compared to operators with low levels of turnover.[71]

Finally, and after establishing that the measure was *prima facie* selective, the Commission continued to analyse the elements provided by the member state to justify said measure by the nature or general scheme of the system. Poland based its justifications on the grounds of the redistributive purpose of the measure "as is the case for profit-based taxes"[72].

However, the EC recalled that the measure taxed undertakings on the level of their turnovers and "as opposed to taxes based on profit, a turnover-based tax does not consider the costs incurred in sales generation. Hence, turnover

[68] Ibid, paragraph 68.
[69] Commission Decision of 30 June 2017, *Polish Retail Tax,* SA.443541.
[70] *Polish Retail Tax,* SA.443541, paragraph 54.
[71] Ibid, paragraph 54.
[72] Ibid, paragraph 57.

taxes hit companies in respect of their size rather than their profitability or ability to pay".[73] Therefore, the EC did not consider the progressive tax rates of the retail tax was justified by the nature and general scheme of the reference tax system.[74]

The next case is about the advertising tax introduced by Hungary in 2014.[75]

Under Hungary's 2014 Advertisement Tax Act[76], companies was taxed depending on their advertisement turnover. Companies with a higher advertisement turnover were subject to significantly higher and progressive tax rates, ranging from 0% to 50%. The EC investigation showed the progressivity of tax rates favoured certain companies, the same reasoning that in Polish Retail Tax investigation, and in a flat-rate tax system, smaller companies would, in any case, pay less tax than their larger competitors because they have a smaller advertising turnover.

However, due to the progressive rates in the 2014 Act, companies with low advertising turnover were able to pay substantially less advertising tax, even in proportion to their advertising turnover, than companies with higher advertising turnover[77]. Thus giving low-turnover companies an unfair economic advantage over their high-turnover competitors. Hungary did not demonstrate that the progressive tax rates was justified by the objective pursued by the advertising tax[78]. The investigation also found that the provision of the 2014 Act regarding the possibility of deducting carried losses also unduly favoured certain companies; since it was restricted to companies that did not make profit in 2013.[79]

The EC said that Hungary did not show that this provision was justified by the advertising tax pursued objective. In particular, Hungary did not demonstrate why a company's advertising tax liability should depend on its turnover, or why this benefit should be available only to companies that did not make a profit in that specific year[80]. It gave those companies an unfair economic advantage over their more efficient competitors. On this basis, the EC concluded that the measure was incompatible with EU state aid rules.

By the time the Commission opened the investigation, it also asked Hungary to suspend the application of the tax. Hungary suspended the tax but implemented a modified version, without notifying or consulting the EC[81]. The amended advertising tax, which came into force in July 2015 and

[73] Ibid, paragraph 58.
[74] *Polish Retail Tax,* SA.443541, paragraph 60.
[75] Commission Decision of 04 April 2016, *Hungarian Advertisement Tax,* SA.39235.
[76] 2014 Act.
[77] *Hungarian Advertisement Tax,* SA.39235, paragraph 51.
[78] Ibid, paragraph 69.
[79] Ibid, paragraph 63.
[80] Ibid, paragraph 52.
[81] *Hungarian Advertisement Tax,* SA.39235, paragraph 7.

maintained progressive rates based on turnover but in a smaller range (0% and 5.3%), took steps in the right direction[82] but did not adequately address the concerns. The modified scheme allows companies to decide whether to apply the modified scheme retrospectively.

However, there is still no objective justification for this differential treatment. Besides, the limitations on the deduction of past losses remained unchanged. Hence the EC concluded that both, the 2014 Act and the 2015 amendment entailed unlawful and incompatible state aid[83].

As can be seen from the above, both cases shows similarities with the SDST under review; both present a turnover tax that seeks to make companies with higher incomes in their respective sectors pay more taxes; both present application thresholds that are very high and which are reached, mostly, by foreign-owned companies[84], and, subsequently, in both investigations the Commission's decision was annulled by The General Court of the European Union (General Court).[85]

4.6 General Courts annulment: Polish tax.

Poland challenged the EC's decision before the General Court alleging: the existence of an error in the legal classification of the measure; disproportionality of the measure by requiring immediate inapplicability; and lack of motivation[86].

Based on the analysis below, the General Court decided to annul the Commission's decision, in particular given the error in the classification of the measure under the state aid rules.

