

Spanish Tax Alert

State regulation of the Urban Land Appreciation Tax partially nullified in the absence of capital gains

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In a recent judgment given on 11 May 2017, the Constitutional Court, sitting in plenary session, upheld the challenge in the question of constitutionality no. 4864-2016 referred by the Judicial Review Court no. 1 of Jerez de la Frontera, voiding articles 107(1), 107(2)(a) and 110(4) of the Recast Text of the Local Public Finance (Regulation) Act, approved by Royal Legislative Decree 2/2004 of 5 March, insofar that they tax situations where capital gains are absent.

The Constitutional Court now confirms the doctrine which it itself settled in judgments no. 26/2017 of 16 February and no. 37/2017 of 1 March in respect of the levying of the Urban Land Appreciation Tax in the historic territories of Gipuzkoa and Araba, respectively, given that the wording of the corresponding provisions in national legislation is identical to that held unconstitutional in the aforementioned judgments.

Thus, in the judgment under consideration, the Constitutional Court notes that the subject matter of said tax is the hypothetical appreciation undergone by urban land over a certain period of time, subject to taxation upon conveyance. However, as currently conceived, such tax is not necessarily tied to the existence of such appreciation, but to mere ownership of the land for a computable period of time running from one (minimum) to twenty (maximum) years. That is to say, the mere fact of holding urban land for a certain period of time in itself determines the payment of tax, even in the event of no capital gains or of capital losses resulting from the difference between the conveyance price and the acquisition price.

Therefore, the Constitutional Court concludes that the treatment given by the questioned provisions of the Local Public Finance (Regulation) Act to cases of inexistent capital gains or actual capital losses consists in automatically taxing an unreal or fictitious appreciation, imposing on taxpayers the obligation to bear the same tax burden as in situations where capital gains have derived from

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the passage of time. In this manner, State legislation taxes 'circumstances that are not expressive of an ability to pay', thus contradicting the ability-to-pay principle – premise of any tax payment obligation - safeguarded by art. 31(1) of the Spanish Constitution.

Lastly, in the judgment under consideration, three qualifications are made concerning the scope of the adjudication (judicial declaration) of unconstitutionality and invalidity of the questioned provisions of the Local Public Finance (Regulation) Act:

- The Urban Land Appreciation Tax is unconstitutional only in those cases in which it taxes circumstances that are not expressive of an ability to pay, that is to say, those that do not give rise to capital gains at the time of conveyance.
- The adjudication of unconstitutionality and invalidity of art. 107(1) and 2(a) of the Local Public Finance (Regulation) Act, which contains a mandatory rule for the determination of appreciation, should also be extended to art. 110(4) of the same legislative text, to the extent that it prevents taxpayers from being able to prove circumstances that are not expressive of an ability to pay.
- The method of determining the existence or non-existence of taxable capital gains lies solely with the legislator, who should make any relevant amendments or adaptations to the tax rules.

Following the publication of this judgment, and pending the determination of the questions of constitutionality nos. 4865, 4866, 4867 and 4868 of 2016 in this same regard, the possibility will be opened for taxpayers to apply for a refund of the tax in those cases where, having conveyed urban property, there were no capital gains, or there were even capital losses, a question of fact that must be assessed case by case.

Tax refunds may be applied for, in general, through the refund procedure for undue payments provided for in art. 221 of the Taxation Act 58/2003 of 17 December. This procedure will be the most advisable route to obtain a refund provided both the limitation period has not lapsed and the tax has not been paid under final and conclusive assessments or self-assessments on which *res judicata* impinges. On the other hand, for those cases where the urban land appreciation tax assessment has been contested in advance and, at any instance, a final and conclusive judgment has been given against the taxpayer, provided a subsequent adjudication of unconstitutionality is claimed, such taxpayer may resort to the procedure of adjudication of the Authority's liability provided for in art. 32 of the Public Sector (Legal Regime) Act 40/2015 of 1 October.