# DOES SPANISH INHERITANCE TAX VIOLATE EU LAW?

Montserrat Hermosin Alvarez[1]

## 1. Introduction

In the ECJ ruling of 3 September, 2014 *Commission v. Spain*, C-127/12, the ECJ ruled that Spanish inheritance and gift tax (IGT) constitutes an obstacle on the free movement of capital. This article analyses the current regulation of Spanish IGT to determine whether it is fully compliant with EU law[2].

The European Commission has demonstrated repeatedly, and through several different channels, the need to resolve the matter of cross-border barriers resulting from inheritance taxation in the EU[3].

In 2007 an infringement procedure was launched against Spain which revealed that Spanish IGT may be incompatible with EU Law. Eventually, the ECJ ruling of 3 September, 2014 *Commission v. Spain*, C-127/12, found that Spain was violating article 63 TFEU[4].

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1 Associate Professor of Financial and Tax Law, Pablo de Olavide University, Spain.

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3 For example, its Communication to the European Parliament, the Council and the European Economic and Social Committee (COM, 2011); its 2011 Recommendation (2011/856/EU) and the public consultations launched in 2011 and in 2014.

4 Judgment of 3 September 2014, *Commission v Kingdom of Spain*, C-127/12, EU:C:2014:2130.

Spain responded to this pronouncement on her internal legislation by incorporating the second additional provision into Spanish inheritance and gift tax law (Law 26/2014 – 27 November).

The aim of this article is to analyse this new amendment to Spain's IGT in relation to taxpayers and deceased persons who are non-resident in Spain and its correlation with EU Law and secondly, problems of unequal treatment occurring in some cases of unlimited liability for persons who are resident in Spain compared to non-residents in Spain.

To summarise, the new amendment enables a "resident of European Union or European Economic Area State" to apply, through different points of connection, the law of the Autonomous Community (AC) with which he or she is most strongly connected. But, when applied literally, the additional provision could generate further problems due to its incompatibility with European law and the equal treatment principle. This occurs when State legislation is applied to taxpayers resident in Spain without them enjoying regional tax benefits.

Firstly, the free movement of capital described in article 63 of the TFEU also prohibits restrictions on the movement of capital between Member States and third countries[5], that are not covered by the additional provision[6]. With the exception of tax havens, where a lack of tax information sharing could justify the inequality of treatment, in order to be completely compatible with the free movement of capital, perhaps, the new legislation also should have covered residents of third countries[7]. The current legal system continues to allow significant taxation differences in lucrative acquisitions[8] between third countries and Member States. Thus, if the deceased person was resident in Spain and the goods and rights are located in Spain, but the successor resides in Ecuador, only State legislation would be applicable to this inheritance, and not the AC-approved tax benefits. There are other cases of this, as will be demonstrated below.

Under the new legislation, there may be also cases where certain taxpayers, resident in Spain, cannot enjoy regional tax benefits, since only State legislation would apply to the acquisition. Undoubtedly, it is these cases which are most noteworthy and hardest to justify. An example occurs during a gratuitous transfer *inter vivos*, where a beneficiary resident in the Andalusia region of Spain receives

5 The ECJ has shown this to be the case on repeated occasions. See Judgment of 17 October 2013, *Welte*, C-181/12, EU:C:2013:662.

6 Second additional provision into Spanish inheritance and gift tax law (Law 26/2014 – 27 November).

7 See Judgment of 18 December 2007, *A Case*, C-101/05, EU:C:2007:804.

8 Basically inheritances and donations.

a gift of a property located in the United States. This acquisition is governed entirely by State legislation despite the transaction being subject to unlimited taxation.

The question here is whether there are objective reasons justifying the non-application of AC-approved fiscal advantages to gratuitous transfers carried out between third countries and a Member State, and to certain gratuitous transfers carried out by Spanish resident taxpayers. This article seeks to analyse and find answers to these questions.

## 2. Cross-border barriers resulting from inheritance tax in the European Union

The need for an overhaul of inheritance tax has been made patently clear over the last years through a number of initiatives undertaken within the EU. The data speaks for itself; the globalisation process, along with the EU freedoms have led to the increased movement of persons and of capital[9].

The IGT situation brings with it a large number of problems and legal issues. These can be summarised using two categories: firstly, double taxation, and secondly, fiscal discrimination constituting an obstacle to the exercise of the EU freedoms. On the matter of double taxation, the European Commission adopted a Recommendation which highlighted the lack of bilateral agreements to eliminate double taxation for inheritances between Member States[10] and underlined the need to improve existing measures to stop double taxation between Member States[11].

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9 To highlight this point, we only need to look at the figures on cross-border obstacles from IGT 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 state ownership increased by 50% between 2002 and 2010 (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).

10 In Spain's case, only two bilateral agreements have been signed for the prevention of double taxation, both of which predated the OECD Model Convention (1982), *OECD MCT Tax on Inheritance and Gifts*, with France on 08/01/1963 and with Sweden on 25/04/1963.

11 On the matter of problems relating to double taxation, despite it not the being the subject of this article, 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

In relation to the second problem, several countries have had to review their internal legislation in order to make their IGT regimes compatible with EU Law[12]. The demand for a debate on this subject has also been launched within the EU, where questions were raised on the subject. In due course, two public consultations were opened about the possible approaches to removing obstacles to cross-border inheritance tax obstacles within the European Union[13]. This revision will no doubt provoke a timely overhaul of taxation associated with *mortis causa* inheritance[14]. However, on this point the case-law of the ECJ has played a fundamental role through that which has been termed "negative integration", given that IGT is not a harmonised tax[15]. Although EU countries have the power to legislate on direct taxation, all legislation on this matter must respect the fundamental freedoms described in the TFEU[16].

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Spain's IGT grants taxpayers subject to unlimited taxation a deduction to compensate for international double taxation.

12 A problem that has been pointed by Tom O'Shea: *"The jurisprudence of the ECJ continues to demonstrate the problems caused by protectionist national inheritance tax regimes that fail to account for the freedoms guaranteed by the TFEU"* ("Belgian Inheritance Tax Rules Successfully Challenged Before the ECJ", *Tax Notes International*, December 5, p.724).

13 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.
The Commission opened a new public consultation entitled (10/04/2014): "*Consultation on cross-border inheritance tax problems within the EU*". See FERNÁNDEZ ARRIBAS, G., Y HERMOSÍN ÁLVAREZ, M.,
https://circabc.europa.eu/sd/a/e59cd9c7-f540-44d5-a2c0-8c41e8442e33/Universidad%20Pablo%20de%20Olavide.pdf.

