THE TAXATION OF CROSS-BORDER PROFIT TRANSFERS AND ITS COMPATIBILITY WITH EUROPEAN LAW, WITH PARTICULAR REFERENCE TO SPAIN[1]

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Synopsis: Inheritance and gift tax exists in most EU Member States, without in itself forming an obstacle to the exercise of fundamental freedoms. However, in Spain, inheritance tax legislation has been created as a result of the transfer of fiscal power to the Autonomous Communities. This has led to different tax regimes being applied to residents, goods or successors located within those Communities. This fact has caused the EU Court of Justice to ask whether the regime is discriminatory, and whether it affects EU citizens exercising their freedoms. The Court finds that applying Spanish State tax laws to residents, goods or successors in other EU countries, and failing to apply tax advantages available within Spain's Autonomous Communities, constitutes the non-fulfillment of stipulations established in article 63 TFEU, of which one stipulation is the free movement of capital.

Key Terms: Free movement, inheritance and gift tax, discrimination, Autonomous Communities, residents, infringement procedure.

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I. Introduction

Over the last few years, the necessity has arisen for an in-depth reform of inheritance law, both in the countries around us and within the Spanish legal system itself.

Firstly, a number of social and economic factors in many countries have led us to at least consider modifications to inheritance laws on a European level[4]. To highlight this point, we only need to look at the figures on cross-border obstacles from inheritance and gift tax that are included in the European Commission's Communication to the European Parliament (EP), the Council, the European Economic and Social Committee. The Communication showed that, in 2010, 12.3 million European citizens were resident in a Member State other than their State of origin, and that cross-border real estate ownership increased by 50% between 2002 and 2010[5]. The demand for a debate on this matter began within the European Union (EU), when questions were raised over the matter. In due course, a public consultation was opened about possible approaches to removing cross-border inheritance tax obstacles in the European Union[6]. This revision will no doubt provoke a timely overhaul of tax associated with *mortis causa* inheritance[7].

Solutions are still needed, since on 10/04/2014 the Commission opened a new public consultation entitled: "*Consultation on cross-border inheritance tax*

4 See Zoppini, A., *Le successioni in diritto comparato*, Utet, Torino, 2002 and Vaquer Aloy, A., "Reflexiones sobre una eventual reforma de la legítima", *InDret,* 3/2007, in which the authors highlight the elements of change that abound in the relevance of such a reform.

5 Communication from the Commission to the European Parliament and the Council and the European Economic and Social Committee, "Tackling cross-border inheritance tax obstacles within the EU", COM (2011) 864 final, p. 4.

6 See the Contribution to the public consultation process opened by the European Commission's Directorate General for Taxation and Customs Union on 'Possible approaches to tackling cross-border inheritance tax obstacles within the EU"; M. Hermosín Álvarez, C. Hornero Méndez, J. Ramos Prieto and A. Rodríguez Benot. Spanish document available online at:

http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/inheritance/universidad_pablo_olavide.pdf

7 Another example demonstrating the launch of reform in European inheritance tax law is the existence of a European Certificate of Inheritance. The Proposal for a Regulation of the European Parliament and of the Council on jurisdiction, applicable law, recognition and enforcement of decisions and authentic instruments in matters of succession and the creation of a European Certificate of Succession (COM[2009] 154 final, 14 October 2009) offers, for the first time since the creation of the Area of Freedom, Security and Justice, a global or single vision of the phenomenon of inheritance in private international law.

problems within the EU"[8]. Several factors led the Commission to launch this process. In December 2011, the Commission recommended that EU countries carry out reforms to their internal laws on cross-border inheritance in order to respect Community regulations and to prevent double inheritance taxation within the European Union[9]. To this end, the Commission has committed to producing a report at the end of 2014 to assess developments in legislation in the Member States. This report will allow the Commission to explore the impact of its recommendation, as well as to discover whether problems still exist and whether the European Union needs to promote new measures to solve cross-border inheritance tax problems.

Within this framework, inheritance tax laws in Spain are of particular importance, given that Spain is one of the main EU countries receiving citizens from the Union, and is therefore becoming one of the main exponents of this issue.

In order to determine the abilities of EU intervention with regard to Inheritance and Gift Tax (IGT) we need to state what its powers are regarding taxation of this type.

EU tariffs are determined by the EU, through the Customs Union, for which the EU has exclusive responsibility (article 3 TFEU). The domestic market, and therefore taxes affecting intra-community trade, is of shared competence[10]. At any rate, and generally speaking, direct taxation is not included in the Treaties, and falls within the responsibilities of the Member States, except in the aforementioned instances where it relates to the domestic market, which, as already stated, is a competence shared with the EU. This means the States retain their responsibilities relating to taxes, on the understanding that they will respect stipulations laid out by the EU in cases where the EU has exercised its competence. For cases such as these, article 115 TFEU includes the option to approximate laws – through adopting directives by unanimous vote in the Council – so as to maintain the

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8 Public consultation open between 10/04/2014 and 03/07/2014: "Consultation on cross-border inheritance tax problems with the EU".

http://ec.europa.eu/taxation_customs/common/consultations/tax/201404_inheritance_tax_en.htm.

9 Commission Recommendation of 15 December 2011, regarding relief for double taxation of inheritances (2011/856/EU), Official Journal of the European Union, 20/12/2011, L 336/81.

10 Regarding indirect taxation, as well discussing is relationship with intra-community trade and therefore prohibiting actions which negatively affect the free movement of goods, article 113 TFEU also set out plans to harmonise legislation so that it would guarantee the establishment and correct functioning of the domestic market. The EU used this possibility in areas of customs and VAT. See TERRAS, B.J.M. and WATTEL, P.J., *European Tax Law*, Wolters Kluwer, Alphen aan den Rijn, 2012, p. 9.

establishment and the functioning of the domestic market[11]. In the case of IGT, this method has not been employed until now, with EU Law having been implemented through judgements from the European Court of Justice (ECJ)[12]. At any rate – and this will be relevant when it comes to analysing the compatibility of Spanish legislation with European regulations – despite the fact Member States are free to design their own fiscal systems, they are obliged to respect the Treaties when establishing their national tax systems, meaning they cannot infringe a) EU freedoms or b) the general prohibition of discrimination on the grounds of nationality[13].

