Autonomous Communities taking advantage of the mechanism to ensure the neutrality of VAT

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1. Introduction

Since 1997, the Spanish Autonomous Communities (hereafter, the Communities) have the right to modify certain aspects of some of the taxes that are owned, and had been therefore traditionally regulated, by the Central State (hereafter, the State). These taxes are called *ceded* taxes, although the term is probably inadequate, as they are not actually ceded, but *delegated* to the Communities. As a result, some ceded taxes are in practice co-regulated by the State and the Communities, although the first holds greater powers to adopt legislation affecting them. Co-regulation requires a great amount of coordination, so as to not to erode the original structure of these taxes, which might eventually lead to them ceasing to serve their function within the tax system.

If we analyse the legislation passed by the Communities on ceded taxes since 1997, we will easily draw the conclusion that, in most cases, they have used their brand new legislative powers on formerly State-only owned taxes, to reduce the tax burden for taxpayers. Moreover, in some cases, the coordination between the legislation adopted by the Communities and the State is not all that perfect[2].

This article deals with one of these problematic cases, namely, the reforms of the Property Transfers and Stamp Duty Tax[3] (hereafter, PTSDT), that, at least at first sight, aims to reallocate part of the revenues that would otherwise accrue to the State in the

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[2] V. RUIZ ALMENDRAL: "*Impuestos cedidos y corresponsabilidad fiscal*". PhD Thesis. Forthcoming at: Valencia: Tirant lo blanch, 2003, pp. 299-429.

[3] "*Impuesto sobre Transmisiones Patrimoniales y Actos Jurídicos Documentados*".

form of VAT. However, when we analyse the relationship between these two taxes, we come to the conclusion that such reallocation will almost always fail.

In order to put forward the problem in the clearest possible way, I will first very briefly explain what these ceded (or shared) taxes consist of. Secondly, I will describe the relationship between PTSDT and VAT. Finally, I will explain how the Communities take advantage of that relationship in order to increase their tax revenues.

2. Delegation of legislative powers to the Communities

2.1. Limited taxation powers of the Communities until 1997

The Spanish Constitution bestows taxation powers upon the Communities (Secs. 133 and 157) but enables the State to limit them through a special law (Sec. 157(3)). The State made use of this power as early as 1980 by adopting the *Autonomous Regions Finance Act*[4], which imposes severe limits on the creation of new taxes by the Communities. The most important limitation is the prohibition of double taxation, which prevents Community taxes from being similar to State and Municipal taxes. As these two bodies had already established taxes on almost every possible source of revenue, little room was left for Community taxes. Moreover, the Constitutional Court has often broadly interpreted these limits[5], making it almost impossible for the Communities to introduce new taxes. Therefore, despite Constitutional provisions that guarantee Communities both the power to establish taxes and financial autonomy (Sec. 156(1)), the limits established by the State have led to a system where taxation powers remained mostly in the hands of the latter[6]. It is not always clear whether it is the limitations on establishing new taxes, or the unwillingness to withstand the political consequences of increasing the tax burden, that has deterred Communities from creating

[4] Original title: *Ley Orgánica 8/1980, de Financiación de las Comunidades Autónomas,* of 22 September 1980.

[5] For example, Decision 289/2000. Decisions of the Spanish Constitutional Court can be found at *www.tribunalconstitucional.es.*

[6] J.J. ZORNOZA PÉREZ: *Los recursos de las Comunidades Autónomas. Cuadernos y Debates,* No. 8. Centro de Estudios Constitucionales, Madrid, 1996, p. 23 *et seq*., and V. RUIZ ALMENDRAL: *"Fiscal Federalism in Spain: the Assignment of Taxation Powers to the Autonomous Communities",* International Bureau of Fiscal Documentation, European Taxation, Vol. 42, No. 11, November 2002.

new taxes. In any case, this situation underlines the importance of intergovernmental transfers in Spain, and the continuing existence of a substantial imbalance between the Communities' spending power – which has been strongly supported by the Constitutional Court (for example, in Decision 13/1992) – and their limited power to raise their own revenues.

The financial dependence of the Communities was not a problem in the early years of the State of Autonomies, as back then Communities were regarded with a certain distrust, and some of their attempts to establish taxes were severely rejected by voters (such as happened in the Community of Madrid, in the late eighties). As time passed, the Communities gradually gained more responsibilities and their financial needs grew substantially. This resulted in a gradual expansion of the transfer system, and a more financially dependent position of the Communities.