14 Another example demonstrating the launch of reform in European inheritance tax law is the existence of a European Certificate of Inheritance. The Regulation (EU) nº 650/2012 of the European Parliament and of the Council of 4 July 2012 on jurisdiction, applicable law, recognition and enforcement of authentic instruments in matters of succession and on the creation of a European Certificate of Succession, 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.

15 "This "negative integration" role is particularly important in the direct tax field because of the small number of "positive" EU tax law rules that have been adopted. By eliminating obstacles to the exercise of the freedoms through its judgments, the Court plays a vital "negative integration" role in the EU regulatory scheme" (Tom O'Shea, "Belgian Inheritance Tax Rules Breach EU Law", *Tax Notes International*, April 18, 2011, p. 218).

16 It has also been pointed that "the Member States retained competence in matters of direct taxation (like inheritance taxes), but they must exercise that competence in compliance with Community Law, and in particular, the fundamental freedoms" (Tom O'Shea, "Accessing EU 'tax advantages", *International Tax Report*, March 2009, p. 7).

## 3. Request for Spain to amend its inheritance and gift tax system

Reforming the Spanish IGT system has been considered a matter of urgency since 2010. Back in 2004, the Commission sent a Communication to Spain requiring that it change its inheritance taxation regime for non-residents[17]. The Commission considered that applying State legislation only, without the AC-approved fiscal benefits, constituted an obstacle to the free movement of persons and capital.

The Commission exercised its powers, expressed in article 258 TFEU, to send Spain on May 5th, 2010, a reasoned opinion stating that Spain should make modifications to its tax regime in the area of inheritance and donations[18]. In this reasoned opinion, the Commission alleged that Spain's inheritance 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, since the Spanish government had not fully complied with European Union Law, the Commission released an additional opinion on 16 February 2011 reiterating the same point[19].

The Commission referred to the transfer of IGT powers to the Autonomous Communities. It indicated that the result of that transfer was that contributors were taxed more lightly within the Autonomous Communities than if they had been taxed according to State law. Therefore, the problem, as the press release pointed out, lay in applying State legislation to non-residents or to donations of assets held outside Spain, as this resulted in more tax being paid than by those resident in Spain, or than those who received gifted assets from within Spain[20].

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17 Case Description. 2004/4090 Taxation. ES.

18 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 >

19 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

20 A problem that had been revealed repeatedly by legal professionals.

The Commission considered that this state of affairs constituted an obstacle to the free movement of persons and capital, as set out in articles 45 and 63 TFEU[21]. Lastly, in 2011 the Commission decided to refer the matter to the ECJ[22] under article 258 TFEU, on the grounds that Spain's discriminatory inheritance tax regime constituted an obstacle to free movement of persons and capital, alleging a violation of articles 21 and 63 TFEU[23].

## 4. ECJ ruling of 3 September, 2014, *Commission v. Spain*, C-127/12

As expected, [24] in the Ruling of 3rd September, 2014, *European Commission v. Kingdom of Spain*, C-127/12, the Court determined that Spain was in breach of article 63 of the TFEU[25].

On the subject of this important pronouncement, it is necessary to highlight some relevant points to complete the objectives of this analysis[26].

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21 About these fundamental freedoms see: BARNARD, C. *The Substantive Law of the EU*, Oxford University Press, Oxford, 2004, pp. 231; WEISS, F. y WOOLDRIDGE, F., *Free Movement of Persons within the European Community*, Aspen Publishers, New York, 2007, pp. 45-46; DEL VALLE GÁLVEZ, A. "La libre circulación de trabajadores", LÓPEZ ESCUDERO, M y MARTÍN Y PÉREZ DE NANCLARES, J., *Derecho Comunitario Material*, McGrawHill, 2000, p. 96.

22 (C-127/12). DO C 126 de 28.4.2012.

23 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

24 This matter was also advanced by the Committee of Experts for Reforms to the Spanish Tax System, *Informe de la Comisión de Expertos para la Reforma del Sistema Tributario Español*, February 2014, p. 245.

25 Of relevance here are observations made by SOLER ROCH M.T., who notes that a simple review of tax law would have been enough to solve the problem. For example, something as straightforward as a rule similar to that which regulates the option set out in article 46 of Spain's Act for Income Tax on Non-residents, which includes a comparability requirement. For IGT, this could have been based on the assumption that more of 75% of the goods and rights acquired by non-residents are in Spain ("Autonomía Financiera, Regional y Jurisprudencia Europea: el caso del Impuesto sobre sucesiones y donaciones", *Libertades Comunitarias, Autonomía Tributaria y Medio Ambiente*, CEF, Madrid, 2015, p.80.)

26 About this pronouncement see BARCIELA PÉREZ, J.A., "El Impuesto sobre Sucesiones y Donaciones y la Libre Circulación de Capitales", N º 6, *Quincena Fiscal*, 2015; FERNÁNDEZ ARRIBAS, G., y HERMOSIN ÁLVAREZ, M., "Los obstáculos de la regulación española sobre el impuesto de sucesiones y donaciones al ejercicio de las libertades fundamentales de la Unión Europea", *Revista de Derecho Comunitario Europeo*, Nº 49, 2014; FERNANDEZ ARRIBAS, G., y HERMOSIN ALVAREZ, M., "The taxation of cross-border profit transfers and its compatibility with European Law, with particular reference to Spain", *The EC Tax Journal*, vol. 15, 2015; FERNÁNDEZ JUNQUERA, M., "Acerca del

The first important point is that the ECJ confirmed Spain's breach of its obligations according to article 63 of the TFEU and article 40 of the European Economic Area Agreement, that prohibit restrictions on the free movement of capital. The Court did not, however, make reference to a breach of article 21 of the TFEU – the free movement of persons – which was also alleged by the Commission.

Specifically, "differences in the tax treatment of donations and inheritances between heirs and donees who are resident or non-resident in Spain, between deceased residents and non-residents in Spain, and between donations and similar dispositions of immovable assets located in the Spanish territory and outside Spanish territory". These differences in tax treatment are declared to be contrary to the principle of free movement of capital[27].

The fact that AC-approved fiscal benefits could not be enjoyed by persons resident in other countries constituted a clear infringement of the principle of free movement of capital. This is derived from established ECJ case-law[28].

The Commission considered it discriminatory that differences in tax treatment occurred depending on the place of residence or the country where the goods were located, and argued that this also prevented the free movement of persons. The ECJ, however, considered that the Commission had not shown how the Spanish legislation affected this freedom from being exercised, nor had it proved that there was a link between Spanish law and article 21 of the TFEU[29].