Despite the option of approximating direct taxation laws, the Commission considered it possible to resolve cross-border IGT matters without having to resort to harmonising legislation[14].

In the case of Spain specifically, the need to reform inheritance and gift tax has become urgent. Despite the wide legislative scope, in terms of both the law itself and events chargeable, inheritance tax has poor potential for collecting revenue, and its weight within the current Spanish tax system is diminishing. Although the statement of purpose of Law 29/1987 states clearly that this tax completes the framework of direct taxation and contributes to the redistribution of wealth, the statistics speak for themselves[15]. The weakness of this revenue owes not only to the tax's legal concept itself, but also to a growing proliferation of fiscal benefits, which have crucially taken the form of reductions in taxable amount. Many of these reductions were not anticipated in the original taxation law when it was approved in 1987, but have been added since – firstly by Spain's central government and secondly, and more recently, by the Autonomous Communities.

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11 Until now, four directives relating to direct taxation have been adopted. Ibid. p. 25.

12 NARVAEZ, E-J., "The influence of EU la on Inheritance Taxation: Is the Intensification of Negative Integration Enough to Eliminate Obstacles Preventing EU citizens from Crossing within the Single Market?", *EC Tax Review*, nº 2, 2012, 85.

13 Commission staff working paper. "Non-discriminatory inheritance tax systems: principles drawn from EU case-law" Accompanying the document Commission Recommendation regarding relief for double taxation of inheritances SEC (2011) 1488 final.

14 COM (2011) 864 final, p. 7.

15 According to data provided by Spain's government tax administration agency, AEAT (www.estadief.meh.es) for the 2011 financial year, the last year which has official data, total tax revenue from the Autonomous Communities from this tax reached 1,964,493 (thousands of euros and according to the cash/settlement approach). For a more detailed analysis of tax revenue data, please see the following work: BARBERÁN LAHUERTA, M.A. and MELGUIZO GARDE, M., "La regulación autonómica en el Impuesto sobre Sucesiones and Donaciones: Eficacia and efecto redistributivo", Revista de Estudios Regionales, nº 87, 2010, págs. 187 a 211.

Furthermore, the technical shortfalls in the law's configuration have been harshly criticised by some, who have gone so far as to suggest that, for reasons of fiscal justice, it should be removed. This discussion has shifted into the political sphere, where various proposals have been made (some of which have already been made a reality in some Autonomous Communities) tending towards the practical elimination of inheritance tax payments within the basic nuclear family. Since these payments are the main component of the taxable product, this would mean most of those liable for this tax would no longer be so.

But the biggest change the tax regime has experienced over the last few years has been brought about through joint regulation between central government and the Autonomous Communities, which consists of state taxation with powers transferred to regional tax offices. This means the Autonomous Communities can standardise certain aspects of taxation according to their own preferences and spending needs, with a view to raising or alleviating the tax burden for taxpayers. In practice, this has translated into ample scope for setting the tax burden, which leads not only to inequalities between Spain's Autonomous Communities, but also to issues of unequal treatment between citizens in different European countries, which will be discussed in the coming pages. This matter became particularly important following the recent ECJ ruling on 17 October 2013 in the Welte case[16], where the ECJ condemned Germany after finding its inheritance regulations to be contrary to the free movement of capital (articles 56 and 58 CE)[17] because it made a distinction between residents and non-residents. This is very similar to the situation in Spain, as advised in the recent ruling from the Commitee of Experts for Reforms to the Spanish Tax System[18]. In the Commission against Spain case, in the recent ruling on 3 September 2014, Spain was found to be violating article 63 TFEU. This matter will be dealt with in subsequent paragraphs.

Specifically, in this report we hope to analyse the current situation vis-à-vis inheritance and gift tax in the other European Union Member States. This will enable us to analyse in detail how Spanish laws are compatible with the various

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16 TJEU Ruling of 17 October 2013, Yvon Welte against Finanzamt Velbert, C-181/12.

17 According to German legislation on inheritance, a non-resident of Germany who acquires a property in this country pays a higher tax rate (with a €2,000 reduction in amount taxable) than when the deceased or heir live in Germany, meaning they will enjoy a better tax benefit (allowing them to have a reduction of up to €500,000 on the taxable amount).

18 As stated by the Commitee of Experts, another problem associated with this tax is the issue of taxing non-residents, who are not granted the fiscal benefits established by Autonomous Community regulations. In several cases strikingly similar to Spanish law, the European Court of Justice has indicated that the difference between residents and non-residents constitutes a restriction in the free movement of capital, which is unjust. (SSECJ Mattner, C-510/08 and Welte, C-181/12, among others) (Report from the Committee of Experts for the Reform of the Spanish Tax System, February 2014, page 265).

EU freedoms, paying particular attention to ECJ case-law, with a view to reaching some conclusions on this matter.

II. INHERITANCE AND GIFT TAX IN SPAIN

1. Inheritance and gift tax in the European Union

Inheritance and gift taxation is present in most Member States. Inheritance tax laws are currently in place in Germany, United Kingdom, Netherlands, Luxembourg, France, Finland, Greece, Denmark, Czech Republic, Belgium, Cyprus, Ireland, Bulgaria and Italy. In countries such as Sweden, Lithuania, Austria, Estonia, Poland and Croatia, there is no specific tax applied to gratuitous transfers[19].

Some countries have continued to collect these taxes, while others have reduced them or removed them completely over the last few years[20]. However, the fact is that we are living in times of taxation on inheritance and gifts[21].

Having briefly outlined the inheritance tax situation in Europe, we can confirm that there does not appear to be any serious issue of offshoring, mainly because – among other reasons – tax burdens are not usually very high.

