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EUROPEAN JUSTICE RULES THAT SPANISH TAX REGULATION VIA "FORM 720" VIOLATES THE EUROPEAN FREE MOVEMENT OF CAPITAL

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Abstract. *This study analyses the Judgement of the Court of Justice of the European Union (CJEU) of 27 January 2022, case C-788/19, resolving the appeal presented by the European Commission against the Kingdom of Spain which considers that the regulations governing the obligation of residents in Spain to declare assets and rights located abroad via "Form 720", and the general rules on penalties for non-compliance with that obligation, represent a restriction of the free movement of capital, and consequently violate European law. The European Court upholds the appeal and annuls the contested rulings. Based on this judgement, the study also analyses its effects on Spanish national law and on the taxpayers affected.*

Keywords: *tax regulation, declaration, assets, abroad, "Form 720", European law, CJEU.*

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Introduction

Spanish Law 7/2012, of 29 October, amending the regulations on taxes and budgets, and adapting financial regulations for intensified activities to prevent and combat fraud, amended the 18th Additional Provision (AP) of Spanish General Tax Law 58/2003 of 17 December (GTL), introducing the obligation for Spanish residents to provide information on their assets of any kind located abroad. It also decreed that there would be no limitation period for actions not known to the Spanish tax authority, which it became aware of later, and approved a regime of penalties for those failing to comply with this obligation. For formal compliance with the obligation to provide information, the information return "Form 720" was created for Spanish residents to report their foreign assets and rights.

The European Commission presented an appeal to the Court of Justice of the European Union (CJEU) with the complaint that the Kingdom of Spain was in breach of its obligations pursuant to Articles 21, 45, 49, 56 and 63 of the Treaty on the Functioning of the European Union (TFEU), and to Articles 28, 31, 36 and 40 of the European Economic Area (EEA) Agreement, due to the consequences stipulated in the new national law for failure to comply with the mandatory reporting of foreign assets and rights via "Form 720". According to the Commission, the disputed regulation, without any equivalent applicable to Spanish residents' assets and rights located in Spain, established restrictions on the free movement of capital insofar as its effect would be to disincentivise transferring their assets abroad. Thus, in their opinion, there should not be any difference in the treatment of taxpayers resident in Spain because their assets are located inside or outside Spanish territory.

In the Judgement issued on 27 January 2022, the European court upheld the Commission's allegations and deemed that:

1. Although national legislation may establish a longer limitation period in order to guarantee the effectiveness of fiscal controls and combat tax fraud and evasion arising from concealing foreign assets, the fundamental requirement of legal certainty is opposed to governments making indefinite use of their authority to end an illegal situation, such that the legislation's choice not to have a limitation period goes beyond what is needed for such guarantees.

2. By penalising taxpayers' breaches of their obligations to report their foreign assets and rights more severely than if the assets and rights were in Spain, with a proportional fine of 150% the amount of the tax settlement and the possible addition of flat-rate fines, Spanish legislation disproportionately undermines the free movement of capital for Spanish residents.

Therefore, the CJEU states that the Kingdom of Spain has breached the rulings of the TFEU by denying Spanish taxpayers affected by these regulations, in practice, the option of relying on the general principle of the limitation period, and by applying more severe and disproportionate penalties to a failure to report assets. For these reasons, it considers this to discriminate against Spanish residents with foreign assets, which means a restriction on the free movement of capital within the territory of the European Union (EU).

Based on analysis of this judgement, our study examines:

1. The legality of the obligation to report foreign assets using "Form 720".
2. Changes to the legislation based on the analysed judgement.
3. The validity of actions, settlements and penalties based on assets reported using "Form 720" before this judgement was issued.
4. The options for reimbursement of debts and penalties already paid.

1. The CJEU Judgement to be analysed

On 1 August 2017 the European Commission presented to the CJEU an appeal against the Kingdom of Spain, case C-788/19, deeming it to have failed to fulfil its obligations under Articles 21, 45, 49, 56 and 63 of the TFEU, and Articles 28, 31, 36 and 40 of the EEA Agreement, due to the penalties applied in Spanish law to non-compliance, faulty compliance or late compliance with the obligation to report assets and rights located abroad using "Form 720". Basically, the Commission considers this to violate Spanish residents' right to free movement of capital (https://curia.europa.eu/juris/liste.jsf?language=en&td=ALL&num=C-788/19).

