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# Spanish legislation regulating tax form 720 is contrary to EU law

**The Court of Justice of the European Union (CJEU) has issued a judgment on the obligation to report overseas assets and rights (tax form 720)**

Legal flash update

January 28, 2022



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## Key aspects

The CJEU judgment of January 27, 2022, (Case C-788/19) concludes that Spanish legislation regulating tax form 720 is contrary to EU law.

Specifically, it finds that restrictions on the free movement of capital are disproportionate with regard to the three issues raised in the proceedings:

- No possibility of benefiting from limitation.
- The fine of 150% linked to the tax resulting from unjustified capital gains imposed on taxpayers that fail to comply with reporting obligations.
- The flat-rate fines imposed for failure to submit tax form 720, for submitting it late, and for providing incorrect information.

The judgment has significant material implications that need to be analyzed on a case-by-case basis.



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### Issues arising from tax form 720

In 2012, the Spanish lawmaker approved extraordinary measures adjusting the taxes paid on income and wealth mainly located abroad, commonly known as “tax amnesty.” This procedure was based on two basic elements:

- > The payment of the corresponding tax amounts through ordinary declarations or through the special tax declaration provided under *Royal Decree-Law 12/2012*.
- > A new reporting obligation on assets held abroad (through *tax form 720*), linked to a specific tax regime if taxpayers did not adequately fulfill their obligations to provide this information: (i) assessment of the tax due on the amounts corresponding to value of the undeclared assets and rights, including where they were acquired during a period that is time-barred, (ii) a material fine of 150% of the tax calculated on the above amounts, and (iii) a formal and flat-rate fine applicable to each missing or incorrect data item or set.

It appeared that the Spanish lawmaker’s ultimate aim was to open up a new stage for taxpayers, also linked to the progress achieved in the international exchange of tax information. However, these new obligations to provide information, which did not apply to assets held in Spain, were so strict and imposed fines so high that they could be considered disproportionate.

This was the view of the European Commission, which denounced the Kingdom of Spain for imposing a reporting obligation with such a severe penalty system that it deterred Spanish taxpayers from making crossborder investments, resulting in a restriction on the free movement of capital regulated under article 63 of the Treaty on the Functioning of the European Union (TFEU). In view of the legislative inaction, the Commission brought infringement proceedings before the CJEU, which has now ruled on the case.

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### CJEU criteria

In its *judgment of January 27, 2022*, the CJEU confirms that this legal system gives rise to a difference of treatment between Spanish residents according to the location of their assets, which could deter Spanish taxpayers from investing in other Member States, constituting a restriction on the free movement of capital.

The Court considers that this restriction is, in principle, justified by a reason of public interest centered on the need to guarantee the effectiveness of fiscal supervision and to prevent tax evasion and avoidance. However, the key issue in the proceedings was that to justify the restriction, it must also be proportionate and not go beyond what is necessary to attain the objective pursued. This is where the CJEU concludes that Spanish legislation introduces a disproportionate restriction on the free movement of capital that undermines the requirement of legal certainty.

Thus, with regard to the specific issues raised in this case, the CJEU diverges from the opinion of Advocate General Saugmandsgaard in his conclusions of July 15, 2021 (discussed in our *Legal Flash* of July 16, 2021) and considers that Spanish legislation goes beyond what is necessary to achieve the objectives pursued in the following respects:



- > Regarding the non-applicability of any limitation period to the value of the assets and rights that have not been declared or have been declared incorrectly or after the deadline and this being treated in tax terms as unjustified capital gains or undeclared income, the CJEU highlights that the system under discussion provides mechanisms that, in practice, are tantamount to indefinitely prolonging the period during which the situation of taxpayers can be regularized, allowing to hold ineffective a limitation period that has already expired simply because of the failure to comply with the obligation to provide information.
- > Regarding the penalty system linked to the failure to comply with the reporting obligations set out in tax form 720 and that can lead to a proportional fine of 150% of the tax liability deriving from this non-compliance being treated as an unjustified capital gain or undeclared income, the CJEU considers that linking the imposition of the fine directly to the failure to comply with reporting obligations gives it a highly punitive nature that may even result in the total amount of the sums payable by the taxpayer owing to the failure to comply with the obligation to provide information being higher than the value of that taxpayer's overseas assets.
- > Regarding the flat-rate fines (€5,000 per data item or set of data that is missing or incorrect, with a minimum of €10,000, and €100 per data item or set of data declared late without prior notice, with a minimum of €1,500), the CJEU notes that their amount is disproportionate to the amount of the fines set out under the penalty system for similar infringements in a domestic context.