Looking at the overall picture in Europe, it is not predicted that an *imitation effect* will occur, as it did with the disappearance of Property Tax. From a theoretical point of view, one could argue that inheritance and gifts should be considered as part of a person's fiscal capacity that along with income, expenditure and consumption, should be taken included in the tax system. However, in recent times this standpoint has been discussed at length, to the extent that the tax does not exist at all in some Member States, as we have seen. In the case of Spain, it is not payable in all the Autonomous Communities. There are many disadvantages and legal problems associated with inheritance and gift tax, which can be summarised

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19 Information obtained from the European Commission's free-access database, at the following address:

http://ec.europa.eu/taxation_customs/taxation/gen_info/info_docs/tax_inventory/index_en.htm

20 For example Sweden, which stopped applying it in 2004.

21 Please see: DE PABLOS ESCOBAR, L.,"La imposición personal sobre la riqueza: su papel en los sistemas tributarios actuales", en *Hacienda Pública Española*, 2001 (p. 281-322). GALE, W., and SLEMROD, J.B., "Policy Watch. Death Watch for Estate Tax?", in *Journal of Economic Perspectives*, vol.15, n.1, 2001, p.205-218. CORONAS I GUINART, J.M.,"La necesaria armonización de la imposición sobre las sucesiones", in *Quincena Fiscal*, number 14, 1998, p.42.

into two main areas: double taxation and tax discrimination. These create obstacles to the exercising of European Union freedoms[22].

2. Reforms needed to the Spanish tax system in order to achieve compatibility with EU Law

Tax on inheritance and gifts has existed in traditional tax systems in various forms and under various descriptions. In Spain, taxing lucrative interests has been present in the tax systems of most democratic states. Despite this, in the last few years, there has been much discussion on whether taxes on gratuitous transfers made *mortis causa* and *inter vivos* should be kept.

In the Spanish tax system, inheritance and gift tax is the responsibility of the State, and only central government can levy it, or remove it completely. However, the fact inheritance tax has been devolved to the Autonomous Communities means these Communities have large control over its regulation, which has resulted in great differences in the tax and its economic capacity.

There is no consensus as to whether or not inheritance tax should be removed, even within the framework of the European Union where there is no common line of action regarding this issue.

However, regarding the situation in Spain, the reformation of this tax has moved beyond a merely doctrinal debate.

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22 On the matter of problems relating to double taxation, despite it not being the subject of our study, it is relevant to note that the European Commission adopted a Recommendation pointing out the low number of bilateral agreements between Member States aimed at removing double inheritance taxation, and focused on the need to improve existing measures between Member States in order to avoid this. See the Commission Recommendation of 15 December 2011 regarding relief for double taxation of inheritances. OJ L 336, 20.12.2011. When no Agreement exists to prevent double taxation, article 23 of Spain's IGT grants taxpayers subject to unlimited taxation a deduction to compensate for international double taxation. See ECJ Ruling of 12 February 2009, Margarete Block against Finanzamt Kaufbeuren, C-67/08, Rec. 2009 I-00883, which specifically affects Spain; BARREIRO CARRIL, M.C. "Internal Market and Non-Discrimination Tax Obstacles. Analysis of the ECJ'S Judgemente in case C-67/08, Block", en en DIEZ-HOCHLEITNER, J., MARTÍNEZ CAPDEVILA, C., BLÁZQUEZ NACVARRO, I. and FRUTOS MIRANDA, J. (coord..), Últimas tendencias en las Case-law de la Tribunal de Justicia de la Unión Europea. Recent trends in the case law of the court of Justice of the European Union, La Ley, Madrid, 2011; LÓPEZ ESCUDERO, M., "Internal Market and non-discriminatory tax obstacles. Analysis of the ECJ's judgement in case C-67/08", Block, en DIEZ-HOCHLEITNER, J., MARTÍNEZ CAPDEVILA, C., BLÁZQUEZ NACVARRO, I. and FRUTOS MIRANDA, J. (coord..), Últimas tendencias en las Case-law..., op. cit.

As already indicated, on May 5 2010, the Commission exercised powers expressed in article 258 TFEU, sending Spain a reasoned opinion stating it should make modifications to the tax regime in the area of inheritance and donations[23].

In this reasoned opinion, Spain was warned that the legal tax system constituted an obstacle to the free movement of persons and capital, and infringed articles 45 and 63 TFEU, given that non-residents of Spain and assets held abroad were being taxed at a higher rate. Spain was given two months to respond to the issues raised.

A year later, the Spanish government had still not fully complied with European Union Law, which forced the Commission to release an additional opinion on 16 February 2011 reiterating the same point[24].

In this case, the information put forward by the Commission made reference to the transfer of IGT powers to Autonomous Communities. It indicated that the result of this transferral was that contributors were taxed more lightly within the Autonomous Communities than if they had been taxed according to State laws. Therefore the problem, as the press release pointed out, lay in applying State legislation to those resident abroad or to donations of assets held outside Spain, as this resulted in more tax being paid than those resident in Spain, or than those whose gifted assets were within Spain[25]. The Commission considered therefore that this state of affairs constituted an obstacle to the free movement of persons and capital, as mentioned in articles 45 and 63 TFEU. Lastly, as we have also indicated, in 2011 the Commission decided to refer the matter to the ECJ (C-127/12)[26] in agreement with statements laid out in article 258 TFEU, considering once more that Spain's discriminatory inheritance tax regime constitutes an obstacle to free movement of persons and capital, and alleging a violation of articles 21 and 63 TFEU[27].

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23 European Commission. Press Release: "Taxation: Commission refers Belgium, Finland and France to the European Court of Justice and sends a reasoned opinion to Spain" IP/10/513, <http://europa.eu/rapid/press-release_IP-10-513_en.htm >

24 European Commission. Press Release: "Taxation: Commission requests Spain to change its discriminatory inheritance and gift tax provisions" IP/11/162, http://europa.eu/rapid/press-release_IP-11-162_en.htm

25 A problem that had been revealed repeatedly by legal professionals. On this matter, LÓPEZ DÍAZ, A., "La amenaza del derecho comunitario para ciertas deducciones autonómicas en el impuesto sobre sucesiones and donaciones", *Quincena Fiscal,* núm. 9, 2009, p. 74.

26 DO C 126 de 28.4.2012.

27 European Commission. Press Release: "Taxation: Commission refers Spain to the Court of Justice over discriminatory inheritance and gift tax rules", IP/11/1278, http://europa.eu/rapid/press-release_IP-11-1278_en.htm

Lastly, on 3 September 2014, the ECJ ruled that Spain had failed to fulfil its obligations in virtue of articles 63 TFEU and article 40 of the Agreement on the European Economic Area of 2 May 1992[28]. This was not, however, the only case of its sort. On 4 September 2014, in case C-211/13[29], the ECJ condemned Germany, too, for breaching article 63 of the TFEU. German legislation on inheritance and gift tax sets larger deductions when the deceased, the donor or the beneficiary reside in Germany. For this reason, the ECJ considered that German laws did not respect the free movement of capital, and did not observe the TFEU.