A second important point is that the Ruling does not directly refer to the AC regulation. The ECJ did not make direct reference to AC-approved regulations.

impuesto sobre sucesiones y donaciones, no residentes y tutela judicial", Nº 11, *Quincena Fiscal*, 2015; VAREA PERIS, S., "Devolución del impuesto de sucesiones y donaciones a los no residentes", *Diario La Ley*, Nº 8378, 2014.

27 Judgment in *European Commission v kingdom of Spain* EU:2014:2130, paragraph 84.

28 See, for instance, the Judgment of 11 December, *Barbier*, C-364/01, EU:C:2003:665; Judgment of 25 October 2007, *Geurts*, C-464/05, EU:C:2007:631; Judgment of 17 January 2008, *Jäger*, C-256/06, EU:C:2008:20; Judgment of 11 September 2008, *Eckelkamp*, C-11/07, EU:C:2008:489; Judgment of 11 September 2008, *Arens-Sikken*, C-43/07, EU:C:2008:490; Judgment of 12 February 2009, *Block*, C-67/08, EU:C:2009:92; Judgment of 22 April 2010, *Mattner*, C-510/08, EU:C:2010:216; Judgment of 10 February 2011, *Missionswerk*, C-25/10, EU:C:2011:65; Judgment of 31 March 2010, *Schröder*, C-450/09, EU:C:2011:198; Judgment of 15 September 2011, *Halley*, C-132/10, EU:C:2011:586; Judgment of 19 July 2012, *Scheunemann*, C-31/11, EU:C:2012:481; and Judgment of 17 October 2013, *Welte* EU:C:2013:662:446.

29 Judgment of 3 September 2014, *Commission v Kingdom of Spain*, C-127/12, EU:C:2014:2130, paragraph 55.

Instead, it made reference to State regulations, and more specifically, to the Assignment of Taxes Law 22/2009. Article 32 of this law, which is the provision that Spain needed to amend, contains the points of connection[30]. The Court's judgment indicates that the only matter in question is the criterion of connection determined by Spanish legislation, which allows the application of fiscal reductions in cases where the taxable persons reside, or when property is physically located, in ACs[31].

Thirdly, the Ruling does not suggest that the Spanish IGT law is discriminatory in itself. The discrimination occurs as a result of the tax system's configuration as a whole and of the decentralisation of the State, when combined with an international element. The ample powers yielded to the Autonomous Communities thus have the potential of breaching EU Law if they result in actions that harm the free movement of capital.

On the other hand, the ruling fails to recognise the non-resident's right to choose the applicable legal system or legislation that is most favourable. Further, it does not demand a uniform tax regime and tax burden throughout the nation.

Lastly, and most importantly, in our opinion, the ruling is not limited to non-resident taxable persons, that is, those with limited liability. The scope of the ruling should extend to any case of tax regime implementation where full State legislation is applied obligatorily, so without the taxpayer benefitting from AC-approved fiscal measures, because it is this element which damages the free movement of capital. Also, of great relevance, is that when the ruling refers to the freedom affected, it generally alludes to non-residents. However, there is no requirement that those non-residents must reside in a European Union or European Economic Area Member State[32]. Thus, any amendment to the tax system must take into consideration these matters in order to ensure full compliance with the ECJ pronouncement. It is, therefore, necessary to analyse the amendment implemented by the Spanish State.

30 Judgment of 3 September 2014, *Commission v Kingdom of Spain*, C-127/12, EU:C:2014:2130, paragraph 58.

31 Judgment of 3 September 2014, *Commission v Kingdom of Spain*, C-127/12, EU:C:2014:2130, paragraph 63.

32 That is, because the free movement of capital also applies to third countries.

## 5. Spain's amendment to its IGT legal regime following the ECJ ruling of 3rd September, 2014, *Commission v. Spain*, C-127/12

Implementing the Court's ruling is extremely complex since the breach of the free movement of capital contained in Article 63 of the TFEU is a result of the tax system's overall configuration in a decentralised country, and its effect on IGT.

Following the ECJ's pronouncement, the Spanish legislature acted almost immediately. It was decided that the IGT legal regime should not be overhauled completely, since this would mean modifying several different affected laws, including those affecting the funding of the Autonomous Communities and the ample powers that are granted to them.

Faced with this difficult dilemma, the reform attempted to put non-residents and residents of the Autonomous Communities on the same level through the third final provision of Law 26/2014 (27 November). Law 35/2006, of 28th November, the Tax on the Rent of the Physical People, was amended; the text of the Real Legislative Decree 5/2004 (5th March) Act for Income Tax on Non-residents was rewritten; amendments to other tax regulations were made; and a second additional provision was introduced into Law 29/1987, IGT, including five new points of connection.

### 5.1. Unlimited and limited tax liability (articles 6 and 7 of Spanish inheritance tax law (LISD)).

Since the points of connection were not restructured, the wording of articles 6 (which regulates unlimited tax liability) and 7 of the Spanish inheritance tax (LISD) (which regulates limited tax liability) was not amended. It is necessary to remember that, according to article 6 of the LISD, taxpayers with their habitual residence in Spain have unlimited tax liability, regardless of where the acquired goods and rights are located.

Article 6 of Law 29/1987 (18 December) on IGT declares that all those habitually resident in Spain are liable, regardless of the location of the assets or rights gained. According to article 7, anyone acquiring assets or rights that are situated, or are to be exercised or fulfilled on Spanish territory, are subject to limited taxation, 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.

Article 32 of Law 22/2009 (18 December), which regulates funding for Spain's Autonomous Communities and Autonomous Cities, and regulates certain tax laws, contains the scope for transfer of power and "points of connection" for IGT[33]. The Article also establishes that the Autonomous Community is given powers to rule on inheritance and gift matters. Points of connections are set out in order to appoint the Appropriate Autonomous Community. 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[34]. 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 that the tax becomes payable.

Consequently, the State Laws are being applied fully without the application any of the benefits approved by the different Autonomous Communities.

### 5.2. Points of connection defined in the second additional provision of Spanish inheritance tax (LISD)

The second additional provision of the LISD now contains five new points of connection which allow residents of the European Union or European Economic Area to apply the law of the AC with which they are most strongly connected.

However, the practical application of these points of connection presents numerous disadvantages and problems of interpretation.

#### 5.2.1. *Mortis causa* acquisitions where the deceased was resident in a European Union or European Economic Area Member State other than Spain

For *mortis causa* acquisitions, if the deceased was resident in an EU or European Economic Area Member State other than Spain, a main point of connection is established and a calculation or complementary rule is applied if the first does not come into play.

a. **Main point of connection:** To know which tax should be applied, the appropriate AC should be that where the greatest number of goods and rights in Spain are located. This point may be explained with the following example:

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33 These connection points determinate the fiscal links between non-residents, the taxable assets and the Autonomous Community.