As a result of this disputed national law, Spanish residents who fail to report their assets and rights held abroad using "Form 720", or whose reports are incomplete or submitted late, are liable for regularisation of the tax they owe in amounts corresponding to the value of those assets and rights, even when they were acquired before the limitation period, and for more severe fines from the application of a specific penalty regime.

According to the Judgement of 27 January 2022, the obligation to report assets or rights located abroad using "Form 720", and the penalties incurred by non-compliance, faulty compliance or late compliance with this obligation, which has no equivalent for assets and rights located in Spain, establishes different treatment for Spanish residents depending on the location of their assets. This obligation may deter such residents from investing in other Member States, stop them from doing so, or limit their options for doing so, thus constituting a restriction on the free movement of capital as defined in Article 63.1 of the TFEU and Article 40 of the EEA Agreement.

Also, the CJEU states in this case that the fact that that legislation is aimed at taxpayers who conceal their assets for tax reasons is not such as to call that conclusion into question. The fact that legislation aims to guarantee the effectiveness of fiscal supervision and to prevent tax evasion cannot preclude a finding that there is a restriction on the movement of capital. Those objectives are only among the overriding reasons in the public interest capable of justifying the imposition of such a restriction, but a law which presumes fraudulent behaviour merely because the required circumstances happen to exist, without allowing the taxpayer any option to refute this presumption, goes beyond what is necessary to combat tax fraud and evasion, and comes into conflict with European law.

2. The disputed national law

2.1. The "Form 720" regime

The "Form 720" regime was established by the 18th additional provision of Spanish General Tax Law 58/2003 of 17 December 2003, as amended by Spanish Law 7/2012 of 29 October, amending tax and budget regulations and adapting financial regulations for more intensive actions to prevent and combat fraud.

According to this additional provision, taxable persons are required to provide the tax authorities, under the conditions laid down by regulation, with the following information:

a) Information relating to accounts situated abroad, opened with institutions which carry out banking or credit activities, of which the persons concerned are holders or beneficiaries, or in respect of which they hold, in any form, an authorisation or a right of disposal.

b) Information relating to all securities, assets, stocks or rights representing the share capital, equity or assets of any type of entity, or concerning the transfer of equity to third parties, of which the persons concerned are holders and which are deposited or situated abroad, as well as information relating to the life or invalidity insurance policies of which they are the holders and to life or temporary annuities of which they are beneficiaries following a transfer of cash capital, or even information on movable or immovable property acquired from entities established abroad.

c) Information relating to immovable property and rights in immovable property situated abroad which they own.

Consequently, taxable persons must report all assets and rights which they are required to declare for tax purposes, using a single form. This is understood to mean that individuals liable for the Spanish Personal Income Tax (IRPF); legal entities liable for the Spanish Corporate Tax (IS); permanent establishments in Spain belonging to non-resident persons or entities; and the entities governed by Article 35.4 of the GTL which own or have right of disposal over foreign assets and rights, must all present an information return using "Form 720".

The "Form 720" legal regime has come under a great deal of criticism in legal scholarship. For example, López López (2013) considers that while the goal of requiring reporting of foreign assets and rights is praiseworthy, the provisions regulating this clearly restrict taxpayers' rights and guarantees, in violation of EC law. Falcón Y Tella (2013) also understands that the obligation to report foreign assets and rights is so broad and the penalty regime so severe that it represents a major obstacle and a restriction on the free movement of people and capital, and has a clearly deterrent effect on foreign investments. Sánchez Pedroche (2016) considers that the lack of a limitation period for the IRPF and IS introduced by Law 7/2012 of 29 October 2012 is absolutely retroactive and would go against European law. Zapata García (2018) states that "Form 720" reporting is justified by the Spanish government as a measure established to combat tax fraud, and could be understood as such in general terms, but if one analyses the consequences of a formal error in its presentation, or a late submission, the intention seems closer to a tax grab than combating fraud. Alonso González (2019) also questions the penalty regime of "Form 720", first because of the lack of an explicit mandate in the law, and then because there is no causal relationship between the action (or non-compliance) and the result, a minimum requirement for demanding responsibility. And Fayos Cobos and Tanco (2015) points out that if the information return is presented late, incomplete, or with incorrect data, this represents two breaches of the 18th AP of the GTL and the 1st AP of Law 7/2021, violating the principles of non-concurrence and of proportionality.

