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# **Is the Spanish Inheritance and Gift Tax incompatible with the free movement of workers and capital?**

## **The reasoned opinion of the EU Commission IP/10/513**

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## 1. Introduction

The aim of my speech is answering to the question if the Spanish Inheritance and Gift Tax is incompatible with the free movement of workers and capital. We are going to pay special attention to the European Commission's request to Spain to change its Inheritance and Gift Tax provisions for Non-Residents or Assets held abroad.

In order to answer to the question mentioned above five points will be explained. At first place I am going to describe the infringement procedure established in the Article 258 that the EU Commission can follow when a Member State doesn't comply with Community Law. At second place, we are going to explain what is the content of the EU Commission delivered on 5<sup>th</sup> of may 2010 regarding the spanish Inheritance and Gift Tax. Then, we will analyse what establishes the Community Law regarding the freedom of workers and capital and how they are understood by the EU Court of Justice in similar cases. Finally, we are going to provide possible amendments that Spain could undertake.

## 2. Infringement procedure under Article 258 TFEU

If the Commission considers that a Member State has failed to fulfil an obligation under Treaties, it can follow the infringements procedure under Article 258 of the TFEU (Treaty on the Functioning of the European Union). This procedure has 3 stages:

- 1) **Formal notice:** the 1<sup>st</sup> stage takes the form of a formal request for information in order to investigate the case and it remains confidential.
- 2) **Reasoned opinion:** the Commission generally issues a press release informing the public about the procedure. If the State concerned doesn't comply with the opinion within a period of 2 months, the Commission may bring the matter before the Court of Justice of the European Union.



- 3) **Referral to the Court of Justice of the European Union** → The resolution is binding. If the State doesn't fulfil the commitment, the Commission will be able to refer to the Court for the 2<sup>nd</sup> time in order to impose an economic sanction.

\* In exceptional cases of particular importance to citizens, the Commission may decide to issue a press release also at the *formal notice* stage or even without a specific infringement procedure.

On 5<sup>th</sup> may of 2010 the European Commission has requested Spain to change its legislation on Inheritance and Gift Taxes because some provisions constitute an obstacle to free movement of workers and capital.

The request takes the form of a reasoned opinion (the 2<sup>nd</sup> step of the infringement procedure provided for in the Article 258). If there is no satisfactory reaction to the reasoned opinion within 2 months, the Commission may decide to refer the case to the Court of Justice of the European Union.

*Article 258 TFEU*  
(ex Article 226 TEC)

If the Commission considers that a Member State has failed to fulfil an obligation under the Treaties, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations.

If the State concerned does not comply with the opinion within the period laid down by the Commission, the latter may bring the matter before the Court of Justice of the European Union.



### 3. Inheritance and Gift Tax in Spain

Spain is politically organised in a central government and 17 autonomous communities. The central legislation is applicable throughout Spain except in the Autonomous Communities of the Basque Country and Navarre (which have their own legislation). In addition, the Autonomous Communities have certain legislative powers subject to certain conditions and requirement specified in the central legislation.



So, in Spain three legislations can be applied to the Inheritance and Gift Tax:

- central legislation
- central legislation modified by the Autonomous Communities that have exercised their legislative powers in respect of this tax
- the legislation of the Autonomous Communities of the Basque Country's counties (Vizcaya, Guipuzcoa and Alava) and Navarre.

Most of the Autonomous Communities have exercised these legislative powers, effectively reducing the Inheritance Tax burden borne by taxpayers in these regions. The decrease of the tax burden is done through: increasing the allowances established by the central legislation, creating their own allowances that are determined by keeping the location of an



asset or activity in the region during a certain time or by deductions and bonifications applied only to the residents.

Meanwhile, central legislation will be the only applicable when:

- the testator is Non-Resident
- the only property transferred is located abroad
- in the autonomous cities of Ceuta y Melilla

The practical result of the tax decentralisation in Spain is that this situation gives rise to differences in the tax burden borne by taxpayers, depending on which legislation applies.

The tax burden under central legislation applicable to the Non-Residents or assets located abroad is much higher than the one applicable to the residents. So, the tax decentralisation has had the effect of discriminating against those taxpayers who can not benefit from the more favourable taxation regimes owing to the geographical location.

#### **4. The principle of Non-Discrimination in the EU**

Article 12 of the TEC (Treaty establishing the European Community) establishes the prohibition of any discrimination based on nationality. This provision is also applied to discriminations on grounds of residence. This means that the EU members cannot treat to the Non-Residents in a disfavoured way in comparable situations without a valid justification.

Inheritance and Gifts Taxes are relevant for the freedom of movement of capital because legislations generally shouldn't treat differently to taxpayers depending on where the capital is invested. Direct taxation is also relevant for the freedom of movement of workers in regard of the taxpayer's place of residence. These freedoms are established in the articles 45 and 63 of the Treaty on the Functioning of the European Union, respectively.

When thinking about the legislative powers of the Member states we have to consider that the art. 65.1 TFEU establishes the right to apply tax provisions that distinguish between



taxpayers residents and Non-Residents when they are not in the same situation. However according to the art. 65.3 this procedure shouldn't constitute a mean of arbitrary discrimination or a restriction on the free movement of capital.

The conclusion under TFEU is the following:

*“No discrimination or restriction of free movement of capital is allowed if the situation between residents and Non-Residents is comparable; however a tax provision in this sense is allowed when there is an appropriate justification”.*

*Article 45 TFEU*

(ex Article 39 TEC)

1. Freedom of movement for workers shall be secured within the Union.
2. Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment.

*Article 63 TFEU*

(ex Article 56 TEC)

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.

*Article 65 TFEU*

(ex Article 58 TEC)

1. The provisions of Article 63 shall be without prejudice to the right of Member States:
  - (a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;
3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63.



## **5. The jurisprudence of the Court of Justice of the European Union**

We consider important to underline four main statements made by the EU Court:

- a) Direct taxation, without prejudice to the right of Member States to establish their own legislation, shouldn't fail to comply with Community Law (**Case Manninen**).
- b) Inheritances are considered as movement of capitals unless the goods are located only in one State (**Case van Hilten-van del Heijden**).
- c) The right of Member States to apply provisions which distinguish between resident and non-resident taxpayers must be understood in a restrictive way. It will be allowed only when the measures and procedures don't constitute a mean of discrimination or restriction on the free movement (**Case Manninen**).
- d) The measures and procedures that distinguish between resident and non-resident taxpayers must affect not comparable situations or must be justified by reasons of general interest (**Case Verkooijen, Manninen or Hollamann**).

## **6. Possible solutions**

Regarding the possible solutions at first place we have to point out that it is not a problem of double taxation, but of discrimination between Residents and Non-Residents. So the promotion of Multilateral agreements wouldn't be the solution.

In order to comply with the Reasoned Opinion of the EU Commission Spain must act at an internal level. Therefore, we have thought about 2 possible amendments:

- 1) The first one would consist in applying to the Non-Residents all the favourable conditions established by the Autonomous Communities.



However, this solution is not possible because there would be cases where it is not possible to link the Non-Resident to a particular Autonomous Communities.

There is not a territory connection in the investment of capital in cases such as: public debt, bonds, etc.

- 2) The second solution we have considered is concentrating all the legislative power in the State by banning all the legislative powers of the Autonomous Communities

So only the central legislation would be applied to both residents and Non-Residents avoiding the existing discrimination.