34 Donations, which are lucrative acquisitions between living people.

**Example 1:** Deceased was resident in Germany and their heir/successor resides in Murcia (Spain). The greatest number of goods and rights in Spain are located in the Community of Madrid.

Unlimited tax liability. Appropriate AC, Community of Madrid. The Community of Madrid's regulations are to be applied.

b. **Calculation rule:** If none of the goods or rights are in Spain, the appropriate AC should be the one in which the taxable person resides. Thus, for example:

**Example 2:** Deceased was resident in Germany and their heir/successor resides in Murcia (Spain). The greatest number of goods and rights are located in Germany.

Unlimited tax liability. Appropriate AC, Community of Murcia. The Community of Murcia's regulations are to be applied.

In relation to the articulation of this new point of connection regarding what is prescribed in articles 6 and 7, it is not clear how to interpret the following example:

**Example 3:** Deceased was resident in Peru and their heir/successor resides in Valencia (Spain). Unlimited tax liability. State legislation is to be applied.

This example seems to fall outside the scope of this point of connection, which requires that the deceased was resident in an EU or European Economic Area Member State. Because the deceased was resident in a third country, a paradoxical example arises where it is not possible to apply regional tax benefits to a taxpayer resident in Spain.

5.2.2. *Mortis causa* acquisitions where the deceased was resident in a Spanish Autonomous Community and the taxpayers reside in a European Union or European Economic Area Member State

With the example of *mortis causa* acquisitions, if the deceased was resident in a Spanish AC and the taxpayers reside in a European Union or European Economic Area Member State, the LISD offers just one rule.

In this case, the appropriate AC should be the one in which the deceased resided.

This point of connection can be described according to the following example:

> **Example 4:** Deceased was resident in Galicia (Spain) and their heir/successor resides in France. Unlimited tax liability. Appropriate AC, Community of Galicia. The Community of Galicia's regulations are to be applied.

Regarding this second point of connection, it seems that the following example cannot be included in it either:

> **Example 5:** Deceased was resident in Murcia (Spain) and their heir/successor resides in China. Unlimited tax liability. State legislation is to be applied.
>
> By requiring that the taxpayer be resident in a European Union or European Economic Area Member State, the LISD cannot apply the AC regulations, even if the taxpayer is a Spanish national.

5.2.3. Gratuitous transfers *inter vivos* of property located in Spain by taxpayers resident in a European Union or European Economic Area Member State

With gratuitous transfers *inter vivos* of properties located in Spain by taxpayers resident in a European Union or European Economic Area Member State, the appropriate AC is that in which the asset is located.

This situation can be summarised with the following example:

> **Example 6:** A resident of Madrid (Spain) donates a building located in Aragón (Spain) to a beneficiary who is resident in Italy. Unlimited tax liability. Appropriate AC, Community of Aragón. The Community of Aragón's regulations are to be applied.

Again, it seems this point of connection would not include the following example in the potential application of any AC tax benefit:

> **Example 7:** A resident of Madrid (Spain) donates a property located in Madrid to their son (the beneficiary) who is resident in Canada. Limited tax liability. State legislation is to be applied.

Since the second additional disposition requires that the taxpayer should be resident in a European Union or European Economic Area Member State, the only legislation that can be applied to this lucrative transfer is that of the State, despite the fact the goods are in Spain and national taxpayers are involved. This example also falls clearly outside the scope of the next rule because it requires that the property be located in a European Union or European Economic Area Member State other than Spain and that the beneficiary be resident in Spain.

5.2.4. Gratuitous transfers *inter vivos* of property located in a European Union or European Economic Area Member State made by taxpayers resident in Spain

The second additional provision also offers a point of connection for gratuitous transfers *inter vivos* for property located in a European Union or European Economic Area Member State made by tax-payers resident in Spain. In this case, the appropriate AC should be the one in which the taxpayers reside.

> **Example 8:** A resident of Portugal donates a building located in Portugal to a beneficiary who is resident in Andalusia (Spain). Unlimited tax liability. Appropriate AC, Community of Andalusia. The Community of Andalusia's regulations are to be applied.

However, it seems the following example would not be covered by the new LISD criterion:

> **Example 9:** Taxpayer resident in Andalusia (Spain) receives the donation of a property located in Venezuela. Unlimited tax liability. State legislation is to be applied. Again, despite this being a case of unlimited liability, the taxpayer would not be able to benefit from fiscal measures approved by the AC of residence when acquiring a property located in a third country.

5.2.5. Gratuitous transfers *inter vivos* of movable goods located in Spain made by tax-payers resident in a European Union or European Economic Area Member State

With gratuitous transfers *inter vivos* of movable goods located in Spain by tax-payers resident in a European Union or European Economic Area Member State, the appropriate AC is that in which the movable goods have been located for the highest number of days during the previous five years.

> **Example 10:** A resident in Catalonia (Spain) donates shares of a company with its head office in Andalusia to a beneficiary who resides in Portugal. Limited tax liability. Appropriate AC, Community of Andalusia. The Community of Andalusia's regulations are to be applied.

In line with the previous examples, if the taxpayer is resident in a third country – for example Argentina – only State legislation would be applicable.

## 6. Summary tables

As can be deduced from the previous comments, the new legislation for points of connection is complex and presents ample opportunities for case studies.

The following table summarises *mortis causa* transfers with unlimited tax liability:

| ***MORTIS CAUSA*** **TRANSFERS** | | |
|---|---|---|
| **Unlimited tax liability (Residents of Spain)** | **Criteria** | **Applicable regulations** |
| | 1. Deceased was resident in Spain. | Those of the AC where the deceased was resident. |
| | 2. Deceased was resident in an EU or EEA Member State. | a. Those of the AC where the greatest number of goods and rights is located.<br>b. If there no goods and rights are located in Spain, the regulation of the AC where the heir or successor is resident is applicable. |
| | 3. Deceased was resident in a third country. | State regulation. |

For tax-payers subject to IGT with limited liability, the following points of connection would be applicable to *mortis causa* acquisitions.

