FREE MOVEMENT OF CAPITAL AND INHERITANCE TAX: THE DIFFICULT COMPATIBILITY WITH THE EC TREATY OF FISCAL BENEFITS APPROVED BY THE AUTONOMOUS COMMUNITIES IN SPAIN

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1. INTRODUCTION

This article analyzes the compatibility with the Treaty of some fiscal benefits that have been introduced in Spain by the Autonomous Communities in the Gift and Inheritance Tax in exercise of their normative powers. These measures that adopt the form of reductions in the taxable base of this tax are linked to the location of the goods or the activities in the territory of one Autonomous Community or another. In particular we will analyze if these measures are compatible with the right or freedom of establishment (article 43 EC Treaty) and mainly with the free movement of capital (articles 56 and 58 EC Treaty).

This legislation establishes a different fiscal treatment in favor of the goods, companies or exploitations located in one Autonomous Community, so that the taxpayer whose goods or exploitations are in other States members will not be able to benefit from the application of those reductions. The problem does not appear when the goods or activities are located in other Autonomous Communities, because in that case it would be exclusively a problem of internal law. We will try to clarify if that different treatment generates a restriction to the free

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movement of capitals or the freedom of establishment and, in that case, if this restriction has a reasonable justification that could determine its admissibility.

This article is divided into five sections. In the first section we will expose the current debate about the convenience of maintaining the Inheritance Taxes analyzing what it is happening in other countries of the European Union. In the second place we will deal with the current situation of the Tax on Successions in Spain paying special attention to the distribution of normative powers in connection with this tax. As immediately we will explain, it is a tax created by the State but the Autonomous Communities can act modifying some aspects of their regulation in the exercise of their legislative powers. In the third place, we will analyze the measures approved by the Communities that outline these problems of compatibility with the Treaty freedoms aforementioned. The following section is dedicated to the study of the ECJ case law that should serve as a guide on the issue of compatibility of this legislation with the Treaty. The article concludes with some basic conclusions.

2. THE INHERITANCE TAXES IN THE EUROPEAN UNION: MAINTENANCE OR ABOLITION?

Inheritance and gift taxes do exist in most of the member States of the European Union. They are not found at this moment in Cyprus, Netherlands, Estonia, Latvia, Lithuania, Malta, Poland, Portugal and Rumania. If we compare the level of fiscal burden that taxpayers have got in the countries that maintain these taxes, we have to conclude that there are important differences among them. The rates are lower in countries like Bulgaria (where donations have to pay rates between 0.4% and 0.8%) or Hungary (where only a few types of transmissions *mortis causa* are taxed at a 10%). Rates applied are not high in Luxemburg either where residents are taxed at rates between 5 and 15%, while non residents are subjected to rates between 2 and 5%. In most of the countries of the European Union, rates depend upon the grade of relationship between grantor and grantee. For instance, in Germany (with rates between 7 and 50%), Austria (where, depending of the grade of relationship it may be applied an surcharge of 2 or 3.5%), Belgium (where the competence for deciding rates is attributed to the regions), Denmark (with rates between 15 and 25%), Spain (with rates that rise considerably for the successions among strangers and where the maximum rate is 34%), Finland (with rates between 7% and 32%), France (between 5% and 60%), Greece (between 1% and 40%), Ireland (with a rate of 22%), Italy (also with a different rates depending of the relationship and ranging between 4% and 8%)[2], United Kingdom (with rates that can go all the way up to 40%), Czech Republic (where rates are between 7% and 40%) and finally Sweden (with rates between 10% and 30% but with the exemption of the survivor spouse).

The question that arises immediately after knowing this reality is if these important differences could give place to taxpayers shopping around for greener pastures. In principle it does not seem that it is happening this way, but it is certain that such big differences could give place to fiscal competition. We would like to highlight also that at state level, there has been controversy in some countries, for instance in Spain, over whether this tax

[2] In Italy the inheritance tax was abolished by the Law No. 383 of 18 October 2001, entitled "First measures for the relaunching of the economy". This fiscal triumph was declared as a compelling reason for choosing the residence in Italy and not in other nations. See the comments about this Law of ANTONINI, M., "Abolition of the Italian Inheritance and Gift Tax", in *European Taxation,* 2002, p. 133-138. But later this tax was reintroduced in October 2006 by the D.L. Nº 262/2006, Art. 2, paragraphs 47 to 54 as modified by the conversion Law Nº 286/2006.

should be maintain or not. Obviously, those favoring the Autonomous communities, whose own revenues come basically from these taxes, the idea is that they are pivotal. They suggest that these taxes contribute to a fiscal system that is more prone to valuate the economic capacity and the progressivity. They also point out that these taxes constitute an important instrument of redistribution of the wealth in favour of the social justice.

The current polarization among those in favour or against patrimonial taxes (Wealth Taxes and Gift and Inheritance Taxes) corresponds to an apparent ideological underlying idea. We say "apparent" because it is difficult to know how many Autonomous Communities that oppose to the abolition of the Gift and Inheritance Taxes, really do so because they fear inmediate the loss of revenues. The real ideological debate underlying the option in favour or against these taxes is a political one. It is a confrontation between the two political views in modern capitalism, socialdemocrats and liberals. We can trace a referent to the position that we have called socialdemocratic in the well-known thesis of CIMBALI, which considers that the Inheritance Tax is the way in which the whole society benefits from private inheritances, id est, the way that the State receives his fair share in exchange for granting individual property. One of the modern formulations of this view is that of Laura DE PABLOS ESCOBAR[3]. In her opinion, fairness, and progressivity of the system are the main justification of these taxes, and these reasons are still valid in the XXI century. DE PABLOS points out that is nowdays it is still widespread the belief that one of the main causes of inequality is the transmission of wealth by the death. It is not the same thing to tax the wealth that somebody gets with his effort, than to tax what somebody receives from somebody else. DE PABLOS suscribes the favorable view among some Anglo-Saxon doctrine in favour of the conservation of the tax that has contested the elimination of the tax in the US for a decade passed by the previous Republican administration. In this sense, G.W. GALE and J.B.SLEMROD[4] estimate that the argument of fairness is still valid which is reinforced by the idea that the wealth has been concentrating in fewer hands from the 80s.

On the other side, there are several defenders of what we have called the liberal view that postulates the abolition of the tax. We could cite as examples to CORONAS and SORIANO. For J.M. CORONAS, the theory of the redistribution of the wealth is the result of not understanding properly the principle of solidarity, and is false and dangerous. False because in most of the cases heirs have materially and morally contributed to the creation of the wealth from the person who died. And dangerous because the main purpose of the State is not to distribute wealth, but to create it[5]. In his view, the theory of CIMBALI can not admitted, since the succession right is a forced consequence of the property and of the person's freedom, and if the person has the right to dispose *inter vivos* also must have the right of disposing *mortis causa*. The State can not interfere in people's rights; people are before the State which in turn is no more that a set of people organized, and an instrument to serve them.