From the points made by the Court in its judgment, it is appropriate to pay attention on the selectivity analysis regarding the structure on which the Polish tax was based.

Thus, according to what was previously analysed, the state aid assessment states that the main element to be determined is whether the reference framework of the measure in question, the Polish tax, is understood to favour a group of companies over others in a comparable factual and legal situation[87].

The General Court established that the reference framework, or "normal" tax regime, cannot go beyond the sector in which the tax in question is circumscribed, that is, the specific retail sector. Therefore, the normal tax

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[82] Ibid, paragraph 80.
[83] Ibid, paragraph 74 and 87.
[84] Ibid, paragraph 32; *Polish Retail Tax,* SA.443541, paragraph 19.
[85] This is not a similarity to the SDST but it does shed some light on the end it might have.
[86] Judgment of 16 May 2019, *Poland v Commission,* joined cases T-836/16 and T-624/17, EU:T:2019:338, paragraph 38.
[87] See Chapter 4 above.

regime would be the tax itself, including both its progressive rate scale, and its tranches and reductions of tax bases.[88]

The EC supported its position when considering that a tax with tranches and progressive rates would be contrary to its objective and would have discriminatory effects among companies in the sector, especially when considering that there would be an advantage for low-turnover companies.[89]

In this sense, the General Court established that: a progressive rate would not be contrary to the objective of obtaining budgetary income, and the Polish regulations would have shown that the objective of the tax would have been to impose a sectoral tax based on the principle of tax redistribution.[90]

Objectives accepted by the General Court when established that it is reasonable for a high-turnover company to enjoy, given the economies of scale to which it may have access, a higher disposable income compared to operators with lower turnover, which would justify paying more taxes on a pro-rata basis.[91]

The General Court concluded by establishing that the lack of selective nature of the measure, the differences in taxation and the advantages derived from the tax simply come from the application of the normal regime and do not undermine the objective of the tax, also that a redistributive logic can justify both the progressiveness of the tax or a total exemption for certain companies[92].

4.7 General Courts annulment: Hungarian tax

Like in *Poland v Commission*, Hungary contested the EC's decision, alleging: an error in the legal characterisation of the measure; the failure to comply with the obligation due to state reasons; and misuse of powers.[93]

The General Court considered that the EC could not infer that selective advantages constituting state aid in the advertising tax existed solely by pointing out its progressive structure.

Also, the EC based its findings on a comparison with a hypothetical "normal" system that did not operate a progressive tax, when it should have considered the progressive tax as the "normal" system in the absence of an alternative.

[88] *Poland v Commission*, paragraph 68.
[89] *Polish Retail Tax,* SA.443541, paragraph 39.
[90] *Poland v Commission*, paragraph 75.
[91] Ibid.
[92] Ibid, paragraph 91.
[93] Judgment of 27 June 2019, *Hungary v Commission*, Case T-20/17, EU:T:2019:448 Paragraph 45.

Moreover, the EC also did not demonstrate that any selective advantage derived from the progressive tax, and did not demonstrate that the structure of the tax was contrary to the established fiscal objectives (establishing sectoral taxation or turnover under the redistributive purpose).[94]

Concerning the deductibility of 50% of the losses of the previous fiscal year, the General Court considered that this is not a selective advantage since it is based on objective criteria. [95]

The measure also meets the redistributive purpose behind the advertising tax and is not discriminatory.[96]

Thus, the Court annulled the EC's decision in its entirety.[97]

In my opinion, the General Court reduced the scope of both cases to the point of being able to issue a resolution setting aside the analysis of the advantages granted by the measure to low-turnover companies.

Nevertheless, according to the General Court, the primary error in both cases was the EC's poor choice of the reference system used to assess the selectivity of the measure, although, it sounds illogical that when measuring the selectivity of a measure, the measure itself is the reference system.

Furthermore, the General Court appears to have ignored the Commission's reasoning that, to determine whether a tax measure is selective in favor of certain companies, it is not sufficient to examine whether there is an exception to the rules of the reference system such as defined by the MS in question, but it is also necessary to verify if the reference system structure or the limits have been defined in a coherent way or, on the contrary, in an arbitrary or biased way to favor those companies.[98]

However, both cases are at the appeal stage before the CJUE, so this may reverse the decision of the General Court, as long as the CJEU develops its future reasonings in line with previous judgments.[99]

4.8 Recent CJEU's decisions.

Two recent CJUE decisions was expected to shed light on the issue of progressive turnover-based taxes (such as the one here analysed) and state aid, but in both cases, the CJUE found that questions concerning state aid were inadmissible.