Obstacles to the exercising of freedoms in the EU remain forbidden in the different statements that regulate them, and the ECJ has stated that they have direct effect[30]. This means that, in accordance with article 45 TFEU, "any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment" is forbidden. And according to article 63 TFEU, "all restrictions on the movement of capital between Member States and between Member States and third countries" are forbidden. These restrictions, laid out in article 63 TFEU, were interpreted by the ECJ in relation to IGT as "those the effect of which is to reduce the value of the inheritance of a resident of a State other than the Member State in which the assets concerned are situated and which taxes the inheritance of those assets"[31]. At any rate, the ECJ does not only refer to restrictions in its case-law, but has also begun to use terms such as "deterrent effect" or "obstacle", which are employed by the Commission in its reasoned opinion[32].

At any rate, as we will discover through our analysis of ECJ case-law, limitations can be applied to the aforementioned freedoms, a possibility that in the instance of free movement of workers is included in article 45.3 TFEU, and which allows limitations for reasons of public order, public security and public health. Regarding the free movement of capital, the possibility of establishing such limitations is included in 65 TFEU. Along with cases of health and public security,

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28 ECJ Ruling of 3 September 2014, European Commission/Kingdom of Spain, C-127/12. Not yet published in the ECR

29 Judgment of the Court (Third Chamber) of 4 September 2014. European Commission v Federal Republic of Germany. Case C-211/13. Not yet published in the ECR

30 LÓPEZ ESCUDERO, M. "El mercado interior: cuestiones generales" in LÓPEZ ESCUDERO, M and MARTÍN and PÉREZ DE NANCLARES, J., *Derecho Comunitario Material*, Mc Graw Hill, Madrid, 2000, p. 34. BARNARD, C. *The Substantive Law of the EU. The Four Freedoms,* Oxford University Press, Oxford, 2004, pp. 261-262; WEISS, F. and WOOLDRIDGE, F., *Free Movement of Persons within the European Community*, Kluwer Law International, Alphen aan den Rijn, 2007, p. 2.

31 ECJ Ruling of 12 February 2009, Block case, paragraph 24

32 BARNARD, C. *The Substantive Law...*, op. cit., pp. 469-471.

it includes the option of establishing distinctions according to tax residency, adopting measures to prevent infractions of national laws, and establishing tax declaration procedures in order to gather information for administrative or statistical purposes.

3. In the Spanish legal and tax system, are there laws that are incompatible with European Union freedoms?

A. State-approved laws

Firstly we need to set out which State laws may contradict EU freedoms. These are the following:

a) Law 22/2009 (18 December), which regulates funding for Spain's Autonomous Communities and Autonomous Cities, and regulates certain tax laws.

Article 32 of this Law contains the scope for transfer of power and "points of connection" for inheritance and gift tax (these connection points determine the fiscal links between non-residents, the taxable assets, and the Autonomous Community). The Article also establishes that the Autonomous Community is given powers for yields inherited or gifted within its territory. Points of connection are set out in order to appoint the Appropriate Autonomous Community. For example, for *mortis causa* acquisitions and life assurance, the Appropriate Autonomous Community is the Community in which the deceased was habitually resident on the date the tax becomes payable. In the case of lucrative acquisitions *inter vivos*, the point of connection depends on the nature of the goods being transferred. If a property is gifted, the Appropriate Autonomous Community is the Community in which the property is located. If the goods being gifted are not property-related, the Appropriate Autonomous Community is the Community where the beneficiary is habitually resident on the date the tax becomes payable.

b) Law 29/1987 (18 December) on inheritance and gift tax.

This Law is the basic State law. It establishes the fiscal system and regulates limited and unlimited tax liability.

Regarding unlimited taxation, article 6 declares that all those habitually resident in Spain shall be liable, regardless of the location of the assets or rights gained[33]. According to article 7, anyone acquiring assets or rights that are situated, or are to be exercised or fulfilled on Spanish territory, shall be subject to limited taxation,

33 Spanish civil servants abroad are also subject with unlimited liability to this tax.

as well as payment of quantities derived from life assurance agreements when the contract has been produced by Spanish insurance companies, or has been carried out in Spain by foreign companies.

Having explained Spain's laws on this subject, we can deduce firstly that limited liability tax contributions have a fundamental consequence; that State laws are being applied fully without the application any of the benefits approved by the different Autonomous Communities. The application therefore of Law 29/1987 occurs in instances where heirs or beneficiaries are not resident on Spanish soil, and in cases where contributors are not habitually resident in Spain but acquire goods or rights that are situated, or can be exercised, on Spanish territory.

But also, there may be cases of unlimited tax liability in which State law shall be wholly applicable, without the contributor accessing any of the benefits approved by the Autonomous Communities, due to the fact that the point of connection system could lead to there being no Appropriate Autonomous Community for taxation.

On the other hand, in cases of *mortis causa* inheritances and life assurance, the Appropriate Autonomous Community will be that in which the deceased is habitually resident, although for acquisitions *inter vivos* this depends on the type of goods concerned. This means that in property transfer cases, the Appropriate Autonomous Community shall be that where the property is situated, and for other goods and rights the Appropriate Autonomous Community shall be that in which the beneficiary is habitually resident.

However, from these State laws it can be deduced that there will be instances where only State law can be applied, without the contributors accessing the numerous tax benefits established by the Autonomous Communities. In short, Law 29/1987 is applicable:

- In the case of non-resident heirs and beneficiaries (when the goods and rights were acquired *inter vivos* and are not property-related).
- When the deceased is a non-resident.
- When the beneficiary of donations of property situated abroad is a resident on Spanish soil.

B. The growing disparities of Spanish tax burdens

The need to reform this tax in Spain has gained momentum throughout the last few years due to the course of regulatory action that has been taken by several Autonomous Communities. The inequalities that have been provoked by applying the legal system to this tax have certainly increased problems of internal relocation or, at the very least, unequal tax treatment throughout the Spanish territory. At present there are enormous tax burden disparities relating to where the transferor resides, where transferred property is located, and, in certain cases, where the transferee resides. These disparities are mainly caused by the reasons laid out below.