[3] DE PABLOS ESCOBAR, L.,"La imposición personal sobre la riqueza: su papel en los sistemas tributarios actuales", en *Hacienda Pública Española*, Monografía 2001 (p. 281-322)

[4] GALE, W., y SLEMROD, J.B., "Policy Watch. Death Watch for Estate Tax?", en *Journal of Economic Perspectives*, vol.15, n.1, 2001, p.205-218.

[5] Vid. CORONAS I GUINART, J.M.,"La necesaria armonización de la imposición sobre las sucesiones", en *Quincena Fiscal*, núm. 14, 1998, p.42; en este sentido puede verse también la obra de ALONSO GONZÁLEZ, L., *La inconstitucionalidad del Impuesto sobre Sucesiones y Donaciones*, Instituto de Estudios Económicos, Madrid, 2001, p.29.

Special attention deserves the arguments in favor of the abolition of the Inheritance Tax in the United States. In this country, where social differences are more obvious than in the EU the argument has been related to another, which is the social fracture that could be created if these taxes were abolished. In 1999 started a discussion between Democratic and Republican Parties over the total abolition of the Federal Estate Tax, even when the rate is very low and the minimum exempted is very generous with taxpayers. Former President CLINTON vetoed the Estate Tax Elimination Act proposed by the republican representatives, but the debate reopened when the new administration was sworn in, because the Republicans turned the issue into an essential priority in their agenda. They managed to get a commitment of progressive reduction until the year 2010, when it will disappear and then it will reappear only with a single rate in 2011. At the moment –and not mentioning inheritance taxes separated that exist in several states that concur with the federal one--, there is a tax called federal gift tax in the transmissions among people that are alive and estate tax applicable to the transmissions *mortis causa*.

As it has been said before, the Estate Tax Elimination Act of G.W.BUSH was the result of a strange commitment with the members of the Congress, and which designed a process that would finish on the 31st of December 2010 with the elimination of the tax. The year 2010 would be the only one in which there would be no inheritance tax and in the year 2011 it would be introduce again with a rate of 55% again and with a minimum exempt of $1,000,000[6].

Apart from the oddity of the process, because it eliminates temporarily a tax –there is always the malicious question of who is expected to die in 2010-- the more unexpected fallout from it has been the opposition of some famous and qualified rich Americans, like Ted TURNER, George SOROS, Paul NEWMAN, several ROCKEFELLERs and ROOSEVELTs, Ben COHEN, Annie DILLARD and two Bill GATES, the senior and the most famous, the junior—signed a general declaration in favor of the conservation of the tax as valid instrument of social cohesion.

In turn, and although we do not want to go into the details now, the debate on the maintenance or abolition of the Inheritance Tax is still open in the European Union, where as we have explained, there are important differences in the tax rates, and where there are also so far nine countries in which the tax does not exist at the moment. By the way, one of the main reasons that allege those who defend the abolition of this tax is that some EU countries do not have it or have abolished them.

3.CONFIGURATION OF THE INHERITANCE AND GIF TAX IN SPAIN AS A TAX TRANFERRED TO THE AUTONOMOUS COMMUNITIES

In Spain the power to tax is shared between the central government, (from now onwards called the State), the seventeen Autonomous Communities and the local governments. The article 133 of the Spanish Constitution establishes:

[6] For a longer explanation see the Report of the Joint Committee on Taxation, Description of "The Death Tax Elimination Act of 2000" (H.R. 8) (JCX-51-00) May 23, 2000.

“1. The original power to establish taxes by means of law belongs exclusively to the State.

2. Autonomous Communities and local Corporations may establish and levy taxes, in accordance with the Constitution and the laws.”

At the Autonomous Communities level, the legislative power is attributed to the regional Parliament. In relation with tax powers we have to distinguish two types of Autonomous Communities. In the first group we have to include the Basque Country and Navarre, called *Comunidades forales* that enjoy more taxing power than other regions[7]. The rest of the Autonomous Regions, commonly called *Comunidades de regimen común,* have limited taxing powers. Nevertheless, they can legislate on certain aspects of the Personal Income Tax, the Gifts and Inheritance Tax, Tax on Transfers and Tax on Gaming and Bets. Their taxing powers are established in the Organic Law 8/1980, called Autonomous Communities Finance Act, and the Law 21/2001.

Although theoretically Spain is not defined as a federal State, in practice the system for financing the Autonomous Communities has transformed Spain functionally into a federal country. The sources of financing of the Autonomous Communities can be classified in three big blocks:

-Tax revenues. In this group we include their own taxes and transferred taxes.

-Revenues to guarantee a minimum level in the benefit of services in the whole national territory and to make effective the principle of solidarity.

-Other revenues, in which we must include the public debt and the revenues of patrimonial nature.

Now the Inheritance and Gift Tax is part of the first group, because it is a transferred tax. Until 1997, transferred taxes were regulated by the State and the Autonomous Communities only received the income originated by these state taxes. Starting in 1997, after an important agreement between the political party who won the general elections in 1996 and some nationalist parties to have a sufficient majority to govern, it was decided to increase substantially the taxation powers of the Autonomous Communities in relation to these taxes. After this reform, it was conferred to the Autonomous Communities the power to regulate some aspects of these taxes (tax brackets, tax rates and some tax credits). This reform tried to reduce what it is called in fiscal federalism literature the vertical fiscal imbalance. It is the situation that arises when one tier of government --usually the

[7] As a result of the Economic Agreements reached by the Spanish and Basque and Navarre Governments, that have their support in the second additional disposition of the Spanish Constitution, the Basque territory and Navarra have their special tax systems, which, in some cases, imply better conditions for those who are planning to invest in this part of the Spanish territory. The Economic Agreements, that were approved by Organic Law 12/2002 for the Basque Country and Organic Law 25/2003 for Navarra have and indefinite duration. It grants special competences to the Basque Country and Navarre. First, they are able to establish and rule, in their territories, their tax systems, except for those taxes referring to the customs. And second, Basque Country and Navarra are also able to levy, collect and review the taxes established. For historical reasons in the case of Basque Country the power to tax is attributed not to the Parliament of the Autonomous Region, but to the provincial governments (called “Diputaciones Generales”) of its provinces (Alava, Guipuzcoa and Vizcaya). Each of them have power to enact a different law for example for Personal Income Tax, Corporate Tax and Gift and Inheritance Tax. In practice, their laws of these taxes are quite similar between them but with important differences with the laws approved by the State for those taxes.

central state--has a greater power to obtain income than it actually needs for the exercise of its authority, while the other –subnational government tier-- is in the opposite situation[8]. In Spain it has been used the term “fiscal responsibility” to mean than the Autonomous Communities have a low tax weight of tax revenues. It has been said that they must be responsible not only of the spenditure but also for the revenues. Anyway in practice this increase of responsibility had to come by the way of the transferred taxes because there are important constitutional limits for the Autonomous Communities to create their own taxes.