The substantive issue of state aid at *Vodafone*[100] and *Tesco*[101] was whether the distinction made by Hungarian legislation, between low and high

[94] *Hungary v Commission,* paragraph 103.
[95] Ibid, paragraph 117.
[96] Ibid, paragraph.
[97] Ibid, paragraph 125.
[98] *Poland v Commission*, paragraphs 47: 51 and 52.
[99] See for example judgments of 21 December 2011, *Commission v World Duty Free Group and Others*, C-20/15 P and C-21/15 P, EU:C:2016:981; and *Gibraltar.*

turnover companies subject to different effective tax rates due to the progressive tax rate structure, constitutes state aid granted to low-turnover companies. Two remarkably substantially similar cases to those analysed before.

However, in both cases the CJEU established the question on state aid in the sense of whether European legislation prohibits progressive taxes[102], thus avoiding to evaluate whether the challenged measures are discriminatory or if they give advantages to low-turnover companies against high-turnover companies.

Furthermore, in *Tesco,* the CJEU was reluctant to evaluate what was mentioned by the National Court in the sense that "all the companies that fall within the lower bands are companies which are owned by Hungarian natural persons or legal persons... Conversely, the companies that fall within the highest band are, with one exception, undertakings linked to companies that have their registered office in another Member State."[103]

Instead, the CJEU determined, in both cases, that it was necessary to "determine whether the progressive scale, using bands, of the special tax may constitute, in itself… indirect discrimination vis-à-vis taxable persons that are controlled by natural persons or legal persons of other Member States, who bear the actual tax burden."[104], thus reiterating that the important thing was to determine the legality of the progressivity of the tax rather than if said tax gave an advantage to low-turnover companies.

Now, to determine if a measure as such is discriminatory, the CJEU has established that if "the taxable persons belonging to a group of companies and covered by the highest band of the special tax are, in the majority of cases, 'linked', within the meaning of the national legislation, to companies which have their registered offices in others Member States, the application of the steeply progressive scale of the special tax to a consolidated tax base consisting of turnover is liable to disadvantage, in particular, taxable persons 'linked' to companies which have their registered office in another Member State."[105]

Nevertheless, in *Tesco* and *Vodafone*, the CJEU departed from that reasoning by establishing that "the fact that the greater part of such a special tax is borne by taxable persons owned by natural persons or legal persons of

[100] Judgment of 03 March 2020, *Vodafone,* case C-75/18, EU:C:2020:139.
[101] Judgment of 03 March 2020, *Tesco,* case C-323/18, EU:C:2020:140.
[102] See *Vodafone,* paragraph 17(2); and, *Tesco,* paragraph 19(2).
[103] *Tesco,* paragraph 16.
[104] *Tesco,* paragraph 48; and *Vodafone* paragraph 38.
[105] Judgment of 05 February 2014, *Hervis*, case C-385/12, EU:C:2014:47, paragraph 39.

other Member States cannot be such as to merit, by itself, categorisation as discrimination”.[106]

Although this reasoning seems correct, it must also be considered what was mentioned by AG Kokott in the sense that foreign-owned parent companies could represent a majority of those in the highest tax band merely because foreign-owned companies dominated the relevant market[107]; therefore, it is clear that if a state measure seeks to change this market condition through its intervention on it, that will threaten to distort it or distort the competition on said market.

5 The Spanish Digital Service Tax and Article 107(1) TFEU.

Now, with a clear idea of the characteristics that a measure must meet to be declared as state aid, and the different ways to carry out the analysis, it is appropriate to place under the magnifying glass of article 107 (1) TFEU, and in particular, under the selectivity criterion, the mentioned SDST.

For that, the following sections will develop a comparability analysis between the SDST, its characteristics, the framing legislator’s intentions and the criterion presented in the cases analysed above.

The main characteristic of the SDST is that it uses thresholds based on turnover to determine whether or not a company is subject to the tax, and in principle, as illustrated above, the use of these thresholds does not constitute direct discrimination, since in this case, it does not distinguish between Spanish and non-Spanish companies, that is, the measure is presented as neutral (not *prima facie* selective[108]).