| *MORTIS CAUSA* TRANSFERS | | |
|---|---|---|
| **Limited tax liability (Non-residents of Spain who acquire goods or rights located in Spain)** | **Criteria** | **Applicable regulations** |
| | 1.a. Heirs/successors are resident in the EU or EEA.<br>1.b. Deceased was resident in Spain. | Those of the AC where the deceased was resident. |
| | 2.a. Heirs/successors are resident in the EU or EEA.<br>2.b. Deceased was resident in the EU or EEA. | Those of the AC where the greatest number of goods and rights is located. |
| | 3.a. Heirs/successors are resident in the EU or EEA.<br>3.b. Deceased was resident in a third country. | State regulation. |
| | 4.a. Heirs/successors are resident in the UE or EEA.<br>4.b. Deceased was resident in Spain. | State regulation. |
| | 5.a. Heirs/successors are resident in a third country.<br>5.b. Deceased was resident in an EU or EEA Member State. | Those of the AC where the greatest number of goods and rights is located. |
| | 6.a. Heirs/successors are resident in a third country.<br>6.b. Deceased was resident in a third country. | State regulation. |

With gratuitous transfers *inter vivos* for tax-payers subject to unlimited liability, the following criteria are applicable.

| TRANSFERS ***INTER VIVOS*** | | |
|---|---|---|
| **Unlimited tax liability (Residents of Spain)** | **Criteria** | **Applicable regulations** |
| | Property located in Spain. | Those of the AC where the property is situated. |
| | Other goods and rights located in Spain. | Those of the AC where the taxable person is resident. |
| | Property located in the EU or EEA. | Those of the AC where the taxable person is resident. |
| | Other goods and rights located in the EU or EEA. | Those of the AC where the taxable person is resident. |
| | Property located in a third country. | State regulation. |
| | Other goods and rights located in a third country. | Those of the AC where the taxable person is resident. |

Lastly, where acquisitions *inter vivos* are implemented by non-residents, the applicable criteria and regulations are:

| TRANSFERS ***INTER VIVOS*** | | |
|---|---|---|
| **Limited tax liability (Non-residents of Spain acquiring goods or rights located in Spain)** | **Criteria** | **Applicable regulations** |
| | 1.a. Property.<br>1.b. Taxable person resident in the EU or EEA. | Those of the AC where the property is situated. |
| | 2.a. Other goods and rights.<br>2.b. Taxable person resident in the EU or EEA. | Those of the AC where they are located. |
| | 3.a. Property.<br>3.b. Taxable person is resident in a third country. | State regulation. |
| | 4.a. Other goods and rights.<br>4.b. Taxable person is resident in a third country. | State regulation. |

## 7. Incompatibility of inheritance and gift tax with the free movement of capital

Following the ECJ's ruling, it must be questioned whether the amendment made to the IGT regime still fails to respect the free movement of capital.

### 7.1. Inheritance as personal capital movements

The fact that IGT is not harmonised within the European Union has meant that the ECJ has encountered numerous conflicts. The Court has established a solid case-law relating to the application of EU principles and freedoms that affect the design of inheritance and gift taxes[35]. Several countries have had to review their internal legislation on gifts and inheritances in order to make it compatible with EU Law. Spain is one of the last countries to be affected by ECJ pronouncements on this subject.

However, the new points of connection adopted in Spain's IGT generate a number of questions.

Firstly, in order to determine whether national tax legislation is compatible with EU Law, it is necessary to refer to ECJ case-law. In this regard, the barriers to the exercise of EU freedoms are prohibited by the different rules regulating them, which the ECJ has recognised as having direct influence[36].

Secondly, the ECJ has acknowledged inheritances as "personal capital movements", "except in cases where its constituent elements are confined within a single Member State"[37]. In *Scheunemann*, Case C-31/11, the Court declared that -

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35 As rightly pointed out by Tom O´Shea: "The ECJ's jurisprudence in the area of inheritance taxes indicated that this is an area that the member states need to reconsider to ensure that their inheritance tax rules fully comply with the EU Law and do not restrict the fundamental freedoms guaranteed by the EC Treaty" (See Tom O'Shea, "*German Inheritance Tax Valuation Rules Incompatible With Free Movement of Capital, ECJ Says*", Tax Notes International, 5 Feb. 2008, p. 5).

36 LÓPEZ ESCUDERO, M. "El mercado interior: cuestiones generales", en LÓPEZ ESCUDERO, M y MARTÍN Y PÉREZ DE NANCLARES, J., *op. cit.*, p. 34; BARNARD, C. *The Substantive Law of the EU. The Four Freedoms,* op. cit., pp. 261-262; WEISS, F. y WOOLDRIDGE, F., *Free Movement of Persons within the European Community*, op. cit., 2007, p. 2. As already indicated by Tom O'Shea: "The inheritance tax rules of the EU member states can therefore have an impact on any of the fundamental freedoms, and any different treatment of EU nationals under such rules must be justified". See footnote 31 above.

37 Judgment of 12 February 2009, C-67/08, *Block*, EU:C:2009:92 paragraph 20.

> "It is also clear from the case-law of the Court that the tax treatment of inheritances falls, in principle, under article 63 TFEU on the free movement of capital". Also, "Inheritances consisting in the transfer to one or more persons of assets left by a deceased person, falling under heading XI of Annex I to Directive 88/361, which is entitled "personal capital movements", are movements of capital for the purposes of Article 63 TFEU" [38].

The ECJ specified again in *Halley* that inheritances constitute movements of capital "except in cases where their constituent elements are confined within a single Member State"[39]. Therefore, from the moment that a cross-border situation occurs involving an inheritance, the free movement of capital contained in article 63 of the TFEU is applicable[40]. 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, which are 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"[41].

At any rate, the ECJ uses the term restriction in its widest sense including "deterrent effect" or "obstacle"[42].

In Spain's current IGT legislation, applying AC-approved provisions, thereby exercising the regulatory powers these Autonomous Communities have been granted, entails a smaller IGT tax burden. In many cases, the tax payers enjoy

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38 Judgment of 19 July 2012, C-31/11, *Scheunemann*, EU:C:2012:481, paragraph 22.

39 Judgment of 15 September 2011, C-132/10, *Halley*, EU:C:2011:586, paragraph 19.

40 As Tom O'Shea has previously noted "if there is a cross-border dimension to the specific activity such as when the deceased resided in a member state and his heirs reside in another or when the assets are located in one member state and the heirs are resident in another, then the free movement of capital contained in article 63 of the TFEU applies and must be respected. This triggers different consequences for the national inheritance tax rules of the member states" ("*Belgian Inheritance Tax Rules Successfully Challenged Before the ECJ*", Tax Notes International, December 5, 2011, p. 723).