The financing system of the Autonomous Communities was reformed in 2001 again, and the normative powers in connection with this tax were enlarged even more. The limits that existed for the rate were eliminated, so nowdays the Autonomous Communities can approve a rate different to that of the State. On the other hand, they were also allowed to increase reductions of the taxable base foreseen in the state legislation, as well as to establish their own reductions for the transmissions that respond to economic or social circumstances of each one of them. In the time passed since this last reform, one could see that the Autonomous Communities have made little use of their power to regulate the tax rate (only some of them have approved a different rate from that established by state law and with minor differences). On the other hand, they have made use of their normative powers for the modification of the requirements to apply the reductions in the taxable base settled down in the state law as for the creation of their own reductions, essentially in relation with the transmission of family companies and farms. In connection with these last measures there is also the problem of compatibility with the Treaty, namely with the principle of free movement of capital. In the following section we will expose shortly which are these reductions and later we will examine their adjustment to the European Treaty.

But before doing that, we would like to comment on something that although is a little colateral to our focus, it is still relevant. The issue is the “tax war” that has started between the Autonomous Communities as a result of the exercise of their normative powers. As a matter of fact, within the Spanish borders there is a significant competition among the Autonomous Communities in order to attract taxpayers offering them better conditions when paying their actions that are subjected to the Inheritance Tax. In this sense, in the last years there is a generalized tendency in the Communities of common regime to the practical elimination of the obligation to pay this tax in the transmissions *mortis causa* in favour of spouses and descendants and in the donations *inter vivos* made in favour of descendants. The situation is a formidable paradox because it is a tax of state ownership and therefore only the State can technically suppress it. In spite of it, the Autonomous Communities through diverse technicalities --as the establishment of reductions in the taxable base, deductions or allowances in the quota or approval of coefficients inferior to the unit-- practically have done away *de facto* with the obligation to pay the tax.

This situation has determined that the amount of tax to pay under the Inheritance tax is different if the person had his domicile in Catalonia or Andalusia or in other Autonomous Communities. These two Autonomous Communities are the worst places for the heirs. On the other hand, if that person is a resident of Madrid, Castile and Leon, Cantabria, Valencia, Rioja or the Balearic Islands, the tax is minimal. These differences could originate

[8] Some interesting comments about the form of the Spanish state can be found in RUIZ ALMENDRAL, V., “Fiscal Federalism in Spain: The Assignment of Taxation Powers to the Autonomous Communities”, in *European Taxation*, 2002, p. 467-468.

a high risk that fiscal transfers take place in the last years of a taxpayer's life thinking of getting the best fiscal treatment for their heirs. These differences among Autonomous Communities as regards to the Inheritance Tax have created in the last years an important business for tax advisers, that conveniently redirect their clients to the place in which they should reside at the time of their death, so that their heirs get the best fiscal treatment possible.

The Autonomous Communities sometimes fight among thenselves to get the big patrimonies. The aforementioned Law 21/2001 regulates the connection point to decide which region is the competent one, but the situation is so complex and the fight so hard among Communities that a collegiate organ of deliberation denominated Arbitration Comission has been appointed at the Ministry of Economy and Treasury to solve the conflicts among Autonomous Communities. The basic rules are as follows: In transmissions *mortis causa* the Autonomous Community competent is the one of the habitual residence of the person who die. In the donations inter vivos the connection point depends on the nature of the good transmitted. If it is a real property it will be competent the Autonomous Community where the property is. If it is a good of another nature it will be competent the Autonomous Community where the person who received the donation has the habitual residence. The application of the connection point in transmissions *mortis causa* has given place to very well known conflicts among Autonomous Communities. As example we can mention the existing conflicts between Cantabria and Madrid about the inheritance of D. Emilio Botin (senior) and between Asturias and Madrid for the inheritance of D. Pedro Masaveu due to the size of the taxable bases.

Is this fiscal competition among Autonomous Communities healthy? We leave the question open. We think that the answer must be yes. Nevertheless maybe the State should have to fix a common minimum with the purpose of eliminating the possibility that the Autonomous Communities have perused of abolishing the tax *de facto*.

4. FISCAL BENEFITS INTRODUCED BY THE AUTONOMOUS COMMUNITIES THAT COULD COLLIDE WITH THE PRINCIPLE OF FREE MOVEMENT OF CAPITAL

The measures approved by the Autonomous Communities in exercise of their normative powers that can be incompatible with the Treaty are fiscal benefits in the Inheritance and Gift Tax and we can classify them in three groups: fiscal benefits related with the transmission of the habitual housing, fiscal benefits related with the transmissions of companies and agricultural exploitations and other fiscal benefits. In this section we will explain shortly these measures.

The Autonomous Communities have two options when developing their normative powers in this tax: they can introduce improvements in the state reductions or they can approve own reductions different to those foreseen in the state law. In the first case, the regulation of the reductions contained in the state law constitutes a minimum that they can enlarge in what refers to the reduction percentage or the taxpayers that can benefit of them. Also, the improvement can consist on the demand of less requirements that those required by the State law for its application. In the case of their own reductions, these will be applied on the taxable base of the tax after the application of the state reductions.

A) Fiscal benefits related to the transmission of the habitual housing

The State Law of the Gift and Inheritance Tax, that is the Law 29/1987, 18 december, states in article 20.2, c) that the taxpayers will be able to apply a reduction of the 95 for 100, with a limit of 122,606.47 euros for each taxpayer and whenever the acquisition must be maintain during ten years following the death of the testator, about the value of the acquisitions mortis causa of the died person's habitual housing, when the heirs are spouse, ascendants or descendants of that, or relative colateral older than sixty five years that has cohabited with the dead during the two years previous to the death. The concept of habitual housing is the one established in the Spanish Law of the Personal Income Tax.

There are some Autonomous Communities that have made use of the first possibility and they have introduced improvements in the reduction foreseen in the state law increasing the reduction percentage until l 98, 99 or even 100% or reducing the permanency requirement from ten to five years. Others have created new reductions with additional requirements that can also arrive to a reduction of 100% of the value of the habitual housing. In some cases the application of these reductions is conditioned to the situation of the property in the territory of the Autonomous Community that cannot be compatible with the community principle of free movement of capital, like we will explain in the following section. This is what happens in the case of the Autonomous Communities of Canaries, Extremadura and Galicia.

B) Fiscal benefits related to the transmission of companies and agricultural exploitations

In this group we must include the fiscal benefits established for transmissions mortis causa and inter vivos of family companies and agricultural exploitations. The requirements are different in both cases.

Article 20 of the state Law of the Inheritance Tax establishes that the taxpayer will be able to apply a reduction in the taxable base of the 95% of the value of the transmitted goods in the transmissions *mortis causa* and *inter vivos* of individual companies, professional businesses or participations in entities if he fulfils certain requirements, some of which are intimately bound to the family character of the company. The requirements to be fulfilled are different in each case.

The Autonomous Communities could also introduce improvements in the state reduction that usually consists on the reduction of the requirements and terms demanded for their application, or to establish own reductions. The Autonomous Community decides if the established reduction is a improvement of the state one or a specific or own reduction. This question has enormous relevance because if the reduction is own the Autonomous Community has to regulate its requirements because in this case those foreseen for the state reductions would not be applicable[9].