However, indirectly these thresholds are designed in such a way that only big foreign-owned digital multinationals end up paying the aforementioned tax. But “indirectly” is a small way to name it because, in a press release,[109] the Spanish Ministry of Finance mentioned that “this tax is created because there is income obtained in Spain for large international companies from certain digital activities that escape the current tax framework”[110], that is, the tax is deliberately designed to tax foreign-owned companies that would

[106] *Vodafone*, paragraph 45; and *Tesco*, paragraph 72.
[107] *Tesco*, paragraph 72.
[108] See 4.5 above.
[109] Press note, 19 October 2018, "The Government presents the draft law against tax fraud to combat new forms of evasion" (El Gobierno presenta el anteproyecto de Ley contra el fraude fiscal para combatir las nuevas formas de evasión).
[110] Translation made by the author.

be, in principle and given European regulations, outside the scope of community law, thus companies outside the EU regulatory framework.

The above mentined would represent that said tax also falls outside the scope of Article 107 (1) TFEU. However, such companies usually operate in Europe through at least one subsidiary that provides services. These subsidiaries do fall within the framework of EU law. Moreover, as will be explained below, to determine discrimination and, where appropriate, selectivity, the intention of the tax schemes must also be considered.

5.1 SDST: the reference system and derogation.

According to all analysed above, and following the reasoning established by the EC in *Polish Retail Tax* and *Hungarian Advertising Tax*, the reference system should be one without the SDST, this is, the system that existed before the implementation of the said measure. Now, according to the General Court in the same cases, the system of reference should be the SDST itself, because the previous system did not operate with a progressive tax. This discrepancy of reasoning concerning the reference system is clearly resolved in *Gibraltar* where the CJEU uses the challenged measure as the reference system.

In *Gibraltar*, the CJEU annulled the, not *prima facie* selective, tax on payroll and sales of Gibraltar properties as state aid, primarily because, *as applied*, it would have exempted (and therefore conferred state aid on) offshore companies. According to the Court, this advantage "was not a random consequence of the regime in question, but the inevitable consequence of the fact that the evaluation bases are specially designed so that offshore companies, which by their nature do not have employees and do not occupy commercial premises, have no tax base."[111] it was, therefore, an illegal state aid.

Following the reasoning established by the Court in *Gibraltar*[112], the SDST *as applied*[113] will exempt companies that provide certain digital services (thus selective by type of operations since it only taxes certain digital services) and whose turnover does not exceed 3 million euros in Spain and 750 million euros globally (thus selective by size) at a group level (thus selective by group status) and is specifically designed to tax large foreign-owned digital multinationals[114] (thus selective by nationality).

This outcome is not a consequence of the regime itself but is a consequence caused by the thresholds established in such a way that only digital companies that provide specific services and that have an influential

[111] *Gibraltar*, Op. Cit. paragraph 106.
[112] *Gibraltar*. Op. cit.
[113] Emphasis added.
[114] See footnote 110.

position in international markets, are affected by the SDST. Moreover, in *Gibraltar*, the CJEU noted that the tax base was manipulated to effectuate changes in the set of liable taxpayers and mentioned that Gibraltar intended to address certain taxable persons "adjusting and combining the tax rules in such a way that their application results in a different tax burden for different companies"[115].

Is not this precisely what Spain did by setting thresholds that only a few companies will reach?

In *Gibraltar*, the tax contested was used as a reference system, and the CJEU was explicit in mentioning that, under the conditions in which said tax operated (*as applied*), it would cause different treatment between economic actors who were in a similar legal and factual situation. So, it is reasonable to think that, if the same criteria were applied in the case of the SDST (*as applied)*, the reasoning would lead to the same conclusions.

On the other hand, it is also clear the different treatment that is granted by the SDST to companies that also base their business on digital platforms, such as some financial services companies (e.g. PayPal) or companies that act as intermediaries between users (e.g. BlaBla car) placing them in a more favourable position concerning the companies which falls within the scope of the SDST.

Moreover, the SDST differentiates between economic operators that even perform the same business model, for example, Spotify Technologies SA, a company that provides music services via streaming, and its business model is a monthly charge for a premium account and advertising ads that appears in the free accounts. That same business model performed by both Apple Music (owned by Apple Inc.) and Google Play Music (owned by Alphabet Inc.). However, this two are, due to the group's worldwide turnover[116], subject to the tax under analysis, because they form part of groups that, as a whole, exceed the threshold established by the Draft Law to be considered taxable and Spotify Technologies S.A., with a turnover of 1.5 billion euros in 2018[117] based in Sweden, is not subject to the SDST.