Firstly, the funding system for the Autonomous Communities awards them ample powers as regards IGT. This means numerous aspects of this tax can be adjusted, for example reductions in the taxable amount, the tax rate itself, amounts and coefficients of the heir's or beneficiary's pre-existing assets, deductions, bonuses in quotas, administration and payment.

On this point, most of the Autonomous Communities have made use of these wide regulatory powers. The consequence is differing inheritance tax rules depending on where you live in Spain, because when applying the point of connection rules in *mortis causa* transfers, the appropriate Autonomous Community is that in which the deceased is habitually resident.

Spain's tax system is not fully contained within State law. As we have already advised, in Spanish legislation, tax is transferred to the Autonomous Communities. For this reason, we now need to examine to what extent the large number of tax measures introduced by the Autonomous Communities for inheritance tax are compatible with freedom of establishment (article 49 TFEU), free movement of capital (articles 63 and 65 TFEU) and free movement of persons and workers (articles 21 and 45 TFEU), by studying the case-law established by the ECJ.

Lastly, the configuration of points of connection for inheritance tax, along with the tax benefits granted by the Autonomous Communities, mean that for situations with an international aspect, the taxation process is even less favourable than for those within Spain.

III. COMPATIBILITY OF DIFFERENT INHERITANCE AND GIFT TAX REGIMES WITH EU FREEDOMS

1. Free movement of persons

As we have already seen, in Spain there are various different laws, and therefore fiscal benefits, for residents of certain Autonomous Communities. Since non-residents or those acquiring goods situated abroad are subject to the State tax system, they cannot benefit from tax advantages that those Autonomous Communities are offering. On this matter, we need to mention that the ECJ has made general pronouncements on the compatibility of tax measures set out by

Member States with EU freedoms. From the outset, in the Schumacker case, the ECJ stated that "although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law"[34]. In subsequent statements the ECJ reiterated that, although direct taxation falls within the power of the Member States, they have to exercise this power according to Union Law, and avoiding any discrimination based on nationality.[35]

In the specific case of Spanish inheritance and gift tax laws, the existence of such differences for reasons of residency or country of location of goods was considered by the Commission as discriminatory, and impeding the free movement of persons. In a recent ruling, however, the ECJ judged that the Commission had not proved in what way the State legislation affected the exercising of this freedom, nor had it shown how these national laws and article 21 TFEU[36] were linked, without going deeper into the subject.

The first issue, therefore, relates to the existence of a regime that discriminates according to residency, which would constitute an obstacle to the freedom of movement included in article 21 TFEU. We appear to be faced with what is known as covert discrimination, given that is not discrimination based on nationality – which is expressly forbidden by article 18 TFEU – but it has the same effect[37].

34 ECJ Ruling on 14 February 1995, Finanzamt Köln-Altstadt against Roland Schumacker, C-279/93, Rec. 1995 I-00225, paragraph 21

35 ECJ Ruling on 11 August 1995, G. H. E. J. Wielockx against Inspecteur der directe belastingen, C-80/94, Rec. 1995 I-02493, paragraph 16; ECJ Ruling on 14 September 1999, Frans Gschwind against Finanzamt Aachen-Außenstadt, C-391/97, 1999 I-05451, paragraph 20; ECJ Ruling on 6 June 2000, Staatssecretaris van Financiën against B.G.M. Verkooijen, C-35/98, Rec. 2000 I-04071, paragraph 32; ECJ Ruling on 11 December 2003, P Herederos del Sr. H. Barbier against Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland te Heerlen., C-364/01, Rec. 2003 I-15013, paragraph 36. It is necessary here to mention the opinion of the Court with regard to its tax-raising powers, indicating that "the disadvantages which could arise from the parallel exercise of tax competences by different Member States, to the extent that such an exercise is not discriminatory, do not constitute restrictions prohibited by the EC Treaty", ECJ Ruling on 16 July 2009, Jacques Damseaux against Estado belga.., C-128/08, Rec. 2009 I-06823, paragraph 27.

36 ECJ Ruling on 3 September 2014, European Commission/Kingdom of Spain, paragraph 55.

37 As the ECJ indicated in the Schumacker case, "tax benefits granted only to residents of a Member State may constitute indirect discrimination by reason of nationality". ECJ Ruling on 14 February 1995, Schumacker case, paragraph 29; See IGLESIAS CASAIS, J.M., *No Discriminación Fiscal and Derecho de Establecimiento en la Unión Europea*, Thomson Aranzadi, Cizur Menor, 2007, pp. 34-35, 81-85.

The concept of discrimination is understood as applying different laws to comparable situations, or applying the same law to different situations.[38] And this is where the issue lies, because generally speaking, the ECJ has considered that on matters of direct taxation, the situation of that of a resident and that of a non-resident are not comparable, meaning it is possible to apply different laws or refuse to grant certain tax advantages[39]. Despite this, on several occasions the ECJ has also declared certain national laws, which were applied differently depending on the place of residence when relating to tax, to be contrary to EU Law [40]. Some of these cases concerned IGT. The Court stated that the reason for this case-law was that "in the case of a tax advantage which is not available to a non-resident, a difference in treatment as between the two categories of taxpayer may constitute discrimination within the meaning of the Treaty where there is no objective difference between the situations of the two such as to justify different treatment in that regard"[41].

As we have seen, in IGT cases the ECJ has considered that residents should be treated the same as non-residents[42], and, in fact, of the eleven matters that have been presented to the Court on the subject of inheritance, in nine of them the Court declared the national law to be discriminatory and contrary to EU Law. In any case, and despite this EU case-law, it is also relevant to mention that the Court itself has also stated in settled case-law, such as in the Block case, which affected Spain, that "the Treaty offers no guarantee to a citizen of the Union that

38 ECJ Ruling on 14 February 1995, Schumacker case, paragraph 30; ECJ Ruling on 27 June 1996, P. H. Asscher against Staatssecretaris van Financiën., C-107/94, Rec. 1996 I-03089, paragraph 40; ECJ Ruling on 14 November 2006, Kerckhaert and Morres case, paragraph 19. In this last case, Mr and Mrs Kerckhaert-Morres claimed that their situation was different because they were receiving share dividends from a company established in another Member State, and that applying the same tax to those as on share dividends from companies within Belgium was discriminatory. This argument was rejected by the Court.