Most of the Autonomous Communities have created their own reductions in the Gift and Inheritance Tax for the *mortis causa* acquisitions of individual companies, professional businesses or participations in entities, with higher reductions in the taxable base that the one foreseen in the state law, linking them to the location of the business or company in the territory of the Autonomous Community. For example there are own reductions of 99% on the taxable base in Andalusia, Principado de Asturias, Galicia, Canary Islands, Castilla and Leon, La Rioja,

[9] For more information about these reductions see ADAME MARTINEZ, F.D., *Fiscalidad de la transmision de empresas en el Impuesto sobre Sucesiones y Donaciones*, Comares, Granada, 2008, p.211-294.

Murcia and Valencia. In all those reductions it is necessary that the companies or their fiscal or social headquarters are in the territory of the Autonomous Community. Some of them demand also that this requirement should be kept during five years after the death.

Apart from the reductions aforementioned, some Autonomous Communities have introduced special tax measures for the transmission of agricultural, forest or rural exploitations that also consist on reductions of the taxable base. For example we can find these reductions in Cataluña (95%), Galicia (99%) and La Rioja (99%). The requirements demanded for these reductions are different.

C) Other fiscal benefits

In this group we must mention a fiscal measure whose compatibility with the Treaty can also be problematic that has been approved by the Autonomous Community of Valencia. It is not a reduction of the taxable base, as all those mentioned up to now. It is an allowance in the quota of the Inheritance Tax of 99% for the acquisitions mortis causa for relatives of the causing one that are descending, adopted, spouses, ascendants or adopting that have their habitual residence in the Valencian Community in the date that the tax must be paid. The application of a different treatment in this tax to residents and non residents could give place to a non compatible restriction with the Treaty.

5. ANALYSIS OF THE COMPATIBILITY OF THE FISCAL BENEFITS OF THE AUTONOMOUS COMMUNITIES WITH THE TREATY IN THE LIGHT OF THE ECJ CASE LAW

5.1. INCOMPATIBILITY WITH THE PRINCIPLE OF FREE MOVEMENT OF CAPITAL

The principle of free movement of capital is established in articles 56 and 58 of the Treaty establishing the European Community (consolidated text) (vid. Official Journal C 325 of 24 December 2002). Article 56.1 establishs:

“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.”

In relation with this principle of free movement of capital article 58 of the same Treaty adds in its first number:

“The provisions of Article 56 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;

(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.”

Anyway this prevision is completed by the section 3 of this article when it states:

"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 56."

To analyze the compatibility of the measures approved by the Autonomous Communities that we have mentioned before with the principle of free movement capital we should go to the case law of the Court of Justice of the European Communities, that as interpreter of the community Treaties, has specified the content and limits of the freedom of movement of capital in tax matters[10].

The first idea that has underlined the Court is that "although direct taxation falls within the competence of the Member States, they must none the less exercise that competence consistently with Community law (Case C-279/93 Schumacker [1995] ECR I-225, paragraph 21; Case C-80/94 Wielockx [1995] ECR I-2493, paragraph 16; Case C-391/97 Gschwind [1999] ECR I-5451, paragraph 20; ; and Case C-35/98 Verkooijen [2000] ECR I-4071, paragraph 32; and Case C-256/06 Barbier [2003], ECR I-15013, paragraph 36).

The Court usually follows the same argument outline in its case law about the compatibility of national legislations with the freedoms of the Treaty. First, the Tribunal analyzes if a certain situation is included or not in the area of application of a Treaty freedom. In the second term, it is determined if there is a situation of discrimination or restriction to that freedom. Once verified the above-mentioned, the Court studies if this restriction can be justified by some exception foreseen in the Treaty or for some other reason of general interest. As the reader will see, this same outline is repeated in the case law that have analyzed the compatibility with the free movement of capital of certain tax measures approved by the States members related with the Inheritance Tax.

Therefore, the first question that has been studied by the Court is if is the inheritances are included in the area of application of the freedom of movement of capital. The Court had the occasion of confirming in the well known judgment *van Hilten-van der Heijden* that the inheritances constitute movements of capitals in the sense of the article 56.1 of the Treaty (ancien article 73 B, paragraph 1)[11].

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[10] For the analysis of the case-law of the Court about the application of the EC Treaty freedoms in the area of direct taxation and the impact on the member states tax systems we recommend the books of MALHERBE, J., MALHERBE, P., RICHELLE, I., and TRAVERSA, E., *Direct Taxation in the Case-Law of the European Court of Justice,* Bruxelles, Larcier, 2008; DAHLBERG, M., *Direct taxation in relation to the freedom of establishment and the free movement of capital*, EUCOTAX Series on European Taxation, London, Kluwer Law International, vol. 9, 2005; KAVELAARS,N., *Tax case law of the Court of Justice of the European Union: direct Taxes, social security law, procedural law, pending cases*, Amersfoort, SDU Fiscal & Financial Publishers, 2006; LANG, M., SCHUCH, J., and STARINGER, C., *ECJ Recent developments in Direct Taxation*, Coll. EUCOTAX Series on European Taxation, The Hague, Kluwer Law International, Vienna, vol. 13, 2006, and VANISTENDAEL, F. (ed.), *Eu freedoms and taxation: EATLP Congress,* Amsterdam, IBFD Publications, 2006.

[11] ECJ, 23 February 2006, *Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst Particulieren*, C-513/03, ECR I-1957, paragraph 40-42. Mrs. van Hilten-van der Heijden died on 22 November 1997. Of Netherlands nationality, she had been resident in the Netherlands until the start of 1988, then in Belgium and, since 1991, in Switzerland. Her estate included immovable property situated in the Netherlands, Belgium and Switzerland and investments in quoted securities in the Netherlands, Germany, Switzerland and the United States of America, as well as bank accounts opened at Netherlands and Belgian branches of banking institutions established in the European Union and

The problem arose because the Treaty does not define the terms 'movement of capital' and 'payments'.By that reason it was necessary to go to Annex of the Directive 88/361, entitled 'Personal capital movements'. This directive implemented the former article 67(1) of the Treaty. Article 1(1) of that directive states: "Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this directive, capital movement shall be classified in accordance with the nomenclature in Annex I". That Annex I, entitled 'Nomenclature of the capital movements referred to in Article 1 of the Directive', is worded as follows: "In this nomenclature, capital movements are classified according to the economic nature of the assets and liabilities they concern, denominated either in national currency or in foreign exchange." That nomenclature comprises 13 different categories of capital movements. For example the second category concerns "Investments in real estate" (defined as investments in real estate on national territory by non-residents and investments in real estate abroad by residents) and the 11th category of that nomenclature, entitled 'Personal capital movements', includes 'inheritances and legacies'. That heading mentions, particularly, as the Advocate General pointed out in point 53 of his Opinion, operations by which the whole or part of a person's property is transferred during his lifetime, or after his death. In the Court's view "an inheritance consists of the transfer to one or more persons of the estate left by a deceased person or, in other words, a transfer to the deceased's heirs of the ownership of the various assets, rights, etc., of which that estate is composed" (paragraph 41). And finally in paragraph 42 we can read: it follows that an inheritance is a movement of capital within the meaning of Article 73b of the Treaty (see to that effect, also, Case C‑364/01 Barbier [2003] ECR I‑15013, paragraph 58), except in cases where its constituent elements are confined within a single Member State[12].