A similar consolidation rule has already been studied by the CJEU, which determined that its application involved indirect discrimination.[118] This,

[115] *Gibraltar*. Op. cit. paragraph 93.
[116] Apple Inc. annual report for the fiscal year ended September 29, 2019. Page 23. https://s2.q4cdn.com/470004039/files/doc_financials/2018/q4/10-K-2018-(As-Filed).pdf; and, Alphabet Inc. annual report For the Fiscal Year Ended December 31, 2018. Page 25. https://abc.xyz/investor/static/pdf/2017_google_annual_report.pdf?cache=5504fde
[117] Spotify Technology S.A. Financial Results for Fourth Quarter 2018. https://investors.spotify.com/financials/press-release-details/2019/Spotify-Technology-SA-Announces-Financial-Results-for-Fourth-Quarter-2018/default.aspx
[118] *Hervis*, p. cit.

according to the CJEU's reasoning discussed above, constitutes an advantage that can clearly be classified as selective.

Likewise, if in *ANGED* the CJEU determined that there was state aid granted in favour of the collective retail establishments that had the same operating surface as the taxed retail establishments, then is reasonable to think that in the case of the SDST they can reach the same conclusions regarding the factual and legal situation of taxpayers and exempt subjects as in the examples presented above.

5.2 Possible justifications

Public policy goals, such as taxation based on the ability to pay, could justify differences in tax that derive from differences in companies' turnover, which would tend to correlate with size. That is the main reason the Government of Spain gave to justify the proposal and approval of the SDST. It should be considered if the measures do not discriminate beyond what is necessary to fulfil their objective.

By using turnover as the primary discriminatory measure, Spain clearly left out measures like net turnover, which also considers other factors such as expenses incurred to determine companies' profit and, according to the EC itself, "turnover is an indication only of an undertaking's size and market position, but not its financial capacity";[119] surprisingly the opposite argument given for the EC to support the EU DST, the base for the SDST.

Moreover, if net income tax would achieve the state's goal of taxing the ability to pay as well as or better than turnover, but with less discrimination, then the MS is not entitled to use the most discriminatory option.[120] Taxation based on the ability to pay measured by net corporate income is a widely recognised principle among MSs, achieving constitutional status in some of them.[121] Therefore, the CJEU would have sufficient arguments to consider that the reasons given by the Spanish Government would not justify the SDST since less discriminatory means to achieve this objective exists.

[119] Opinion of 16 April 2015, AG Kokott, *Vodafone*, Case C-75/18, EU:C:2019:492, para. 100.
[120] Mason Ruth and Parada Leopoldo, Company Size Matters (December 16, 2019). British Tax Review 5, 2019.
[121] *Id.*

6 Conclusions

The aim of this investigation was to determine if the recently approved SDST could pass the analysis established by the selectivity criterion to determine that a measure constitutes state aid.

Through this investigation, it was found that the criteria applied by both the European Commission and the CJEU, although presents some discrepancies, are generally clear in the development of what the state aid rules seek.

While it is true, as seen, that both the EC and the CJEU have managed to divert some of their decisions regarding turnover taxes, it is also true that, according to CJEU case law, is possible to have a clear idea of the reasoning that may lead to a successful challenge, for state aid reasons, of taxes such as the SDST.

Similarly, it was concluded that, although *Vodafone* and *Tesco* cases did not provide the expected clarity regarding turnover taxes, they did help to clarify the path that should not be followed if what is sought is to challenge a tax such as the SDST. As it has been observed, challenging the progressive turnover taxes on the grounds of its illegality or incompatibility with the EU legislation, will not bring good dividends.

Therefore, clear reasonings on how taxes such as the SDST, in their application, are selective (discriminates) based on the criteria described and analysed throughout this research, must be presented before the EC and, eventually, the CJEU. Subsequently, it was also clear that future judgments in the Polish retail tax and the Hungarian advertising tax cases may provide a more precise idea of the reasoning that the CJEU may present in turnover tax case law.

To conclude, derived from the analyses carried out throughout this research, it is possible to establish that, the SDST would not approve the analysis that the selectivity criterion established in Article 107 (1) of the TFEU imposes to measures that grant illegal state aid.

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