41 Judgment of 12 February 2009, C-67/08, *Block*, EU:C:2009:92, paragraph 24.

42 These terms are employed by the Commission in its reasoned opinion. See BARNARD, C. *The Substantive Law…*, op. cit., pp. 469-471. The ECJ defined the concept of restriction in the *Dassonville* Case: "All trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be regarded as measures having an effect equivalent to quantitative restrictions" (Judgment of 12 July 1974, C-8/74, *Dassonville*, EU:C:1974:82, paragraph 5).

fiscal benefits, amounting to as much as 99% in tax discounts and deductions. This fiscal decentralisation needs to avoid unwanted discrimination, since tax regulations can constitute a significant barrier to the free movement of capital, due to this principle having a very broad scope. However, as the previous discussion has shown, there continues to be many cases where the only option is to apply State legislation, without the taxpayer being able to benefit from considerable AC-approved fiscal benefits. Thus, it is necessary to determine if these differences in tax burden are justified in light of the TFEU freedoms and ECJ case-law. Except in justified, objective situations, Member States cannot treat non-resident heirs or deceased persons in a less favourable way since this would violate the free movement of capital[43]. However, Article 63 of the TFEU needs to be interpreted in light of the provisions contained in Article 65 TFEU which acknowledges that Member States can differentiate on grounds of the place of residence and place of investment, provided that they "shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments". Thus, cases where the ECJ ruled on the matter of non-justified discrimination on the grounds of residency and which would appear to constitute a barrier to the free movement of capital are particularly interesting. The first of these is the *Barbier* case[44], which was followed by the *Jäger* case[45]. As the ECJ indicated in *Barbier* - "a Community national cannot be deprived of the right to rely on the provisions of the Treaty on the ground that he is profiting from tax advantages which are legally provided by the rules in force in a Member State other than his State of residence"[46].

However, limits can be applied to the aforementioned freedom. Regarding the free movement of capital, the possibility of establishing such limitations is included in Article 65 TFEU[47].

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43 Article 63 TFEU: "1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited. 2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited".

44 Judgment of 11 December, *Barbier*, C-364/01, EU:C:2003:665, paragraph 62.

45 "The *Jäger* case is also interesting because of the Court's comments on the effects that inheritance tax rules have on the free movement of capital" (Tom O'Shea, "German Inheritance Tax Valuation Rules Incompatible With Free Movement of Capital, ECJ Says", *Tax Notes International*, 5 February, 2008, p. 5).

46 Judgment of 11 December, *Barbier*, C-364/01, EU:C:2003:665, paragraph 71.

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

## 7.2. Possible justification of tax treatment differences with regard to the free movement of capital

With regard to Spain's IGT and Article 63 of the TFEU, it is appropriate to ask whether this unequal treatment is justified. It is important to emphasise that, as the text of Article 63 of the TFEU expresses, this freedom also applies to operations with third countries. Although Article 63 TFEU does not refer to exchange of tax information, this freedom is applicable whenever there is an International Agreement on the exchange of tax information. This requirement comes from ECJ´s cases[48]. Nevertheless, the exercise of freedom of movement within the Community cannot be transposed in its entirety to movements of capital between Member States and third countries. Legislation such as that at issue in the main proceedings therefore entails a restriction of the movement of capital between Member States and third countries which, in principle, is prohibited by the TFEU. As the ECJ specified in the *A* case relations between the Member States take place against a common legal background, characterised by the existence of Community legislation[49]. To define the scope of this, it is necessary to distinguish between capital movements between Member States and those between Member States and third countries.

### 7.2.1. Member States

As observed by the ECJ, when a tax advantage is requested by a taxpayer, Member States can use instruments to obtain data needed for the correct tax application[50]. There is a framework for cooperation between the competent authorities of the Member States which does not always exist between those authorities and the competent authorities of a third country where the latter has given no undertaking of mutual assistance[51]. On 16 October 2014, Council Directive 77/799/EC was amended by Directive 2011/16/EU on Administrative Cooperation (DAC) in the field of direct

48 See Judgment of 18 December 2007, *A Case*, C-101/05, EU:C:2007:804.

49 Judgment of 18 December 2007, *A Case*, C-101/05, EU:C:2007:804: "that case-law, which relates to restrictions on the exercise of freedom of movement within the Community, cannot be transposed in its entirety to movements of capital between Member States and third countries, since such movements take place in a different legal context" (paragraph 60).

50 The ECJ declared that "a request by the tax authorities of a Member State for information concerning a body established in another Member State, in order to determine whether a gift made to that body can benefit from a tax advantage, is by no means outside the scope of Directive 77/799" (Judgment of 27 July 2009, *Persche*, C-318/07, EU:C:2009:33, paragraph 62).

51 Judgment of 18 December 2007, *A Case*, C-101/05, EU:C:2007:804, paragraph 61.

taxation between Member States[52]. The directive sets out to fulfil the Member States' growing need for mutual Assistance because of greater taxpayer mobility.

The requests for mutual assistance are not obligatory. It is up to each Member State to assess the specific cases where information is lacking[53]. As the ECJ indicated, Member States do not have to resort to the Mutual Assistance Directive

> "each time that the information provided by that donor is not sufficient to establish whether the recipient body fulfils the conditions laid down by the national legislation for the grant of tax advantages" (paragraph 64)[54].

The taxpayer must be given the option to produce the necessary documents in intra-EU situations like in the *ELISA case*[55]. Within the EU there is exchange of information so the tax authority could use that to verify the evidence produced by the taxpayer. In third country situations, it may not be possible to do this because there is no exchange of information.

Regarding the effectiveness of the Directives mentioned above and the problem of applying them to situations of IGT, the ECJ observed that

> "that difficulty cannot justify the categorical refusal to grant the tax benefits in question since the tax authorities could request the taxpayers concerned to provide…the evidence which the authorities consider necessary to be fully satisfied that those benefits are granted only where the jobs in question fulfil the criteria set out under national law"[56].

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52 Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC. This Directive was amended by the Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation. Mutual assistance in the field of direct taxation has been possible since 1977 in accordance with Council Directive 77/799/EC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation.

53 Judgment of 27 July 2009, *Persche*, C-318/07, EU:C:2009:33, paragraph 65.

54 As Tom O'Shea has pointed out: "The Court underlined that the word "may" in article 2 of the Directive 77/799 indicated that the request for mutual assistance was not an obligation on the part of the member states" ("Belgian Inheritance Tax Rules Breach EU Law", *Tax Notes International*, April, 2011, p. 220).

55 Judgment of 11 October 2007, *ELISA*, C-451/05, EU:C:2007:594.

56 Judgment of 25 October 2007, *Geurts*, C-464/05, EU:C:2007: 631.

In *Olivier Halley, Julie Halley* and *Marie Halley v. The Belgian State*, C-132/10, regarding the effectiveness of tax supervision, the ECJ indicated that "the mere fact that the taxable items concerned are located in another Member State does not justify the general application of an additional recovery period which is in no way based on the time needed to have effective recourse to those mechanisms of mutual assistance"[57].