managed by them. Her heirs were assessed to inheritance tax calculated on the basis of Article 3(1) of the Law on Succession of 28 June 1956. According to this article "A Netherlands national who, having resided in the Kingdom, dies or makes a gift within 10 years after ceasing to reside there shall be deemed to have been resident in the Kingdom at the time of the death or of the making of the gift." Those assessments were upheld by the Inspector after an appeal brought by four of the heirs. The latter then brought an action against that decision before the Hertogenbosch Regional Court of Appeal. This Tribunal decided to stay the proceedings and to refer the questions to the Court for a preliminary ruling asking, in essence, whether national legislation such as that in question in the main proceedings is within the scope of Article 73c(1) of the Treaty and/or within that of Article 73d(3) of the Treaty. Mrs van Hilten-van der Heijden's heirs claimed that there is indirect discrimination and possibly an indirect restriction in that, first, a distinction is drawn according to whether the person resided, before death, in the Netherlands and, second, that provision does not apply if the person who leaves the Netherlands has a nationality other than that of the Netherlands. The Tribunal finally rules that a national legislation "which provides that the estate of a national of a Member State who dies within 10 years of ceasing to reside in that Member State is to be taxed as if that national had continued to reside in that Member State, while providing for relief in respect of the taxes levied in the State to which the deceased transferred his residence, does not constitute a restriction on the movement of capital" (paragraph 45). Some observations to this ECJ judgment with a few examples that there may be a restriction on the free movement of capital in some cases may be found in the article of VAN DEN BROEK, J.J., and WILDEBOER, M.R., "European Court of Justice Permits Inheritance Tax Based on Nationality in van Hilten-Van der Heijden", in *Bulletin for International Taxation,* May 2007, p. 214-219. About the consequences of this judgement in the Spanish Tax Law see ALONSO MURILLO, F., "Libre circulación de capitales e Impuesto sobre Sucesiones: Sentencia van Hilten-van der Heijden", in *Noticias de la Unión Europea,* n. 269, 2007, p. 68-73.

[12] ECJ 11 December 2003, *Heirs of Barbier v. Inspecteur van de Belastingdienst Particulieren*, C-364/01, ECR I-15013. Mr Barbier, a Netherlands national born in 1941, died on 24 August 1993. His heirs are his wife and his only son. In 1970, Mr Barbier moved from the Netherlands to Belgium, from where he continued to exercise his activities as director of a private

In consonance with the above-mentioned, in the inheritances with goods located in several States members, the prohibition of any restriction to the free movement of capitals by the way of granting fiscal treatments differed in function of the location of the goods is directly applicable.

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company established in the Netherlands operating clothing boutiques. In the period from 1970 to 1988, while he was resident in Belgium, Mr Barbier acquired a number of properties situated in the Netherlands, from which he received rent. Under Article 49(1)(b)(2) of the IB 1964 such rent contributes to the gross domestic income of the taxpayer. Those properties were mortgaged. Under Netherlands Law on Succession of 28 June 1956 in the case of the estate of a person who was not resident in the Netherlands at the time of death, an obligation to transfer title to immovable property situated in that Member State is not one of the domestic debts referred to in Article 13 of Netherlands Law on Wealth Tax and therefore cannot be deducted from the basis of assessment laid down in Article 5(2) of the Law on Succession 1956. By contrast, in the case of the estate of a person resident in the Netherlands, that obligation may be deducted, since inheritance duty relates to all the assets and liabilities falling within the estate. The Inspector added the value of all the properties to the declared estate and did not allow any deduction in respect of the obligation to transfer legal title. The heirs appealed against the tax assessment made by the Inspector on the ground that, as a result of the obligation to transfer legal title, the value of those properties should have been reduced to zero. The Tribunal decided to stay proceedings and to refer the following questions to the Court of Justice for a preliminary ruling asking if Community law preclude a Member State (the State in which the property is situated) from levying on the inheritance of immovable property situated in that Member State a tax on the value of that property which allows the value of the obligation to transfer title to that property to be deducted if, at the time of death, the deceased resided in the State where the property is situated but not if he resided in another Member State (the State of residence). The ECJ consider that the national provisions at issue in the main proceedings have the effect of restricting the movement of capital. In its opinion "national provisions such as those at issue in the main proceedings, which determine the value of immovable property for the purposes of assessing the amount of tax due when it is acquired through inheritance, are such as to discourage the purchase of immovable property situated in the Member State concerned and the transfer of financial ownership of such property to another person by a resident of another Member State. They also have the effect of reducing the value of the estate of a resident of a Member State other than that in which the property is situated who is in the same position as Mr. Barbier" (paragraph 62-63). It is also important to point out that in relation with the Netherlands Government's argument that the fact that the objective of selling the financial ownership of that immovable property was to avoid or delay the payment of a transfer tax should deprive the heirs of protection under Community law, the ECJ considers that "suffice it to recall that 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." (paragraph 71). This is a general conclusion that the ECJ has held in its case-law on the free movement of capital and inheritance duties. See for example, also, case law *Eckelkamp*, ECJ 11 September 2008, C-11/07, paragraph 66. In this case the appellants claimed that the provisions of the Flemish Code concerning the assessment of duties on the transfer of property mortis causa which do not allow for mortgage-related charges relating to the immovable property to be deducted from the value of that property on the ground that, at the time of death, the person whose estate is being administered was residing in another Member State are contrary to Community law. They maintain that those provisions constitute indirect discrimination on grounds of nationality and a restriction on the free movement of capital. The ECJ stated: "The combined provisions of Articles 56 EC and 58 EC must be interpreted as precluding national legislation, such as that at issue in the main proceedings, concerning the assessment of inheritance and transfer duties payable in respect of an immovable property situated in a Member State, which makes no provision for the deductibility of debts secured on such property where the person whose estate is being administered was residing, at the time of death, not in that State but in another Member State, whereas provision is made for such deductibility where that person was, at that time, residing in the first-mentioned Member State, in which the immovable property included in the estate is situated." See the interesting comments to this Judgement of Prof. M. LANG –"Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions", in EC Tax Review 2009/3, p. 110, and SCHWARZ, J., "Personal Taxation under the European Court of Justice Microscope", in *European Taxation,* 2004, p. 548-549.

On the other hand, the case law of the Court have also shown that the article 56 allow the application of the tax law of the States members that 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. Nevertheless, that article as a derogation of the fundamental principle of the free movement of capital, must be interpreted strictly. According to that, this rule cannot be interpreted as meaning that any tax legislation making a distinction between the residence of the taxpayers or the place where they invest their capital is automatically compatible with the Treaty. Article 58(3) EC provides that only could be compatible with the Treaty the measures that not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article (Case C-319/02, *Manninen*, paragraph 28)[13].

