

# Spanish exit tax ruled contrary to EU Law; US MNCs should consider refund claims

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## In brief

The European Court of Justice (ECJ) ruled on April 25 (case C-64/11) that Spanish legislation levying an immediate exit tax on the transfer of residence or the transfer of a company's assets to another European Union (EU) member state is contrary to EU law. Thus, US multinational companies (MNCs) with affiliates or permanent establishments (PEs) in Spain that are affected by this decision should consider filing refund claims.

## In detail

Article 17.1 of the Spanish Corporate Income Tax Act treats as taxable income unrealized gains (i.e., the difference between fair market value and tax basis) on assets that are:

- owned by a Spanish resident entity that transfers its tax residence outside of Spain, unless such assets are allocated to a Spanish PE
- allocated to a Spanish PE that then ceases its activity, or
- allocated to a Spanish PE that then moves out of Spain.

In response to a European Commission action, the ECJ declared that immediate taxation in the first and third

cases above restricts the freedom of establishment under Article 49 of the Treaty on the Functioning of the European Union (TFEU).

The Court has confirmed that EU law does not prevent a member state from taxing the economic value generated by unrealized gains when a company or asset leaves that member state's territory. However, the ECJ ruled, immediate taxation of unrealized gains by way of an exit charge goes beyond what is necessary to safeguard Spain's taxing powers.

In particular, the Court referred to mutual assistance mechanisms in force between EU member states that would allow the Spanish tax

authorities to confirm the veracity of tax returns filed by companies that might choose to defer the payment of the tax on the capital gain.

However, the Court concluded that the exit charge in the second case above does not amount to a restriction of the freedom of establishment. The Court reasoned that when a PE ceases its activity in Spain, there should be no difference in treatment between a situation covered by TFEU Article 49 and a purely domestic situation.

This decision is in line with the Court's previous judgments in *National Grid Indus* (C-371/10) and *Commission vs. Portugal* (C-38/10). We now await the Spanish government's reaction to the judgment.

### ***The takeaway***

US MNCs with affiliates or PEs in Spain that are affected by this decision should consider filing refund claims

within the Spanish statute of limitations (four years). For periods for which the statute of limitations has expired, affected companies should consider an action of compensation

for damages within the one-year period from official publication of the Court's judgment.

### ***Let's talk***

For a deeper discussion, please contact:

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