Soon, debates about the Communities' fiscal responsibility became one of the main issues in the relationship between the State and the Communities. From the beginning, there was a certain general agreement in that it was fiscal responsibility "*at the margin*"[7], as opposed to total equivalence between income and expenditures, the objective to attain. The responsibility of subnational tiers of government to generate income/funds in addition to what they obtain from the State in the form of financial transfers, in order to be able to finance improvements in the provision of public services, has been considered a substantial requirement for any decentralization of powers[8]. Moreover, the transfer of at least some taxation powers to the said tiers of government has also been considered essential in order to implement a certain level of political autonomy. In this sense, it has been said that if the most essential principle in matters of taxation is the guarantee that the institutions that establish them have a democratic representation, which has been traditionally expressed through the maxim "*No Taxation without Representation*, the basic principle in the decentralization of

[7] D. HEALD and N. GEAUGHAM: "Financing a Scottish Parliament". (Ed.: S. TINDALE): *The State and the Nations*, Institute for Public Policy Research, London, 1996, p. 173 *et seq*.
[8] A. CASTELLS OLIVERES: *Hacienda Autonómica, Una perspectiva de Federalismo Fiscal,* Ariel, Barcelona, 1988, p. 75.; J. RAMALLO MASSANET: "*El reparto de competencias tributarias entre los distintos ámbitos de gobierno*". *Revista Española de Derecho Financiero*, No. 60, 1988, pp. 534-535; J.J. ZORNOZA PÉREZ, see note 6, pp. 20 *et seq*.; and C.E. McLURE Jr.: "Tax Assignment and Subnational Fiscal Autonomy", *Bulletin*, IBFD, Vol. 54, No. 12, 2000, pp. 634 *et seq*.

authority in a multilevel government may be expressed with the saying: "*No Representation without Taxation*"[9].

2.2. 1996 and 2001 Reforms

Eventually, in September 1996, there was a major reform in the regional finance system, and the Communities were granted significant legislative powers over ceded taxes. The main objective of the reform was to make Communities as responsible for the revenues they raised as they already were for those they spent -thus decreasing what in fiscal federalism literature is known as "*vertical fiscal imbalance*", which is the situation that arises when one tier of government has the power to obtain a larger amount of revenues than it needs for financing its dependent authorities[10].

Until then, ceded taxes had been State taxes whose yield was granted to the Communities according to the taxes paid within their territory. Due to powers delegated by the State, the Communities had also taken on the responsibility of administering these taxes. Ceded taxes were then a kind of *transfer*, by which some of the taxes owned and entirely regulated by the State were transferred to and administered by the Communities. In order to give the Communities more room for taxation, a reform was enacted giving these taxes quite a different meaning than they had had until then. First, the Personal Income Tax became a ceded tax –albeit only partially. Second, the power to regulate some aspects of these taxes – mainly tax brackets, tax rates and some tax credits – was conferred on the Communities. This was done by way of delegation of legislative powers by the State to the Communities, something which – unlike in other federations – is allowed by the Spanish Constitution (Sec. 150). Such delegation implies that the State can both control the powers exercised by Communities and revoke them at

[9] D. HEALD, N. GEAUGHAN, and C. ROBB: "Financial Arrangements for UK Devolution", *Regional and Federal Studies*, Vol. 8, No. 1/1998 (*Special Issue: Remaking the Union, Devolution and British Politics in the 1990s*, Eds.: H. ELCOCK and M. KEATING, 1998, pp. 28 *et seq.*

[10] R.W. BOADWAY: "The Economics of Equalization", AA.VV., Eds. R.W. BOADWAY and P.A.R. HOBSON: *Equalization: Its Contribution to Canadá's Economic and Fiscal Progress,* John Deutsch Institute for the Study of Economic Policy, Queen's University, Kingston, 1998, pp. 46 *et seq*.

any time[11]. However, it is very probable that the exercise of this power by the State would create too much stress on the financial relations between these two tiers of government. For this reason, the new powers of Communities regarding ceded taxes are probably, in practice, irrevocable.

Following this reform, the revenues from ceded taxes still accrue to the Communities on the basis of taxes paid by their residents. But now, should a Community exercise its new legislative powers, the revenues will be the result of the Community's own taxing autonomy. What until 1997 had been a form of *transfer* has become a form of *tax sharing*[12].