According to the doctrine invoked by the Tribunal in this last case for national tax legislation, similar to that of the fiscal measures passed by the Spanish Autonomous Communities in the inheritance tax, a discrimination is not arbitrary, and therefore compatible with the Treaty provisions on the free movement of capital, "the difference in treatment must concern situations which are not objectively comparable or be justified by overriding reasons in the general interest, (*Verkooijen*, paragraph 43, Case C-35/98, and *Manninen*, paragraph 29 o *Hollamann*).

Therefore, to determine if the fiscal measures introduced by the Autonomous Communities in the Inheritance Tax are compatible with the Treaty it is necessary to examine, first, if the situation of a taxpayer that perceives an inheritance integrated by goods located in their Autonomous Community and the situation of another that receives goods located in different countries is comparable. Once confirmed that their situation is comparable, so that the measures were compatible with the Treaty the different treatment gives to both taxpayers should be justified for imperious reasons of general interest. Let us see first if both situations are comparable and

[13] ECJ 7 September 2004, *Manninen*, C-319/02, ECR I-7477. Mr. Manninen challenged the compatibility with Community law of Finnish legislation on the taxation of dividends. Mr Manninen who was fully taxable in Finland, holded shares in a Swedish company quoted on the Stockholm (Sweden) Stock Exchange. Mr Manninen applied to the Central Tax Commission of Finland for a determination whether, having regard to Articles 56 EC and 58 EC, dividends which he received from a Swedish company were taxable in Finland. In its preliminary decision of 7 February 2001, that Commission held that Mr Manninen was not entitled to the tax credit in respect of dividends paid to him by a Swedish company. Mr Manninen appealed against that decision to the Administrative Tribunal. This Tribunal decided to stay the proceedings and refer the following questions to the Court of Justice for a preliminary ruling. The Court states that "the Finnish tax legislation has the effect of deterring fully taxable persons in Finland from investing their capital in companies established in another Member State", and "also has a restrictive effect as regards companies established in other Member States, in that it constitutes an obstacle to their raising capital in Finland. Since revenue from capital of non-Finnish origin receives less favourable tax treatment than dividends distributed by companies established in Finland, the shares of companies established in other Member States are less attractive to investors residing in Finland than shares in companies which have their seat in that Member State (Case C-35/98 Verkooijen [2000] ECR I-4071, paragraph 35; Case C-334/02 Commission v France [2004] ECR I-0000, paragraph 24). It follows from the above that legislation such as that at issue in the main proceedings constitutes a restriction on the free movement of capital which is, in principle, prohibited by Article 56 EC" (paragraphs 22-24). See the comments to this judgement of DASSESSE, M., "Taxation des dividendes transfrontaliers après l'arrêt Manninen: état des lieux et perspectives", in *Cahiers de droit européen*, 2005, p.493-514; GARUFI, S., "Tassazione dei dividendi e libera circolazione dei capitali: il caso Manninen", in *Temi attuali di diritto tributario comunitario*, 2005, p.51-84, and MARINI, G., "Sentenza Manninen del 7 settembre 2004: divieto comunitario di discriminazione e libertà di circolazione dei capitali", in *Rassegna tributaria*, 2004, p.1910-1922,

second we will analyze the imperious reasons of general interest that have been admitted by the Court to justify in similar cases the admissibility of that difference treatment.

The first question can be answered easily going to the doctrine of the Court contained in its Judgment of 17 of January of 2008, case *Jähger*, C-256/06, in pre-judicial question outlined by Bundesfinanzhof. In this case, the German tribunal doubted whether the provisions of the Paragraph 12(3) and Paragraph 12(6) of the German Law on inheritance and gift tax, to the extent to which they differentiate according to the place in which the assets included in the estate or a part thereof are located, are reconcilable with the principle of the free movement of capital.

Under Paragraph 12(3) of the ErbStG property consisting of agricultural land and forestry situated in Germany is to be valued under a special procedure laid down in Paragraphs 140 to 144 of the Law on Valuation. The valuations carried out in accordance with that procedure amount, on average, to only 10% of the current market value of the assets in question.

By contrast, under Paragraph 12(6) of the Law on inheritance and gift tax, read in conjunction with Paragraphs 9 and 31 of the Law on Valuation, property consisting of agricultural land and forestry situated outside Germany is to be valued according to its fair market value. Under Paragraph 9(2) of the Law on Valuation, that value is defined as the price at which those assets could be sold in the ordinary course of business.

Also the Court doubted of the compatibility with the principle of free movement of capital of two rules for calculating the inheritance tax on agricultural land and forestry assets included in the Paragraphs 13a(1) y 13a(2) of the Law on inheritance and gift tax. The first point of the paragraph 13a(1) provided that assessment of the acquisition of domestic assets consisting of agricultural land and forestry is excluded up to a special tax-free amount and the remaining value of that property, after deduction of the tax-free amount granted in relation to those objects, is to be taken into account, for the purposes of calculating the tax, in the form of a 'valuation at a reduced rate' of only 60%.

As consequence of the application of this legislation, in the case of an heir inheriting an estate made up of both domestic assets and foreign assets consisting of agricultural land and forestry, this results in a situation whereby, as a result of the fact that the assets consisting of agricultural land and forestry are situated abroad, the acquisition of the domestic assets is subjected to higher inheritance tax than would be applicable if the assets consisting of agricultural land and forestry were also domestic assets.

In that case, the difference in the amount of tax paid according to whether the inheritance consists only of agricultural land and forestry situated in Germany or consists also of such an asset situated in another Member State tried to be justified on the ground telling that it concerns situations which are not objectively comparable. But the Tribunal considered that they were comparable. Also in case law *Arens-Sikken*, where it was discussed if it could be compatible with the provisions of the Treaty on the free movement of capital the rules of the Netherlands law concerning inheritance duties and transfer duties which do not provide for the deduction, in the assessment of those duties, of overendowment debts resulting from a testamentary parental partition inter vivos where the person whose estate is being administered was not residing, at the time of death, in the

Member State in which the immovable property included in the estate is situated. The ECJ states that contrary to the Netherlands Government's contention, that difference in treatment cannot be justified on the ground that it concerns situations which are not objectively comparable, adding that "the situation of the heirs of the deceased concerned in the main proceedings is comparable to that of any heir whose inheritance includes an immovable property situated in the Netherlands and left by a person who was residing in that State at the time of death" (paragraph 54-55)[14].

According to the case law of the ECJ, from the perspective of the calculation of the tax, directly linked to the value of the assets included in the estate, the situation of two taxpayers, one whose inheritance consists only of agricultural land and forestry situated in his/her Autonomous Community and other whose inheritance consists in agricultural land and forestry situated in different countries is therefore comparable.

Once answered the first question, we have to examine whether the restriction on the movement of capital resulting from this legislation may be objectively justified by an overriding reason in the general interest. Only in that case it would be acceptable the different treatment that introduce the fiscal allowances established by the Autonomous Communities and that determine a smaller tax for the companies or agricultural exploitations located in the own Autonomous Community in front of those located in another European countries.