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## Practical implications

### **Is it still obligatory to submit tax form 720?**

Yes, the obligation to provide information on assets and rights located abroad has not been declared contrary to EU law. Therefore, it remains fully in force.

### **Does the judgment exclude the obligation to declare assets and rights located abroad that were acquired in statute-barred periods?**

No, the obligation to declare these assets and goods remains in force.

However, failure to comply with this obligation, according to the CJEU's criteria, does not allow the tax authorities to (i) qualify the value of these assets and rights as unjustified capital gains or undeclared income; (ii) impose the fine of 150% linked to the failure to comply with reporting obligations, which has been declared contrary to EU law; or (iii) impose formal fines owing to failure to submit tax form 720, or for submitting incomplete or inaccurate information, without prejudice to general fines being imposed where applicable in cases of tax infringements resulting from failure to submit declarations.

This scenario may apply to taxpayers that have not regularized their situation until now, and the implications of carrying out a regularization process at this time must be analyzed on a case-by-case basis.



### **Are fines imposed under the system declared illegal valid if they penalize failure to submit the declaration, or declarations submitted incorrectly or after the deadline?**

These fines are no longer legal. It must be analyzed on a case-by-case basis whether these fines can be challenged.

In any case, we expect a legal amendment to be made in the near future, whereby the Kingdom of Spain will adapt the penalty system linked to future non-compliance to the CJEU judgment. In this case, the legal amendment will supplement the imminent regulatory amendment that must be made so that tax form 720 includes the reporting obligation imposed since 2021 affecting ownership of virtual currency located overseas (under Act 11/2021, of July 9).

### **Does the judgment affect legislation in force in the Basque Country and Navarre (chartered communities)?**

Although the CJEU judgment refers to legislation applicable in common territory, it will be necessary to analyze the regulations applicable in chartered territories, as some specific rules apply, mainly in Guipúzcoa.

### **How does the judgment affect taxpayers whose income, resulting from late compliance with the obligation to provide information, qualifies as unjustified capital gains or undeclared income?**

In the context of a tax inspection, it is now illegal to fine taxpayers on the basis of unjustified capital gains resulting from failure to comply with a reporting obligation.

Also, these fines may have been applied at the same time as the imposition of proportional fines of 150% and flat-rate fines. Taxpayers that have been charged a proportional fine of 150% and flat-rate fines may benefit from the CJEU's criteria, which considers these fines to be disproportionate and, therefore, contrary to EU law.

Therefore, settlements that are not yet final must be declared invalid together with their respective fines, usually resulting in a refund of undue amounts paid.

In the case of settlements that are final, it will be necessary to analyze on a case-by-case basis the best procedure to follow to recover any amounts paid.

### **How does the judgment affect taxpayers that voluntarily disclosed an unjustified capital gain to avoid the penalty system that has now been declared contrary to EU law?**

Situations where it should be possible to recover tax payments must be analyzed on a case-specific basis.

The tax authorities should accept applications for a refund filed by taxpayers that have voluntarily regularized their situation and requested the adjustment of their self-assessments. If an application has not been filed, each case must be analyzed individually to ascertain the best procedure to follow to recover any amounts paid.



## **Does the CJEU judgment restrict its scope based on the foreign jurisdiction in which the assets and rights are located?**

The CJEU judgment makes no distinction with regard to the jurisdiction in which the overseas assets are located. More specifically, the CJEU makes no reference as to whether the jurisdiction in question is required to have information exchange mechanisms with Spain.

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