



The CJEU declares the consequences of failure to declare overseas assets and rights to be contrary to EU Law

## Tax Alert



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# The CJEU delivers its Judgment on three effects of breach of the obligation to declare overseas assets

With this Judgment (case [C-788/19](#)) the Court brings to a close the proceedings brought against Spain in relation to the consequences of breach of the obligation to declare overseas assets and rights (form 720), taking the view that, by imposing disproportionate restrictions on the free movement of capital, the Kingdom of Spain has failed to fulfil its obligations. The Judgment thus declares both the penalty regime and the rule whereby unjustified capital gains are not subject to the statute of limitations null and void.

## Background

In 2012, against a backdrop of major financial and budgetary instability, Spain passed legislation<sup>1</sup> that paved the way for a tax amnesty in respect of undeclared assets, introducing for the purpose a special tax return ("Form 750").

Almost simultaneously, with a view to combatting tax fraud (and incentivising the above amnesty) it passed additional legislation requiring tax residents to declare overseas assets and rights (using form 720) and providing for three serious consequences in the event of failure to file or late filing of the above form 720, or filing of a form containing incomplete, inaccurate or false information.

Specifically, the above consequences were:

- a. A penalty consisting of flat-rate fines for each data item or set of data incorrectly declared.
- b. Treatment of the undeclared asset value as an unjustified capital gain attributable to the earliest of the non-statute-barred tax periods for the income tax to which their holder was subject (PIT or corporate income tax) with no possibility of invoking limitation, on the grounds that no statute of limitations was applicable.
- c. A penalty consisting of a monetary fine of 150% of the tax charge deriving from the above debt.

The European Commission received complaints against Spain on the grounds of a purported infringement of the principle of free movement of

capital, on the understanding that the related penalty regime was disproportionate.

Following the pertinent proceedings (case C788-19), the Commission referred the case to the Court of Justice of the European Union ("CJEU") to rule on whether or not the Spanish law was proportionate, and, by extension, whether or not it was compatible with the fundamental freedoms enshrined in EU Law.

## Matters addressed in the ruling

In its Judgment, the Court of Justice rules on the **proportionality** of the legislation at issue and, specifically, on the three consequences of breach of the obligation.

## Ruling of the Court

The Judgment was published on the CJEU website on 27 January 2022.

In it, the Court holds that Spain has **failed to fulfil its obligations** under the principle of free movement of capital:

- 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;
- 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

<sup>1</sup> The above legislation was declared unconstitutional in Constitutional Court Judgment 73/2017.

the tax calculated on amounts corresponding to the value of those assets or those rights held overseas, which may be applied concurrently with flat-rate fines, and

- 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.

In this case, the Court of Justice has not observed the recommendations of the Advocate General of the Court, and has instead taken the view that all of the penalties and consequences are disproportionate and should be deemed **totally incompatible** with European Union Law.

### Implications for taxpayers subject to penalties

As noted above, the penalty regime declared null and void in this Judgment allowed for penalties consisting of flat-rate fines for each data item and treated the value of any assets not declared on time as an unjustified capital gain, while further providing for a fine of 150% of the income tax to which such gain was subject (PIT or CIT).

In the case of voluntary adjustment, the Spanish tax authorities ruled to exclude the 150% penalty in both the CEAT resolution of 14 February 2019 and the ruling of the Directorate-General of Taxes of 5 June 2017.

Notwithstanding, in the case of taxpayers subject to penalties (or who declared the relevant adjustment late, as a capital gain), the question now arises as to whether or not it will be possible to recover the amounts paid.

This question calls for a specific case-by-case analysis of a range of different scenarios.

#### Provisional penalties subject to appeals pending resolution

The Court's declaration of invalidity of the penalty regime and its effect *ex tunc* will have to be taken into account by any body currently tasked with deciding on the appropriateness or otherwise of penalties issued and subject to appeal. Any such penalties will be declared null and void and, as the case may be, refunded.