To answer to this second question we must go to the case law of the Court to know what imperious reasons of general interest have been admitted in other occasions as justification of restrictions to the free movement of capital. What we have to do is to determine if there would be some imperious reason that could be invoked to justify the difference of fiscal treatment that introduce the legislation of the Autonomous Communities that we are analysing.

In *Jäger*[15] the ECJ concluded that it has not been established that the national legislation at issue in the main proceedings is justified by overriding reasons in the general interest, Article 56.1 of the Treaty [ancien Article 73b(1)] precludes such legislation. German Administration had argued (see paragraph 47-48) that there was an overriding reason in the general interest which justifies that legislation. In its opinion, the national legislation at issue in the main proceedings was designed to compensate for the specific costs involved in maintaining the social role fulfilled by agricultural land and forestry holdings. That legislation made it possible to prevent, first,

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[14] ECJ 11 September 2008, *D. M. M. A. Arens-Sikken v Staatssecretaris van Financiën*, C-43/07. See the comments to this judgment of O'SHEA, T., "Dutch Inheritance Tax Rules Incompatible With EU Law, ECJ Says", in *Tax Notes International*, 2008, Vol. 52, nº 1, p.20-23.

[15] ECJ, 17 January 2008, *Jäger v Finanzamt Kusel-Landstuhl,* C-256/06, ECR I-123. In relation with this case see the comments of O'SHEA, T.,"ECJ Nixes German Inheritance Valuation Rules", *Tax Notes International* 2008, Vol.49, nº 6, p.468-471. Before this judgment the problem of the different valuation methods for foreign and domestic real state was analysed, in relation with the case of a legal person that may be compared to a foundation called Stiftung that received real estate in Spain as a gift from a German resident, by BURGSTALLER, E., and HASLINGER, K., "Inheritance and Gift Tax and EC Fundamental Freedoms – German Federal Tax Court Rules on Different Valuation Methods for Foreign and Domestic Real Estate", in *European Taxation,* 2005, p. 315-322. About the recent changes in the methods of valuation in the Inheritance and Gift Tax Act of Germany see the article of PERDELWITZ, A., "German Inheritance Tax Law Reform 2008", in *European Taxation,* p. 207-209. About the situation in Austria see also the article of KNÖRZER, P., PERDELWITZ, A., and SCHNEIDER, N., "Inheritance Tax – Quo Vadis?", *European Taxation,* 2008, p.291-298.

the heir to an agricultural company from being forced to sell or relinquish it in order to be able to pay the inheritance tax and, secondly, the break-up of agricultural land and forestry holdings guaranteeing productivity and jobs and also required to comply with their obligations under the national legal order. In its opinion that overriding reason in the general interest could be considered the same as, indeed, the need to safeguard the coherence of the tax system. There was, concluded the alegation, a direct link between the specific obligations resulting from the subordination of those holdings to the general interest and the particular kind of valuation applied to those holdings in inheritance matters. Answering to this the ECJ noted in paragraph 52 that "in the case in the main proceedings, with regard to the objective of preventing the tax burden from jeopardising the continuation of the activities of agricultural and forestry holdings, and thereby the preservation of the social role of those holdings, there is no evidence in the present case to support a finding that the holdings established in other Member States are not in a comparable situation to that of holdings established in Germany."

Also the German Administration had invoked to justify the different treatment introduced by the national legislation of the inheritance tax, the need to safeguard the coherence of the tax system, the objective of preventing the tax burden from jeopardising the continuation of the activities of agricultural and forestry holdings, and thereby the preservation of the social role of those holdings, and practical difficulties which preclude the transposition of the assessment criteria provided for by the legislation at issue in the main proceedings to agricultural land and forestry assets situated in other Member States. ECJ refused all these supposed overriding reasons in the general interest noting in paragraph 55 of this judgement that "any disadvantages encountered in determining the value of assets situated in the territory of another Member State under a special national procedure cannot, in any event, be sufficient to justify restrictions on the free movement of capital such as those arising under the legislation at issue in the main proceedings, which, apart from that assessment procedure, also reserves application of two other tax advantages to assets situated within German territory (see, to that effect, Case C-334/02 Commission v France [2004] ECR I-2229, paragraph 29)"[16].

[16] In the opinion of ECJ in case law *Arens-Sikken*, C-43/07, previously cited, the Netherlands Government did not justify the restriction on the movement of capital by an overriding reason in the general interest (see paragraph 58). There are two pending cases at the ECJ about the free movement of capital that are interesting. The first one is the Case *Vera Mattner v Finanzamt Velbert*, C-510/08, where the question referred for a preliminary ruling by the Finanzgericht Düsseldorf (Germany) to the Court on 24 November 2008 is if the articles 39 EC and 43 EC and Article 56 EC in conjunction with Article 58 EC must be interpreted as precluding national legislation of a Member State on the charging of gift tax which, where land situated within the country is acquired by a non-resident person, provides for a tax-free amount of only EUR 1100 for the non-resident acquirer, while on the gifting of the same land a tax-free amount of EUR 205000 would apply, if at the time the gift was effected the donor or acquirer were domiciled in the Member State concern. The second one is the Case *Commission of the European Communities v Federal Republic of Germany,* C-244/09, where the action brought by the Commission concerns the provisions of the German Law on Income Tax (Einkommensteuergesetz) whereby the decreasing balance depreciation for wear and tear -that is, the use of depreciation rates higher than those used for straight line depreciation during the early stages of the depreciation period- which is provided for in the fiscal treatment of immovable property is restricted to buildings located in Germany. This difference in the treatment of immovable property located in and outside Germany could be contrary to the free movement of capital guaranteed under Article 56 EC. According to settled case-law, Article 56 EC prohibits all measures which treat cross-border capital movements less favourably than wholly internal capital movements, thereby deterring residents from engaging in the former. The effect of that provision is that investment in property abroad is less appealing than investment in property in Germany, and investors might be deterred from constructing or buying a building in another Member State. According to the Federal Government, the

Applying this jurisprudence of the Court to the fiscal reductions and allowances approved by the Autonomous Communities that can only be applied to the properties, companies or exploitations located in the territory of the own Autonomous Community and not to the established ones in other countries of European Union, we conclude that these measures lack of a reasonable justification that could determine their admissibility. We do not believe that the coherence of the tax system, or the practical difficulties to apply identical regimes can be invoked like imperious reasons of general interest that justify the restrictions that can be generated to the free movement of capital. And finally, it is not acceptable to use as justification the financial autonomy, although this argument is used internally to justify the different fiscal treatment among Autonomous Communities[17].

5.2. CONSIDERATIONS ABOUT THE POSSIBLE INCOMPATIBILITY WITH THE FREEDOM OF ESTABLISHMENT

Another interesting issue that have been studied by the ECJ is the compatibility with the Treaty of some fiscal measures approved by European regions that condition the enjoyment of fiscal benefits or exemptions to the recruiting or the maintenance of a number of workers in a certain area of a State member. Although it is not exactly the same case that the one of the fiscal measures approved by the Autonomous Communities in Spain, we believe that it is important in this article to expose this doctrine of the Court because in the future other regions of countries like Italy, Belgium or Spain, could approve similar fiscal benefits to those mentioned before as it has made a Region in Belgium. As it is a question that does not affect strictly to the fiscal measures approved by the Autonomous Communities we will make a very brief reference to this question.