2.2. No limitation period

In the scenarios where the "Form 720" regime is applied, the amendments affecting the Spanish Personal Income Tax Law 35/2006, of 28 November 2006 (IRPFL), and Corporate Tax Law 27/2014, of 27 November 2014 (ISL) introduced by Law 7/2012 results in the removal of the limitation period. More specifically, based on that amendment Article 39 of the IRPFL on unjustified capital gains rules that (Fernández Caballero, 2022):

a) "Assets or rights the possession, declaration, or acquisition of which does not correspond to income or capital declared by the taxpayer, and the entry of non-existent debts in a declaration in respect of this tax or wealth tax, or their entry in official books or registers shall be regarded as unjustified capital gains. Unjustified capital gains shall be included in the general taxable amount for the tax period in which they were discovered, unless the taxpayer demonstrates that he or she acquired ownership of the rights or assets in question during a prescribed period.

b) In any event, the possession, declaration or acquisition of assets or rights for which the obligation to provide information referred to in the 18th additional provision of the GTL has not been complied with within the prescribed period shall be treated as unjustified capital gains and included in the general taxable amount for the earliest tax year which has not yet become time-barred and may still be regularised. However, the provisions of this paragraph shall not apply if the taxpayer provides proof that the assets or rights held by him or her were acquired by means of declared income or income obtained in tax years for which he or she was not liable to that tax."

Meanwhile, Article 121 of the ISL, on the presumption of income from unaccounted for or undeclared assets and rights, provides:

1. "Assets held by the taxpayer which are not entered in his or her accounts are presumed to have been acquired by means of undeclared income. That presumption also exists in the case of partial concealment of the acquisition value.

2. Assets not entered in the accounts are presumed to belong to the taxpayer where he or she is in possession of them.

3. The amount of undeclared income is presumed to be equal to the acquisition value of the assets or rights not entered in the accounts, minus the amount of actual debts incurred to finance that acquisition, which are also not entered in the accounts. The net amount may not be negative under any circumstances. The amount of the acquisition value shall be checked against the relevant supporting documents or, if this is not possible, against the valuation rules laid down in the GTL.

4. There is a presumption of undeclared income where non-existent debts are entered in the taxpayer's accounts.

5. The amount of income established on the basis of the abovementioned presumptions shall be attached to the earliest tax year which has not yet become time-barred, unless the taxpayer demonstrates that it corresponds to one or more other tax years.

6. In any event, assets or rights in respect of which the obligation to provide information referred to in the 18th additional provision of the GTL has not been complied with within the prescribed period shall be regarded as having been obtained by means of undeclared income attached to the earliest tax year which has not yet become time-barred and may still be regularised. However, the provisions of this paragraph shall not apply if the taxpayer provides proof that the assets or rights held by him or her were acquired by means of declared income or income obtained in tax years for which he or she was not liable to that tax.

The general principle of the limitation period on taxes is established in Article 66 of the GTL, which sets the limitation period on the right of the Administration to determine and require payment of tax debt at four years from the expiry of the voluntary declaration or settlement period; and in Article 189 of the GTL, which also sets the limitation period for imposing tax penalties at four years from the time at which the corresponding non-compliance occurred. In contrast, in the application of Articles 39 of the IRPFL and 121 of the ISL, after their amendment by Law 7/2012, in practice there is no limitation period on the right of the Administration to regularise and penalise non-compliance with the obligation to report using "Form 720", given that the undeclared assets and rights are always attributed to the earliest tax year within the limitation period, such that the non-compliance will also be understood to have occurred within the four-year limitation period. For these reasons, the regulation of both taxes, in relation to the obligation to declare assets and rights located abroad, violates the general principle of a tax limitation period, set at four years, and grants the tax authority the power to regularise and penalise in such case without any time limits.

However, the requirement of legal certainty precludes public authorities being able to use indefinitely their power to end an illegal situation (Alarcón García, 2016). In this case, the Spanish tax authority may act without time limits and may ignore a limitation period which has already expired, simply because a taxpayer fails to comply with the formality of providing information on their foreign assets or rights by a given deadline. By attributing such serious consequences to a failure to comply with this reporting obligation, Spanish legislation chooses to go beyond what is necessary to guarantee the effectiveness of fiscal controls and combat tax fraud and evasion (Maroto Sifres, 2017).