Any unequal treatment must therefore be justified, otherwise it would go against the free movement of capital. The ECJ has observed this on several occasions, for example in *Jäger* which concerned German legislation, the Court highlighted that it was "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 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"[58].

### 7.2.2. Third countries

The ECJ has also had the opportunity to make pronouncements on the granting of tax benefits affecting third countries[59].

One such example is the *Persche* case[60], where in relation to charitable bodies established in non-member countries, the Court noted that the taxing Member State was authorised to deny the granting of the tax advantage if it were not possible to obtain the necessary data from that country, in cases where the third country has not entered into any contracted treaty obligation to provide information[61]. In addition, in the subsequent *Welte* case, the Court ruled that Germany's inheritance tax legislation was contrary to the free movement of capital since it made a

57 Judgment of 15 September 2011, *Halley*, C-132/10, EU:C:2011:586, paragraph 36.

58 Judgment of 17 January 2008, *Jäger*, C-256/06, EU:C:2008:20, paragraph 44.

59 It is clear that "when the principle of free movement of capital was extended, pursuant to Article 56(1) EC, to movements of capital between third countries and the Member States, the latter chose to enshrine that principle in that article and in the same terms for movements of capital within the Community and those relating to relations with third countries" (Court´s reasoning in Judgment of 12 December 2006, *FII GLO*, C-446/04, EU:C:2006:774, paragraph 166).

60 Member States have the prerogative of determining what constitutes a charitable activity as part of their power but the different rules from one Member State to the next does not mean that charitable bodies across the EU are not in a "comparable situation" (Judgment of 27 July 2009, *Persche*, C-318/07, EU:C:2009:33).

61 Judgment of 27 July 2009, *Persche*, C-318/07, EU:C:2009:33, paragraph 70.

distinction between non-residents and residents of third countries[62]. In this regard, the *Welte* ruling stated that -

> "articles 56 EC and 58 EC must be interpreted as precluding legislation of a Member State relating to the calculation of inheritance tax which provides that, in the event of inheritance of immovable property in that State, in a case where, as in the main proceedings, the deceased and the heir had a permanent residence in a third country, such as the Swiss Confederation, at the time of the death, the tax-free allowance is less than the allowance which would have been applied if at least one of them had been resident in that member State at that time"[63].

The ECJ was stricter with respect to taxpayers in the *A* case[64]:

> "*However, that case-law, which relates to restrictions of the exercise of freedom of movement within the Community, cannot be transposed in its entirety to movements of capital between Member States and third countries since such movements take place in a different legal context*"[65].

In this decision, the ECJ made clear that –

> "where the legislation of a Member State makes the grant of a tax advantage dependent on satisfying requirements, compliance with which can be verified only by obtaining information from the competent authorities of a third country, it is, in principle, legitimate for that Member State to refuse to grant that advantage if, in particular, because that third country is not under any

62 As observed by HERRERA MOLINA, the ECJ's *Welte* ruling protects the free movement of capital of a third country resident but does not consider it justified to restrict this freedom either under the principle of coherence, or in the necessity to safeguard fiscal controls (P.M HERRERA MOLINA., "*Welte* ECJ Ruling: "El fin de las reducciones y beneficios fiscales autonómicos en el Impuesto sobre Sucesiones? (The end of regional tax reductions and benefits on inheritance tax?", *ECJ Leading Cases, UNED*, 2013).

63 Judgment of 17 October 2013, *Welte* EU:C:2013:662:446, paragraph 68.

64 Judgment of 18 December 2007, *A Case*, C-101/05, EU:C:2007:804, paragraphs 60 et seq.

65 The ECJ established that "relations between Member States take place against a common legal background, characterized by the existence of Community legislation, such a Directive 77/799 which laid down reciprocal obligations of mutual assistance. Even if, in the fields governed by that Directive, the obligation to provide assistance is not unlimited, the fact remains that that directive established a framework for cooperation between the competent authorities of a third country where the latter has given no undertaking of mutual assistance" (Judgment of 18 December 2007, *A Case*, C-101/05, EU:C:2007:804, paragraph 60).

> contractual obligation to provide information, it proves impossible to obtain that information from that country"[66].

Nevertheless, in intra-EU situations, the ECJ accepted different justifications in *ELISA* and indicated that there is no reason why

> "the tax authorities concerned should not request from the taxpayer the evidence that they consider they need to effect a correct assessment of the taxes and duties concerned and, where appropriate, refuse the exemption applied for if that evidence is not supplied"[67].

As observed by the ECJ, the taxpayer should not be excluded a priori from providing relevant documentary evidence enabling the tax authorities of the Member State imposing the tax to ascertain, clearly and precisely, that he is not attempting to avoid or evade the payment of taxes[68].

Having reviewed the ECJ cases, the Spanish legislation in this area must be considered.

The different situations that fall within the scope of the new points of connection expressed by the LISD, following the ECJ ruling on Spain, have been exposed. However, these provisions seem incompatible with the free movement of capital (article 63 TFEU) and with established case-law on inheritance tax and this fundamental freedom.

Firstly, the free movement of capital with third countries has different justifications[69]. There are no objective situations justifying the non-application of AC-approved fiscal advantages to gratuitous transfers between third countries and a Member State. The ECJ ruling of 3 September 2014 *Commission v. Spain*, C-127/12, found that the Spanish tax legislation amounted to a restriction on the free movement of capital in

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66 The ECJ stated in Judgment of 28 October 2010, *Rimbaud*, C-72/09, EU:C:2010:645, paragraph 41, that "the framework established by Directive 77/799 for cooperation between the competent authorities of the Member States does not exist between those authorities and the competent authorities of a non-member State where that State has not entered into any undertaking of mutual assistance".

67 Judgment of 11 October 2007, *ELISA*, C-451/05, EU:C:2007:594, paragraph 95.

68 See Judgment of 11 October 2007, *ELISA*, C-451/05, EU:C:2007:594 paragraph 96; Judgment of 8 July 1999, *Baxter*, C-254/97, EU:C:1999:368, paragraphs 19 and 20; Judgment of 10 March 2005, *Fournier*, C-39/04, EU:C:2005:161, paragraph 25.