In 1997, the Communities were given legislative powers to regulate certain aspects of the following taxes:

Ceded Taxes as of 1 January 1997			
Ceded Taxes	**Revenue accruing to Communities**	**Administration**	**Legislative Power that Communities may take on**
Personal Income Tax	33%	State	• Tax rates (the number of tax brackets must remain the same as under the State tax) • Tax credits, under certain conditions
Tax on Wealth	100%	Communities	• Tax rates (the number of tax brackets must remain the same as under the State tax) • Minimal deduction
Death and Gift Taxes	100%	Communities	• Reductions of the taxable income. • Tax rates
Property Transfer Tax and Stamp Duty	100%	Communities	• Tax rates
			• Exemptions

[11] M. MUÑOZ MACHADO: *Derecho Público de las Comunidades Autónomas, II,* Civitas, Madrid, 1984, pp. 459 *et seq.*; J.A. SANTAMARÍA PASTOR: *Fundamentos de Derecho Administrativo I,* Centro de Estudios Ramón Areces, Madrid, 1988, p. 599.

[12] J.J. ZORNOZA PÉREZ: "*Corresponsabilidad fiscal y financiación de las Comunidades Autónomas: el modelo para el quinquenio 1997-2001*", Eds. Jiménez-Blanco and Martínez Simancas: *El Estado de las Autonomías*, Vol. IV., CEURA, Madrid, 1997.

Gambling Taxes	100%	Communities	• Taxable base • Tax rates • Tax credits • Tax administration regulations

In July 2001, the Communities and the State agreed to broaden the scope of ceded taxes, which gave room for a substantial legislative reform[13]. As a result, the Communities' legislative powers to amend some taxes have increased, and new taxes have been ceded to them. The asymmetry between the different ceded taxes is now larger than ever. This means that depending on the tax, the yield will totally or partially accrue to Communities, which may or may not take on legislative powers, and may or may not be in charge of the administration of the tax. Thus, depending on the tax, the powers conferred to Communities vary so widely, that in some cases the ceded tax operates as a mere transfer, such as VAT, while in other cases, the broad scope of the Communities' powers makes the ceded tax very similar to an autonomous tax, such as the Gambling Taxes. A general outline of the new legislative powers can be seen in the following chart:

Ceded Taxes as of 1 January 2002			
Ceded Taxes	**Revenue accruing to Communities**	**Administration**	**Legislative Power that Communities may take on**
Personal Income Tax	33%	State	• Tax rates (the number of tax brackets must remain the same as under the State tax) • Tax credits, under certain conditions
Tax on Wealth	100%	Communities	• Tax rates • Minimal deduction • Tax credits
Death and Gift Taxes	100%	Communities	• Reductions of the taxable income • Tax rates • Deductions and tax credits • Tax administration regulations
Property Transfer Tax and Stamp Duty	100%	Communities	• Tax rates • Tax credits • Tax administration regulations
Gambling Taxes	100%	Communities	• Exemptions • Taxable base • Tax rates

[13] Carried out, among other, by the State Law No. 21/2001 of 27 December 2001. (Original title: *Ley 21/2001, de 27 de diciembre, por la que se regulan las medidas fiscales y administrativas del nuevo sistema de financiación de las Comunidades Autónomas de régimen común y Ciudades con Estatuto de autonomía).*

			• Tax credits • Tax administration regulations
VAT	35%	State	None
Excise	40%	State	None
Tax On Wine	40%	State	None
Tax on Electricity	100%	State	None
Tax on Vehicles	100%	Communities	• Tax rates (under certain conditions and limits)
Special tax on Gas	100%	Communities	• Tax rates (under certain conditions and limits) • Tax administration regulations

The Communities are free to choose whether they want to exercise their regulatory powers. This is consistent with the so-called "optional autonomy principle" ("*principio dispositivo*") that is implicitly assimilated in the Spanish Constitution. Under that principle, each Community may decide what powers and authorities it wants to take on[14]. In the absence of Community initiatives, the State regulates every aspect of the ceded taxes. If a Community decides to exercise regulatory powers over any ceded tax, it may do so by adopting legislation that replaces the State law in those aspects where the Community can legislate. For instance, in the case of the Tax on Wealth (where Communities may set the tax rates), the tax rates set by the State legislation only applies to residents in those Communities that decided not to set their own tax rates. The way that this principle has been structured – and the fact that the State still guarantees Communities lump-sum grants allocated on the basis of historical shares in State transfers – creates a strong disincentive for Communities to use their new taxation powers. Proof of this disincentive is the fact that, since 1997, Communities have mainly used their powers to create new fiscal benefits – assuring that they will be seen by taxpayers as the "Fairy Godmothers" offering services to citizens without asking for money in exchange, while the taxing role of "Wicked Stepmother" is played by the State.