39 ECJ Ruling on 14 February 1995, Schumacker case, paragraphs 31-34. See TERRAS, B.J.M. and WATTEL, P.J., *European Tax...*, op. cit. pp. 95-96; FORNIELES GIL, A. "Prohibiciones de discriminación y restricción a la libertades comunitarias: aproximación desde los procedimientos tributarios nacionales", en FERNÁNDEZ MARÍN, F. (direc.) and FORNIELES GIL, A. (coord.), *Derecho Comunitario and Procedimiento Tributario,* Atelier, Barcelona, 2010, p. 201; Documento de trabajo de los servicios de la Comisión. "Regímenes del impuesto sobre..., op. cit. p.3; Sobre el concepto de discriminación and su relación con el Impuesto sobre la Renta, See HINOJOSA MARTÍNEZ, L.M. "Reflexiones en torno al concepto de discriminación: los obstáculos fiscales a la libre circulación de personas", Revista de Derecho Comunitario Europeo, vol. 2, 1997., pp. 511-545.

40 IGLESIAS CASAIS, J.M., *No Discriminación Fiscal and Derecho de Establecimiento...*, op. cit. p. 86

41 ECJ Ruling on 27 June 1996, Asscher case, paragraph 42.

42 Working paper of the services of the Commission. "Regímenes del impuesto sobre..., op. cit. p.3.

transferring his residence to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage or not, according to circumstances"[43].

Despite this case-law, the way in which this discriminatory regulation affects the free movement of persons has not been the subject of any judicial order, because judicial order have been based primarily on the violation of the free movement of capital. At any rate, the ECJ considered that "the tax consequences in respect of inheritance rights are among the considerations which a national of a Member State could reasonably take into account when deciding whether or not to make use of the freedom of movement provided for in the Treaty"[44].

With regard to Spanish law, it is difficult to tally differing treatment and granting tax advantages to residents of certain Autonomous Communities with ECJ case-law, since these practices could clearly pose an obstacle to free movement of persons. This is due to the fact there is no objective situation justifying this difference of treatment, given that in Spain the amount taxed is calculated according to the value of the goods transferred, and whether or not its recipient or beneficiary lives in a certain Autonomous Community[45] – or whether their goods are situated there – is not a factor determining the value of the transfer. As indicated by the ECJ in the Jäger case, "The calculation of the tax is, under the national legislation at issue in the main proceedings, directly linked to the value of the assets included in the estate, with the result that there is objectively no difference in situation such as to justify unequal tax treatment so far as concerns the level of inheritance tax payable in relation to, respectively, an asset situated in Germany and an asset situated in another Member State."[46].

With regard to the possible application of some of the exceptions that would permit this difference in treatment, article 21 TFEU states that the right to circulate and reside shall be "subject to the limitations and conditions laid down in the Treaties". The limits included in article 45.3 TFEU[47] relating to public order, public security and public health can therefore be applied, which seem to be of little relevance to this situation. On the other hand the ECJ also stated certain

43 ECJ Ruling on 12 February 2009, Block case, paragraph 35.

44 ECJ Ruling on 11 December 2003, Barbier case, paragraph 75.

45 Ibid. paragraph 76.

46 ECJ Ruling on 17 January 2008, Theodor Jäger against Finanzamt Kusel-Landstuhl., C-256/06, Rec. 2008 I-00123, paragraph 44.

47 CONDINANZI, M., LANG, A. and NASCIMBENE, B., *Citizenship of the Union and...*, op. cit. p. 29.

exceptions which permit discriminatory treatment, provided that they have a legitimate objective that is compatible with the Treaty or if it is justified by reasons relating to the public interest[48], and eminently related to tax, for example equitable burden sharing, tax cohesion, the fight against tax evasion and procedural difficulties for executing tax[49]. At any rate, it is also difficult to apply these exceptions to the situation in Spain, and besides, they have never been accepted by the ECJ on the matter of IGT.

2. The right of establishment and *mortis causa* transfers by companies and businesses.

As we have already seen, the Commission's reasoned opinion considered that Spanish laws on IGT constituted an obstacle to free movement of persons, and in accordance with article 21 TFEU, broad scope of this freedom permits us to include in our analysis the right of establishment and freedom to provide services[50].

It is therefore interesting, despite the ECJ having not considered the violation of article 21, to reference how Spanish IGT laws affect to the right of establishment relating firstly to the specific case-law on this matter, and secondly to the fact that, as stated earlier, the ECJ considered that the tax inheritance laws of a Member State can influence the decision of exercising free movement. The right of establishment is established as "pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period"[51].

The ECJ has analysed many times how compatible certain Member State-approved measures are with the right of establishment stated in article 49 TFEU. With regard to IGT, the ECJ Ruling in the Geurts and Vogten case[52] is one good example, which makes interesting reading with regard to the situation in Spain. This case occurred after the death of a Belgian resident who left his estate to his wife and son. According to article 60a, paragraph one, point b) of the Belgian

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48 ECJ Ruling on 27 October 2007, Maria Geurts and Dennis Vogten against Administratie van de BTW, registratie en domeinen and Belgische Staat, C-464/05, Rec. 1 2007 I-09325, paragraph 24.

49 FORNIELES GIL, A. "Prohibiciones de discriminación and restricción a la libertades..., op. cit. pp. 207-208.

50 MARTÍN and PRÉREZ DE NANCLARES, J., "El Derecho de establecimiento", en LÓPEZ ESCUDERO, M and MARTÍN and PÉREZ DE NANCLARES, J., *Derecho Comunitario...*, op. cit. p. 108

51 ECJ Ruling on 25 July 1991, The Queen against Secretary of State for Transport, ex parte Factortame Ltd and otros, C-221/89, Rec. 1991 I-03905, paragraph 20.

52 ECJ Ruling on 27 October 2007, Geurts and Vogten case.

code on inheritance tax, "shares in a family company or claims against such a company" were exempt from this tax, "on condition that in the three years preceding the death of the deceased at least 50% of the undertaking or the shares in the company belonged continuously to the deceased and/or his or her spouse, and that they are mentioned voluntarily in the declaration of estate"[53].