2.3. The specific penalty regime

The 18th additional provision cited above also introduced a specific regime of infringements and penalties relating to non-compliance with the obligation to report via "Form 720", according to the following provisions: "It is a tax offence not to submit within the prescribed period the informative declarations provided for in this additional provision or to include incomplete, incorrect, or false information. It is also a tax offence to submit such declarations by means other than electronically, by computer and telematically where it is stipulated that such methods be used.

The above offences are very serious and shall be penalised in accordance with the following rules:

a) Failure to comply with the obligation to declare accounts held with credit institutions located abroad shall be liable to a flat-rate fine of EUR 5,000 for each data item or set of data relating to the same account which should have been included in the declaration, or for each data item which is incomplete, incorrect or false, the minimum fine shall be set at EUR 10,000. The fine is EUR 100 for each data item or set of data relating to the same account, with a minimum fine of EUR 1,500, where the declaration has been submitted out of time, without prior request from the tax authorities.

b) Failure to comply with the obligation to declare securities, assets, stocks, rights, insurance and annuities deposited, managed or obtained abroad shall be liable to a flat-rate fine of EUR 5,000 for each data item or set of data relating to each individual asset, depending on the category in question, which should have been included in the declaration, or for each data item which is incomplete, incorrect or false, the minimum fine shall be EUR 10,000. The fine is EUR 100 for each data item or set of data relating to each individual asset, depending on the category in question, with a minimum fine of EUR 1,500, where the declaration has been submitted out of time, without prior request from the tax authorities.

c) Failure to comply with the obligation to declare immovable property and rights in immovable property situated abroad shall be liable to a flat-rate fine of EUR 5,000 for each data item or set of data relating to the same immovable property or to the same right in immovable property which should have been included in the declaration, or for each data item which is incomplete, incorrect or false, the minimum fine shall be set at EUR 10,000. The fine is EUR 100 for each data item or set of data relating to the same immovable property or the same right in immovable property, with a minimum fine of EUR 1,500, where the declaration has been submitted out of time, without prior request from the tax authorities."

However, according to Articles 198 and 199 of the GTL, which determine in general terms the penalties applicable to taxpayers who fail to meet their reporting requirements, or who do so incompletely, out of time, or in the wrong format, failing to present a declaration in the set time will be penalised with a flat-rate fine of EUR 200, except for particular cases, or half that amount in the case of the taxpayer reporting late but without being told to do so by the tax authority. Meanwhile, the presentation of an incomplete, incorrect or false declaration will be penalised with a flat-rate fine of EUR 150, while the presentation of a declaration in the wrong format will be penalised with a flat-rate fine of EUR 250.

We can gather from the above that the amount of the flat-rate fines specifically established by the 18th AP are not in any way proportional to the amounts imposed on general taxpayers in

accordance with Articles 198 and 199 of the GTL, which should be comparable, given that they penalize non-compliance with equivalent obligations. According to the CJEU, this lack of proportion should be enough to demonstrate that the flat-rate fines established in this provision represent a disproportionate restriction on the free movement of capital.

As well as these flat-rate fines, it also provided that the laws governing each tax could establish specific consequences for non-compliance with the reporting obligation established in the 18th AP. Thus, a special penalty regime was established for cases of unjustified capital gains and the presumption of income relating both to the IRPF and to the IS, considered to be a very serious tax offence in these circumstances, applying a single proportional fine of 150% of the penalised unpaid tax.

Consequently, taking into account that the penalties with flat-rate fines regulated in the additional provision in question were incompatible with those established for general cases in the GTL, and that the penalties with a proportional fine of 150% imposed by the IRPFL and ISL were specific to these particular cases, it can be stated that ultimately there was a specific penalty regime for non-compliance with the obligation to report using "Form 720", different to the general penalty regime applicable to other taxpayers. The European Commission had previously ruled on this matter in the Reasoned Opinion-Infraction 2014/4330, issued on 15 February 2017 (https://www.fiscal-impuestos.com/sites/fiscal-impuestos.com/files/dictamen-motivado-ce-720-1.pdf), whose conclusions were already warning the Kingdom of Spain that the legal regime of the obligation to report foreign assets and rights, and its penalty regime, violated the principle of proportionality, were discriminatory, and were in conflict with multiple EU freedoms (Calvo Vérgez, 2021).