69 See Tom O'Shea, "Third Cap GLO and Third Country Rights: Which Freedom Applies?", *Tax Notes Int'l*, Apr. 23, 2007, p. 371).

relation to the tax treatment for "non-residents" and the donation of goods "located outside Spain"[70]. Nowhere does the ruling establish that non-residents must reside within the EU or the EEA, or that the goods outside Spain must be located within the EU or the EEA. Nevertheless, it is this line that has been followed in the LISD's new additional provision.

When configuring the points of connection, it is important to bear in mind the difference between unequal treatment on the grounds of residence permitted by article 65 of the TFEU, and arbitrary discrimination, which is prohibited by Article 65(3) TFEU. To ensure compatibility with the Treaty, differences in tax treatment are only acceptable if they apply to situations which are not comparable with each other or else are justified by a mandatory reason in the general interest. But a non-resident who is in a situation that is comparable to a resident has the right to equal tax treatment in the host Member State when a fundamental freedom is exercised. This comparison is of the utmost importance.

Whereas that Spanish Law continues to consider heirs and beneficiaries as taxable persons subject to IGT whether they are resident or not, there is no objective difference in situation justifying the different tax treatment of a resident and a non-resident. The ECJ has already made this comparison on other occasions, pointing out that

> "the cost of acquisition is directly linked to the payment made on the occasion of a share repurchase so that, in this regard, residents and non-residents are in a comparable situation. There is no objective difference between the two situations such as to justify different treatment on this point as between the two categories of taxpayers"[71].

In addition, the Spanish tax administration can currently obtain the necessary information in order to be able to apply regional tax benefits to residents of third countries, not through International Agreements on IGT, but by means of exchange of information agreements and tax treaties and the taxpayer can supply the information. However, in relation to the information that the taxpayer can supply, it is necessary to make a distinction between intra-EU and third country situations. In this context the Court had stated in *ELISA* case that the taxpayer should not be excluded a priori from providing relevant documentary evidence because

70 Judgment of 3 September 2014, *Commission* v *Kingdom of Spain*, C-127/12, EU:C:2014:2130.

71 of 19 January 2006, *Bouanich*, C-265/04, EU: C:2006: 51, paragraph 40.

he is not attempting to evade the payment of taxes[72]. The taxpayer may be able to supply information and documents involved in third countries situations but the tax authority may not be able to verify them in situations where there is no tax treaty or exchange of information provision applicable. As the ECJ has ruled[73], if –

> "the legislation of a Member State makes the grant of a tax advantage dependent on satisfying requirements, compliance with which can be verified only by obtaining information from the competent authorities of a third country, it is, in principle, legitimate for that Member State to refuse to grant that advantage if, in particular, because that third country is not under any contractual obligation to provide information, it proves impossible to obtain such information from that country"[74].

Therefore, perhaps with the exception of tax havens, there is nothing to justify this differential treatment[75].

### 7.3. Difference in tax treatment in cases of unlimited liability

Inequalities also occur in cases of unlimited tax liability, where Spanish residents are required to pay tax in accordance with State legislation, without benefitting from advantages approved by their AC of residence – and, therefore, receive less favourable fiscal treatment than that of a resident of an EU or EEA Member State. The need to amend the points of connection is therefore urgently required. In our opinion, this discrimination towards Spanish residents is not justified.

The ECJ accepted in the *Van Hilten* ruling[76] that in certain cases "reverse discrimination" is permitted in scenarios where a Member State treats its own nationals less favourably with regard to IGT[77]. It emphasised that –

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72 Judgment of 11 October 2007, *ELISA*, C-451/05, EU:C:2007:594, paragraph 100.

73 The ECJ stated that "with regard to the documentary evidence which the taxpayer may provide to enable the tax authorities to ascertain whether the requirements under national legislation are satisfied, the Community harmonisation measures on company accounts which apply in the Member States allow the taxpayer to produce reliable and verifiable evidence on the structure or activities of a company established in another Member State, whereas the taxpayer is not ensured of such an opportunity in the case of a company established in a third country which is not required to apply those Community measures" (Judgment of 18 December 2007, *A Case*, C-101/05, EU:C:2007:804, paragraph 63).

74 Judgment of 18 December 2007, *A Case*, C-101/05, EU:C:2007:804, paragraph 63.

75 See Tom O'Shea, "Swedish Tax Treatment of Third-Country Dividends", *Worldwide Tax Daily*, 2008, p. 5.

76 Judgment of 23 February 2006, *Van Hilten*, C-513/03, EU:C:2006:131.

> "such distinctions, for the purposes of allocating powers of taxation, cannot be regarded as constituting discrimination"[78].

However, this jurisprudence is not applicable to the Spanish situation since the criterion of nationality is not used by the legislation that sets down the criterion for fiscal residence. The Spanish IGT legislation at issue generates less favourable tax treatment for Spanish residents compared to residents of other EU Member States in similar situations, which seems unjustified from any point of view.

## 8. Final considerations

Given the high number of conflicts regarding EU Law and IGT that the ECJ has been faced with, a solid case-law has been established on the subject.

The free movement of capital within the EU and the movements of capital between Member States and third countries take place in different legal contexts. So, restrictions of the exercise of freedom of movement cannot be understood in their entirety in the same way in relations with third countries.

It has been argued that Spain's new IGT regulations continue to disrespect the fundamental freedoms. The free movement of capital with third countries creates the most restrictions. There are no objective situations justifying the non-application of AC-approved fiscal advantages to gratuitous transfers between third countries and a Member State.

The Spanish tax administration can currently obtain the necessary information in order to be able to apply regional tax benefits to residents of third countries too. Possibly with the exception of tax havens, there is nothing to justify this differential treatment.

In addition, these inequalities also occur in cases of unlimited tax liability, where Spanish residents are required to pay tax in accordance with State legislation, without benefitting from advantages approved by their AC of residence and, therefore, receive less favourable fiscal treatment than an EU or EEA Member

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77 It was noted that "Van Hilten demonstrates that reverse discrimination is possible in an EU setting because a member state is entitled to treat its own nationals less favourably from a taxation point of view than the nationals of other member states who exercise their EU law rights in relation to its territory", Tom O'Shea "German Inheritance Tax Valuation Rules Incompatible With Free Movement of Capital, ECJ Says", *Tax Notes International*, 5 February, 2008, p. 6).

78 Judgment of 23 February 2006, *Van Hilten*, C-513/03, EU:C:2006:131, paragraph 47.

State resident. The need to modify the points of connection is therefore urgently required.

The moment seems to have arrived for a detailed plan for the reform of IGT in Spain. Without this, the Spanish State may find itself subject to another European Union infraction procedure. This is because the restructuring of the points of connection that was implemented after the ECJ ruling in *Commission v. Spain*, C-127/12 is not in line with EU law.