Amongst the goods left by the deceased there were shares in two companies domiciled in Maastricht which both fulfilled the requirement of having employed five workers for more than three years. However, the exemption was denied because paragraph five of article 60a required that the company had employed at least five workers within Belgium, for a period of three years preceding the death. The complainants interpreted the applications of this law as being contrary to the mandate of articles 43 and 56 of TCE (currently articles 49 and 63 TFEU). The ECJ resolved this matter, affirming that "in the absence of valid justification, Article 43 EC precludes inheritance tax legislation of a Member State which excludes from the exemption from that tax available for family undertakings those undertakings which employ in the three years preceding the date of death of the deceased at least five workers in another Member State, whereas it grants such an exemption where the workers are employed in a region of the first Member State"[54].

The law in question therefore introduced direct discrimination between passive subjects of IGT, based on a criterion of location in which they had employed a number of workers during a determined period. This could impede those passive subjects exercising their freedom of establishment.

In Spain, in Law 29/1987 (18 December) on Inheritance and Gift Tax, the government states a reduction of 95% is applicable to the amount taxable (article 20.2.c)).

Government regulations put a condition in the application of this fiscal benefit, consisting of the fulfilment of a series of objective, subjective and temporal requisites[55]. None of these requirements infringes the freedom of establishment discussed in article 49 TFEU. Specifically, at no moment is the condition attached to this tax advantage that companies with shares are being transferred *mortis causa* should have their head office on Spanish soil.

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53 Ibid. paragraph. 6

54 Ibid. paragraph 29.

55 Article 20.2.c) of Law 29/1987 applies a condition to *mortis causa* acquisitions by spouses, descendants or adoptive children of the deceased, that the acquisition is maintained for ten years following the death, unless they die themselves during this period.

However, we have seen that IGT is prone to being modified by the Autonomous Communities in certain respects, for example applying reductions to the taxable base. These reductions can be applied in two ways. Firstly, Autonomous Communities can create new reductions, provided they meet economical or social circumstances belonging to the Autonomous Community concerned. Secondly, Autonomous Communities can adjust reductions set out by the government. If doing this, they must retain conditions similar to those established by the government, or improve the conditions either through increasing the reduction amount or reduction percentage, by increasing the number of contributors who qualify, or by reducing the requisites that allow contributors to qualify[56].

Many Autonomous Communities have *improved* the reduction discussed in article 20.2.c) of Law 29/1987. As we have seen, Law 22/2009 authorises them to maintain the reduction in conditions similar to those established by the government, or to improve it, essentially through lowering the requisites that are needed for it to be applied. In no case are the Autonomous Communities permitted to toughen or restrict the conditions allowing these tax benefits to be enjoyed.

However, there are Autonomous Communities that have *worsened* this incentive by increasing the number of requirements that enable it to be applied. In order to benefit from this reduction when acquiring a company, professional business or shares in certain companies, the company is required to have its head office within the Autonomous Community. In some cases it is also required that the transferee has their tax residence in that Autonomous Community.

Such regulations seem to go against the right of establishment laid out in article 49 TFEU. According to the ECJ case-law cited, applying a fiscal benefit, in this case for a *mortis causa* transfer of a family business, cannot be dependent on the company having its head office in a certain Member State country, nor in a particular Autonomous Community. Without any doubt, these legal provisions that restricting the application of significant fiscal benefits impede the freedom of establishment.

3. Free movement of capital

As we have already seen, the ECJ has confirmed Spain's infringement of article 63 TFEU, which prohibits restrictions to free movement of capital defined in articles 63 and 65 TFEU. On this matter, with regard to the application of discriminatory IGT law, the ECJ has been vocal in many areas. Firstly the ECJ has acknowledged

56 Article 48 of Law 22/2009 (18 December).

inheritance as “Personal capital movements”, “except in cases where its constituent elements are confined within a single Member State”.[57]

Regarding Spain, there are therefore some matters in which the Court has made statements on unjustified discrimination on residency grounds, and how this may constitute an obstacle[58] to the free movement of capital[59]. The first of these examples, which has served as a basis for the rest of ECJ case-law, is the Barbier case[60]. In this case, Dutch inheritance laws stated certain tax deductions were allowed only to deceased persons who had been resident within the Netherlands. The ECJ found that it was contrary to the Treaty for a non-resident to be taxed at a higher rate than a resident[61].

As we have seen, the ECJ has made a number of pronouncements against differences in treatment and the application of certain fiscal benefits. On some occasions these statements have been made in relation to the residency of the deceased at the moment of death. In the Eckelkamp[62] case, it was not permitted that mortgage-related charges be deducted from the value of property inherited, and in the Arens-Sikken[63] case, it was not permitted that debts be deducted from inherited assets. In other instances these rulings have made relating to the

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57 ECJ Ruling on 12 February 2009, Block case, paragraph 20.

58 In matters of taxation LÓPEZ ESCUDERO classifies the obstacles as discriminatory measures (in breach of article 63 TFEU), and neutral measures (limitations to free movement of capitals due to the inevitable consequence of the fact that Member States have retained their sovereignty as regards direct taxation). LÓPEZ ESCUDERO, M., “Internal Market and non-discriminatory…”, op. cit. p. 890.

59 On the matter of discrimination of tax matters to the free movement of capital, the ECJ has made rulings on various different points, considering that even though freedom of circulation prohibits discrimination based on where a company is domiciled, it is also the case that discrimination can consist of applying the regulation to different situations, a matter that was dealt with in the Columbus Container Services case, but as the Court indicated in the aforementioned Kerckhaert and Morres case “the position of a partner receiving profits is not necessarily altered merely by the fact that he receives those dividends from a company or partnership established in another Member State”. ECJ Ruling on 6 December 2007, Columbus Container Services BVBA & Co. against Finanzamt Bielefeld-Innenstadt, C-298/05, Rec. 2007 I-10451, paragraph 42. Sobre el trato diferenciado See también, ECJ Ruling on 20 May 2008, Staatssecretaris van Financiën against Orange European Smallcap Fund NV., C-194/06, Rec. 2008 I-03747, paragraphs 51 and 59.

60 ECJ Ruling on 11 December 2003, Barbier case.

61 Ibid. paragraph 62.

62 ECJ Ruling on 11 September 2008, Hans Eckelkamp and others against Belgische Staat, C-11/07, Rec. 2008 I-06845, paragraph 61-63.