So although there has been a reassignment of taxation powers, and Communities now have more room than they ever had for designing their own taxation policies, they still prefer to rely mainly on State transfers. In 2000, conditional and unconditional transfers still represented (roughly) 60% of the Communities' total revenues and the yield derived

[14] DE OTTO Y PARDO, I: *Derecho constitucional: sistema de fuentes*, Ariel, Barcelona, 1995, p. 256.

from ceded taxes represented 25%. However, if we take into account that most ceded taxes act as “transfers” when the Communities do not exercise any regulatory powers on the tax rates, we must conclude that transfers from the State still represented about 85% of Communities’ total revenues, as most of them had only exercised their powers to create new tax benefits. Taking into account that they are in charge of almost 40% of total expenditure, the fiscal imbalance is obvious. Thus, as I have said before, if one of the reasons for the reform was to increase the Communities’ fiscal responsibility and make them more accountable to taxpayers for the money they spend, it has failed to attain its goal. It remains to be seen whether the most recent increase of the Community taxation powers will help to change this situation. This shall not be easy, as the incentive problems just described remain largely the same in the laws putting the new agreements into practice[15].

So far, the only exception has been the PTSDT. Since 1997, when Communities were granted the power to set their own tax rates, most Communities have increased the tax burden of these taxes. As can be seen in the chart, Communities are entitled to the revenue of these taxes in their respective territories. They are also in charge of collection of the tax, and, since 2002, may also establish tax credits.

3. The Communities’ legislation on PTSDT

3.1. Tax Rates of PTSDT

The PTSDT is a complex tax that actually consists of three different taxes. The first is the Property Transfer Tax[16], which puts a 6% tax on the acquisition value of immovable property, unless the supply is subject to VAT. The Communities have the power to increase or decrease the tax rate. So far, almost all Communities have increased it to 7%.

The second tax is the Stamp Duty[17]. The tax burden depends on three factors:

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[15] V. RUIZ ALMENDRAL, see note 6, p. 475.
[16] “*Impuesto sobre Transmisiones Patrimoniales*”.
[17] “*Impuesto sobre Actos Jurídicos Documentados*”.

– the value of the transaction,
– the number of sheets of paper of the notarial deed or official document reflecting it, and
– whether or not the transaction is subject to Property Transfer Tax or VAT.

The Stamp Duty has two rates: a fixed rate of EUR 0.30 per sheet, and a proportional rate of 0.5% of the declared value of the property. The proportional rate only applies when the transaction is not subject to Property Transfer Tax, which will be the case when the transaction is subject to VAT.

The Communities only have legislative powers to increase or decrease the proportional tax rate. So far, almost all Communities have increased it to 1%.

Property Transfer Tax and Stamp Duty rates for immovable property (to be applied on the declared value)

Property Transfer Tax		**Stamp Duty**	
State's tax rate (applicable in: Canarias, Castilla-La Mancha and Castilla y León)	Communities' tax rate (applicable in Andalucía, Aragón, Asturias, Baleares, Cantabria, Cataluña, Extremadura, Galicia, Madrid, Murcia, La Rioja and Comunidad Valenciana)	State's tax rate (applicable in: Baleares, Canarias, Castilla-La Mancha, Castilla y León, Murcia and La Rioja)	Communities' tax rate (applicable in Andalucía, Aragón, Asturias, Cantabria, Cataluña[18], Extremadura, Galicia, Madrid and Comunidad Valenciana)
		EUR 0.30 per sheet of official paper	
6%	**7%**	**0.5%**	**1%**

The third tax is the Corporation Transactions Tax[19], which taxes operations or transactions undertaken by Corporations, such as increases in capital, mergers, etc. The tax is of little interest in the context of this article, as the Communities have no power to amend it, and will not be discussed.

[18] A special case is Cataluña, that in 2001 established a progresive rate in the Stamp Duty, as follows:

Taxable value (EUR)	**Tax rate**
0-30,000	0.5%
30,001-60,000	0.75%
> 60,000	1%

[19] "*Impuesto sobre Operaciones Societarias*".