3. Transposition of the CJEU ruling to the Spanish national legal system

3.1. The CJEU resolution

Through the judgement analysed here, issued on 27 January 2022, the CJEU states that the Kingdom of Spain has failed to fulfil the obligations of Articles 63 of the TFEU and 40 of the EEA Agreement, specifically:

a) By providing that the failure to comply with or the partial or late compliance with the obligation to provide information concerning assets and rights located abroad entails the taxation of undeclared income corresponding to the value of those assets as 'unjustified capital gains', with no possibility, in practice, of benefiting from limitation.

b) By subjecting the failure to comply with or the partial or late compliance with the obligation to provide information concerning assets or rights located abroad to a proportional fine of 150% of the tax calculated on amounts corresponding to the value of those assets or those rights, which may be applied concurrently with flat-rate fines.

c) By subjecting the failure to comply with or the partial or late compliance with the obligation to provide information concerning assets or rights located abroad to flat-rate fines the amount of which is disproportionate to the penalties imposed in respect of similar infringements in a purely national context and the total amount of which is not capped.

For these reasons, the CJEU concludes that the disputed regime interferes with the free movement of capital guaranteed by Articles 63 of the TFEU and 40 of the EEA Agreement, insofar as its effect is to deter Spanish residents from transferring their assets abroad, when in reality there should be no objective difference between taxpayers resident in Spain depending on whether their assets are located in or outside Spanish territory.

3.2. Effects of the CJEU judgements

CJEU judgements are highly significant for the national legal systems of Member States, given that their courts and public authorities are obliged to apply them and consider them, in compliance with the principle of the precedence of European law. In Spain, according to the Spanish Constitutional Court, CJEU rulings become effective from the moment a law considered to conflict with European law comes into force, not on the date on which the CJEU ruling was issued,

such that they are fully retroactive; in other words, ex tunc (see Spanish Constitutional Court Ruling 145/2012, of 2 July 2012). Thus, the European Court itself has stated more than once that the rights of the citizens are not based on its rulings but directly on the European laws which are applied to resolve the cases, as they have a direct effect on the national legal systems of Member States (for example, see the CJEU Judgement of 14 December 1982, case 314/81, and the CJEU Judgement of 5 March 1996, case C-46/93).

Also, CJEU judgements annulling provisions of national laws because of conflicts with European law have an undeniable "debugging" effect on national legal systems, exactly like the constitutional reviews of the Member States themselves. But these pronouncements go beyond resolving conflicts between existing European and national laws: they also prevent the adoption of new state laws, insofar as these could go against EU law. To some extent, the judicial activity of the CJEU also favours the harmonisation of national laws, both negatively by purging legislation which conflicts with European law, and positively by establishing the limits of a kind of shared judicial framework.

In the words of Tomás Mallén (2017), the CJEU has gradually been configured as a "European Constitutional Court", not so much by the more or less formal or symbolic statements which it may have included in some rulings, or even by the dogmatic construction of fundamental rights through significant Praetorian efforts, but simply by constitutional powers which were first attributed to the original Treaties and have been consolidated through their reforms. And he states that although logically the emphasis is on the European Commission as the driver of the construction of Europe, it has been the CJEU which has secured the evolution and solidity of the EU as a "Community of Law".

3.3. Effects of the analysed CJEU judgement on the internal law of Spain

The statements of the CJEU in the analysed judgement have led to the following effects on Spanish internal law (Alarcón García, 2022):

1. The obligation for Spanish residents to report foreign assets and rights via "Form 720" is maintained, given that the information available to the national authorities relating to the assets held abroad by their tax residents is overall less than that available to them on assets held in Spanish territory, even taking into account the existence of mechanisms for sharing information or administrative assistance among Member States. For this reason, it is recognised that the disputed law is appropriate for these objectives.