63 ECJ Ruling on 11 September 2008, D. M. M. A. Arens-Sikken against Staatssecretaris van Financiën, C-43/07, Rec. 2008 I-06887, paragraphs 51-55.

residency of the heirs. In the Mattner case, the ECJ could find no objective reason to justify an IGT tax reduction if one or more of the parties involved was resident in the country[64].

On the subject of residence, it is necessary to note that non-discrimination is not only applicable between residents of European Union countries, but also to residents of non-EU countries, as stated in article 63.1 TFEU and later confirmed by the ECJ in its recent ruling in the Welte case[65].

But the ECJ's statements have not only been about discriminatory tax regimes according to place of residency. In the Jäger case[66], the court studied whether German inheritance tax laws infringed the principle of free movement of capital since, in the valuation of assets included through a *mortis causa* transfer, it used the least favourable method of estimating and calculating tax due, with regard to an agricultural and forest asset located in another Member State. The Court considered that the EC Treaty must be interpreted as "precluding legislation of a Member State which, for the purposes of calculating the tax on an inheritance consisting of assets situated in that State and agricultural land and forestry situated in another Member State, provides that account be taken of the fair market value of the assets situated in that other Member State, whereas a special valuation procedure exists for identical domestic assets, the results of which amount on average to only 10% of that fair market value, and reserves application of a tax-free amount to domestic agricultural land and forestry in relation to those assets and takes account of their remaining value in the amount of only 60% thereof"[67].

In summary, as indicated by López Escudero, national tax laws respresent a violation of free movement of capital when "they provide for lower tax allowances with respect to non-residents; when they provide for different rules for the valuation of assets that are part of the inheritance, depending on where valuation of assets are located; or when they restrict the deductibility of debts/liabilities related to assets that are part of the inheritance of non-residents".[68]

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64 ECJ Ruling on 22 April 2010, Vera Mattner/Finanzamt Velbert, C-510/08, Rec. 2010 II-00147, paragraph 36.

65 ECJ Ruling on 17 October 2013, Yvon Welte against Finanzamt Velbert, C-181/12.

66 ECJ Ruling on 17 January 2008, Jäger case.

67 Ibid. paragraph 57.

68 LÓPEZ ESCUDERO, M., "Internal Market and non-discriminatory...", op. cit. p. 888. The ECJ also indicated in its Ruling in the Van Hilten case what measures could be considered as restrictions to the movement of capital regarding inheritance, saying it would be " those whose effect is to reduce the value of the inheritance of a resident of a State other than the Member State in which the assets concerned are situated and which taxes the inheritance of those assets", ECJ Ruling on 23 February 2006, Herederos de M. E. A. van

With regard to Spain, the uncontrolled use of legislative powers by some Autonomous Communities seems, in some cases, to once again be contrary to EU regulations, since they put into place tax benefits relating to residency or to location of assets. Several cases have shown this to be the case.

Firstly we shall refer to tax deductions in transfers of main residence. Many Autonomous Communities have made adjustments to deductions for transfers of main residence discussed in article 20.2.c) of Law 29/1987. Essentially, the fiscal benefit consists of the taxable amount being reduced by 95%, with a maximum limit of 122,606.47 euros, as long as the contributor retains ownership of the house for ten years following the death of the deceased. Some Autonomous Communities have increased the percentage of the State-applied reduction, and in some cases this percentage has reached 100%. They have made this tax benefit conditional on the property concerned being physically situated within the Appropriate Autonomous Community. This means that, taking into consideration the ECJ case-law, these measures seem to fit badly with the principal of free movement of capital.

Coming now to tax reductions for transfers of businesses and farmland, several Autonomous Communities have adjusted this legislation by introducing more restrictive conditions than those established by government legislation, and stating that the company's head office needs be located within that Autonomous Community in order for this fiscal benefit to be applied. Again, considering ECJ pronouncements, we can conclude that these types of regulations, that permit a better or worse tax treatment depending on where the lucrative transfer is located, could infringe free movement of capital.

IV. CONCLUSION

Over the last few years much thought has been given to whether we should continue to charge inheritance and gift tax. In most EU Member States, there is still a tax of this type. However it seems timely to introduce international standards in order to achieve better harmonisation, and reduce the considerable discrepancies that are currently occurring in this area – which are inappropriate for a common area such as the EU – in the interest of facilitating coordination and administrative collaboration between States.

Regarding IGT in Spain, the ECJ has found that Spanish legislation impedes the free movement of capital. Covert discrimination is occurring, with tax advantages

Hilten-van der Heijden/Inspecteur van de Belastingdienst/ Particulieren/ Ondernemingen buitenland te Heerlen, C-513/03, Rec. 2006 I-01957, paragraph 44 available for residents of Autonomous Communities, or for successors, heirs, or companies with their head office within these communities. Fiscal benefits also may exist depending on whether the asset is located in a certain Autonomous Community. Since there is no objective situation permitting the difference of treatment or exemptions from tax application, all these examples show that ECJ case-law is being breached.

As we have seen, in practice there are large fiscal differences depending on which Autonomous Community is charging the inheritance or gift tax. We believe there should not be such disparities of tax burden. As this report has shown, certain tax measures applied by the regions correspond badly with EU freedoms and ECJ case-law. A person who is resident in the EU but not in Spain is subject to State fiscal regulations and "point of connection" limitations. They are subject to government legislation, and not the regional regulations of the Autonomous Communities, where enormous fiscal benefits can be enjoyed. This constitutes, in our view, an obstacle to community freedoms. Consequently, we believe it appropriate to approach this matter by limiting the possibilities of tax competition and internal relocation, in order to avoid the divergence in tax treatment for *mortis causa* and *inter vivos* transfers. One method of action would be to strip the Autonomous Communities of their powers so they were no longer able to offer reductions leading to the near-cancellation of the tax. Another method would be to set a minimum State tax that has to be respected by all the Autonomous Communities, to avoid the tax being cancelled. This common minimum of standards would have particular relevance for transfers of businesses, where the biggest divergences between Autonomous Communities occur. It would be helpful for the Spanish government to set clear limits for the fiscal powers granted to the Autonomous Communities.

Furthermore, in our opinion, we need to reconsider the current points of connection currently determining subjection to unlimited and limited tax liability, so the same laws be applied to non-residents and residents. We believe it necessary to revise the topic in order to avoid the disparities that translate into obvious fiscal competition and limit the exercise of community freedoms, and the fairness of national tax systems.