The ECJ had the opportunity to judge about the compatibility of that measure with the right of establishment in a case in which it studied a fiscal exemption introduced by the Flemish region of Belgium in relation with the Inheritance Tax. We refer to the case law c-464/05, *Geurts and Vogten*[18], that analysed the compatibility with the freedoms of establishment and movement of capital of the Article 60a of that Inheritance Tax code of Belgium, as it applies to the estates of deceased persons in the Flemish Region, inserted by the decree of the Flemish Parliament containing various measures accompanying the 1997 budget. It has to point out that it is difficult to distinguish between these two important freedoms because the ECJ has enlarged the first one so much that it is confused with the second one. That article exempts the shares in a family company or the claims

aforementioned restriction is justified by overriding reasons in the public interest, since the purpose of the provision at issue is to promote the construction of apartments for rent in Germany. According to settled case-law, support for the domestic economy is not an objective that can justify a restriction of the fundamental freedoms. Even if the objective - promotion of the construction of apartments for rent- were to be recognised as a non-economic objective, the strict limitation of decreasing balance depreciation to buildings situated in Germany would be neither necessary nor proportionate. The promotion of the construction of apartments for rent in Germany would not be adversely affected if it were possible to apply the decreasing balance method of depreciation to immovable property in other Member States also. Everything seems to indicate that the conclusion of the ECJ will be that the Federal Government has not, therefore, put forward any grounds that might justify the interference in the free movement of capital that has been established by that legislation.

[17] This conclusion also has been defended by LÓPEZ DÍAZ, A., “La amenaza del derecho comunitario para ciertas deducciones autonómicas en el impuesto sobre sucesiones y donaciones”, in *Quincena Fiscal,* núm. 9, 2009, p. 74.

[18] ECJ 25 october 2007, *Maria Geurts and Dennis Vogten v Administratie van de BTW*, C-464/05, ECR I-9325. See the comments to this judgment of KAUFF-GAZIN, F., “Exonération de droits de succession”, *Europe 2007 Décembre Comm.,* nº 334, p.21-22, and PARISIS, G., “Arrêt Geurts*”, Journal des tribunaux/droit européen* 2008 , nº 147, p.76-79.

of the legal successor of the deceased, his heir, against such a company from inheritance tax if the company has employed at least five workers in the three years prior to the death of the deceased, but restricts that exemption to cases in which those workers have been employed in the Flemish Region.

As it can be noticed, this legislation treats the owner of family companies and, after his death, his heirs, in a different way according to whether that undertaking employs workers in that Member State or in another Member State. We have to analyse if that condition is compatible with the provisions of the EC Treaty on the right of establishment and free movement of capital.

Article 43 of the Treaty establishs about the right of establishment:

"Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital."

In accordance with well-settled case law of the ECJ, even though Article 43 EC is, according to its terms, aimed particularly at ensuring that foreign nationals are treated in the host Member State in the same way as nationals of that State, it also prohibits the Member State of origin from hindering the establishment in another Member State of one of its own nationals as well as of nationals of other Member States residing in its territory (see, to that effect, C‑251/98 Baars, paragraphs 28 and 29 and C-464/05, Geurts and Vogten, paragraph 15).

The tax consequences in respect of inheritance rights are among the considerations which a national of a Member State could reasonably take into account when deciding whether or not to make use of the freedom of movement provided for in the Treaty. The has already held this conclusion in Case C-364/01 Barbier, paragraph 75, and C-464/05, Geurts and Vogten, paragraph 17.

As the ECJ regards from their case-law, it follows that "the rules regarding equal treatment prohibit not only overt discrimination by reason of nationality or, in the case of companies, their seat, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result (Case C-156/98 Germany v Commission [2000] ECR I‑6857, paragraph 83 and the case-law cited)" (paragraph 20).

The Court rules that the Flemish legislation introduces, for the purpose of granting a tax benefit, indirect discrimination between taxpayers on the basis of the place of employment of a certain number of workers in a certain period, discrimination which is liable to hinder the exercise of freedom of establishment by those taxpayers. The different treatment introduced by that legislation would be permissible only if it would pursue a legitimate objective compatible with the Treaty or if it would be justified by overriding reasons in the public interest. But in the opinion of the ECJ in this case there is not a valid justification. The Belgian Government put

forward considerations connected with the survival of small and medium-sized undertakings and the maintenance of employment in them in the event of succession. The ECJ considered that these arguments would be acceptable justifications for national legislation providing for a tax benefit for natural or legal persons, under certain circumstances and conditions, because family undertakings having their seat in another Member State are in a situation comparable to that of undertakings established in the first Member State.

6. SOME BASIC CONCLUSIONS

The fiscal benefits that have established the Spanish Autonomous Communities in the Inheritance for the transmissions of the habitual housing, family companies or agricultural exploitations, are only applied when the goods or the activities are located in the territory of an Autonomous Community. These measures can in our opinion be incompatible with the interpretation that have carried out the ECJ of the freedom of establishment (article 43 Treaty) and mainly with the principle of free movement of capitals (articles 56 and 58 Treaty).

This legislation establishes a difference of fiscal treatment in favour of the goods, companies or exploitations located in the own Autonomous Community, so that the taxpayer whose goods or exploitations are in other Member States can not benefit of the application of those reductions.

The ECJ have confirmed that the successions constitute movements of capitals, for what the prohibition of any restriction to the free movement of capital would be harmed by a legislation that foresees a different fiscal treatment in regard of the State member where are located the goods.

The situation of a taxpayer that perceives an inheritance integrated by goods located in their Autonomous Community and the one of another that receives goods located in different European countries is comparable. Therefore, according to the case law of the ECJ, so that the fiscal reductions or allowances approved by the Autonomous Communities were compatible with the Treaty that different treatment should can to be justified for imperious reasons of general interest. Otherwise, it would be an arbitrary forbidden discrimination.

In the case of the fiscal benefits settled down by the Autonomous Communities in the Inheritance Tax we do not think that there is any imperious reason of general interest that can be invoked to justify the difference of fiscal treatment that motivates the restriction to the free movement of capital. The argument of the survival of the small and medium companies and the maintenance of the work positions it is not valid to justify a difference treatment as the one introduced in the cases analysed, because expressly it has rejected it by the ECJ in the case *Geurts and Vogten*. Neither they would be valid the arguments of the necessity to assure the coherence of the tax system and to guarantee the effectiveness of the fiscal controls (this last specifically rejected in the aforementioned case), neither the financial autonomy of the Autonomous Communities. This last argument can justify the fiscal differences inside the Spanish territory, because by definition the financial autonomy in the revenues determines the possibility that those differences exist, but it can not justify restrictions to the free movement of capitals.