2. In relation to the lack of a limitation period in cases of unjustified capital gains, the 5th final provision of Spanish Law 5/2022, of 9 March 2022, repeals Articles 39.2 of the IRPFL and 121.6 of the ISL, instead applying a general limitation period of four years to these cases, as provided in Articles 66 and 189 of the GTL. According to the repeated jurisprudence of the CJEU, the mere fact that a resident taxpayer holds assets or rights outside the territory of a Member State cannot be the basis for a general presumption of tax fraud and evasion (for example the Judgements of 11 March 2004, case C 9/02, and 7 November 2013, case C 322/11).

3. On the specific penalty regime for non-compliance and scenarios relating to the obligations of "Form 720", the 4th final provision of Spanish Law 5/2022 of 9 March 2022 repeals the second section of the 18th AP of the GTL, which established the specific regime of infractions and penalties of "Form 720", such that after the ruling, the general penalty regime of the GTL will apply.

4. The fine of 150% is considered excessively severe, and in many cases, given the addition of this fine to the flat-rate fines also envisaged, could lead to the total amount of the penalties exceeding 100% of the value of the unreported assets or rights. For this reason, the CJEU deems that the Spanish legislation causes a disproportionate restriction on the free movement of capital. The 4th final provision of Spanish Law 5/2022 of 9 March 2022 repeals the third section of the 18th AP of the GTL, which established the option of setting specific penalties for non-compliance with the reporting obligation of "Form 720" through the laws governing each tax, nullifying the penalty

of 150% introduced at the time by the 1st AP of Law 7/2012, of 29 October 2012, regarding the IRPF and IS.

5. As the effectiveness of the CJEU's judgements is ex tunc, i.e., they nullify repealed provisions from their time of creation, this means that all actions taken based on the repealed provisions are also nullified, and settlements and fines unduly paid on that basis must be reimbursed. Thus, any such settlements and fines which were appealed against and are not final must be annulled directly by the administrative or judicial bodies which are hearing the appeals. Meanwhile, those which have finalised will also generate the right to reimbursement for undue payments, including reimbursements on the motion of the Administration (for example, see the Spanish Supreme Court Judgement of 16 July 2020, rec. 810/2019) (Alarcón García, 2022). At the same time, if the Administration should refuse to recognise the right to reimbursement of unduly paid amounts or fail to reimburse them on its own motion, there could also be a path to the financial responsibility of the lawmaker State, even after the period indicated for this purpose has expired. On this possibility, there is an opposite CJEU Judgement of 28 June 2022, case C-278/20, which in fact declares that the regulation of the financial responsibility of the lawmaker State in breaches of European law goes against the principle of effectiveness configured by CJEU jurisprudence, which rules that it must be possible to exercise the subjective rights of EU citizens in conditions guaranteeing their full and effective realisation by the courts of the Member States.

Conclusion

According to everything discussed above, and to respond to the questions asked at start of this study, we can conclude the following:

First, the CJEU judgement analysed resolves that the regime for reporting foreign assets through "Form 720", introduced by Spanish Law 7/2012 of 29 October 2012, violates the basic principle of the EU on the free movement of capital. Due to this law, the treatment of Spanish taxpayers holding assets abroad was much more severe than for those holding assets in Spain, to the point of being disproportionate and against European law.

However, in relation to the legality of the obligation to report foreign assets using "Form 720", this obligation is maintained, given that the information available to the national authorities relating to the assets held abroad by their tax residents is less than that available to them on assets held in Spanish territory, and for this reason the disputed law is appropriate for these objectives.

As for changes to the legislation based on the analysed judgement, Spanish Law 5/2022 of 9 March 2022 repealed the specific penalty regime of "Form 720", relating both to flat-rate fines and to the proportional fine of 150% (4th final provision) and imposed a statute of limitations on unjustified capital gains in the IRPF and IS (5th final provision).

On the validity of actions, settlements and penalties based on reports made using "Form 720" before this judgement was issued and taking into account that CJEU judgements are effective ex tunc, i.e., fully retroactively, the settlements and fines unduly paid based on the repealed provisions must be reimbursed, whether they are pending decisions or finalised.

For all these reasons, this CJEU judgement is undoubtedly of great value for the Spanish national legal system, as it limits the abusive position of the tax authority, which treated taxpayers more severely for assets and rights located abroad than for those located in Spain. Thus, the European courts not only safeguard compliance with European law throughout EU territory, requiring national authorities to adapt their internal legislation; they also enable a degree of indirect harmonisation of national legal systems because their rulings must be followed by all Member States.

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