#### Returns for non-statute-barred years filed to regularise an unjustified capital gain

Where the limitation period for rectifying returns (four years) has yet to run, a rectification return may be filed, together with a request for a refund of amounts unduly paid.

One of the consequences of the Judgment analysed here is the invalidity of the rule whereby no statute of limitations was deemed to apply in respect of the capital gain. With this in mind, and since it is once again permitted to evidence the statute of limitations on the original debt that gave rise to the obtainment of overseas assets, it is highly recommendable that affected taxpayers be able to access some means of evidence capable of demonstrating that they have owned such overseas assets since periods that are now statute-barred, with a view to assessing the possibility of rectifying the relevant regularisation.

#### Penalties not subject to appeal

In other cases (penalties declared final or gains from statute-barred periods) it will be necessary to analyse the most suitable means of proceeding.

#### Financial liability of the State as lawmaker

Where penalties or attribution of income have been appealed and a final administrative or judicial decision has already been rendered, a claim for liability may be brought against the State as lawmaker. Cases of this type call for case-by-case analysis, in view of the requirements of the procedure in place for claiming liability.

Lastly, it is worth noting that the domestic Spanish legislation regulating the procedure for claiming liability of the State as lawmaker is itself currently subject to review by the Court of Justice of the European Union, to ascertain whether the limitations set out in the rules concerning exercise of this right are, in turn, in breach of Community law.

In the above proceedings (case C278-20) the issue before the Court is whether the underlying rules governing breaches of EU Law themselves run contrary to the principle of effectiveness and equivalence, as they subject reparation for the loss or damage caused by the Spanish lawmaker in breach of EU Law to highly restrictive conditions or conditions that are less favourable than those applied in the case of damage or loss caused by infringement of the Spanish Constitution.

## Implications for taxpayers that have NOT correctly declared all of their overseas assets or rights

Since the Court has ruled that the penalty regime is null and void as it runs contrary to the principle of free movement of capital, as of the Judgment date and until such time as replacement legislation is passed, there is no specific penalty regime in place for breach of this obligation.

In this scenario, it is highly recommendable that, where appropriate, taxpayers proceed to review and correctly complete the declaration of overseas assets, filing the pertinent tax returns in each case.

## Implications of the new obligation to include CRYPTOCURRENCIES located abroad in the declaration of overseas assets

Law 11/2021 provides that as of 2021, taxpayers must declare cryptocurrencies held outside Spain.

Unless such assets are interpreted as current accounts, the current legislation regulating the obligation to file form 720 makes no express provision for either the format in which these assets are to be declared, or the minimum threshold up to which taxpayers are exonerated from declaring them.

Specific regulations are thus called for in relation to this reporting obligation.

The CJEU Judgment has declared the entire penalty regime in respect of form 720 to be null and void. Thus, in the absence of a specific form for cryptocurrencies and there likewise being no specific penalty regime in this regard, it is likely that the future penalty regime will also cover these assets.

## Conclusions

- 1 The Judgment holds that the penalty regime and the effects of non-applicability of a statute of limitations for the declaration of assets located abroad (be it in the European Union or in third countries) are null and void.
- 2 It does not, however, repeal the obligation to declare overseas assets and rights and this obligation therefore continues to apply (note that the filing deadline for 2021 is 31 March 2022).
- 3 Following the elimination of the penalty regime from Spanish law and until such time as a new

penalty regime that is aligned with European Union Law is approved, regularisations relating to the formal obligation to declare overseas assets and rights cannot be penalised.

- 4 The Spanish government has announced plans to draw up a new penalty regime that is in keeping with EU Law.
- 5 A specific penalty regime will need to be approved in respect of cryptocurrencies located abroad.
- 6 The recovery of penalties already paid will need to be analysed on a case-by-case basis in order to ascertain the feasibility of such recovery and the most suitable procedure in each case.

Please contact KPMG Abogados, S.L.P. if you require assistance or have any queries concerning the analysis of any specific cases regarding this matter.

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