3.2. The relationship between PTSDT and VAT

The relationship between PTSDT and VAT depends on the taxes that are embedded in the PTSDT. The Community legislation that we will deal with here, takes advantage of that relationship, which will first be analyzed.

With respect to the Property Transfer Tax, the general rule is that transactions that are subject to VAT are not subject to Property Transfer Tax[20]. Under Sec. 7.5 of the PTSDT Act, Property Transfer Tax only applies to transactions that are within the scope of VAT, but are declared exempt from it under the provisions of the VAT Act[21]. Such VAT exemption applies to the supply of used immovable property, unless the property has been renovated.

Due to the special structure of VAT, taxable persons may prefer to waive the exemption of the supply of immovable property and pay VAT, instead of Property Transfer Tax. At first sight, it may seem strange that taxpayers prefer to waive a tax exemption, but it is perfectly logical within the system of VAT, as taxpayers that are engaged in transactions that are exempt from VAT are not entitled to recover any input tax relating to those transactions. On the other hand, when the transaction is not exempt from VAT, the supplier is entitled to deduct the tax paid on goods and services used for the purposes of making that transaction from the tax payable on their output.

The possibility to waive a VAT exemption is not an individual benefit, but a means to maintain the neutrality of the tax with respect to business transactions[22]. For this reason, the VAT Act establishes special and strict conditions for waiving VAT exemptions[23]. First, it will only be permitted for certain operations, such as sale of used immovable property. Second, it will only be accepted when the buyer is also a trader, who is buying

[20] Sec. 7(5) of the Law regulating the PTSDT; Act (*Texto Refundido*) No. 1/1993 of 24 September 1993.
[21] Act No. 37/1992 of 28 December 1992.
[22] A. ASPICHUETA GRIJELMO: "*La renuncia a las exenciones inmobiliarias del IVA*", *Crónica Tributaria*, No. 181, 1993, p. 3.
[23] J.M. TEJERIZO LÓPEZ: "*Los conflictos de aplicación normativa: Impuesto sobre el Valor Añadido versus Impuesto sobre Transmisiones Patrimoniales*", Revista de Información Fiscal, 2001, p. 33; and J. RODRÍGUEZ MÁRQUEZ: "*El Impuesto sobre el Valor Añadido en las Operaciones Inmobiliarias*", *Cuadernos de Jurisprudencia Tributaria*, No. 24, Aranzadi, Navarra, 2002, pp. 46 *et seq*.

the property for business purposes and has the right to deduct VAT. Finally, the buyer must be informed of the waiver, which will usually be done through the notarial deed that reflects the transaction. It is relevant to recall here that such deed is usually subject to Stamp Duty. This way of aligning VAT and PTSDT is not exclusive for Spain, but constitutes a common practice in numerous countries[24].

3.3. Communities taking advantage of the relationship between VAT and PTSDT

As I have said above, the Communities have the power to set their own tax rates for Property Transfers Tax and Stamp Duty. For the latter, such power only affects the deeds and official documents relating to transactions that are not subject to Property Transfer Tax, i.e. that are subject to VAT.

Since 1997, some Communities have established reduced tax rates in certain cases where they are able to take on revenues that would normally accrue to the State in the form of VAT. This has been done by increasing the rates in the Stamp Duty, and decreasing them in the Property Transfer Tax, in order to encourage or discourage the waiver of the VAT exemption. Thus, when a transaction in used immovable property is exempt from VAT, and the conditions to waive the exemption (opt for taxation) are fulfilled, a lower Property Transfer Tax applies if the supplier does not opt for taxation. Likewise, a higher rate of Stamp Duty will be applicable if the supplier exercises the option for taxation.

The first Community to establish these different tax rates was Aragón in 2001. Catalonia, Madrid and La Rioja followed in 2002. Finally, the Communities of Andalusia, Asturias, Baleares, Cantabria and Extremadura adopted similar measures in 2003. A feasible explanation for this copycat behaviour lies in the fact that the Communities are fully aware that such legislation is only just within the boundaries of the lawfulness. Thus, they prefer not to implement such measures until they are certain that they will not encounter any legal problems. This explanation may seem too simple, but it is not if we are aware that this kind of behaviour is actually very common among

[24] A.A. TAIT: *Value Added Tax, International Practice and Problems,* International Monetary Fund,

Communities. A good example of this is the way Community taxes are often introduced. When a Community introduces a new tax, the others pay very close attention to its structure and the way the new tax is received by the State. If it is considered an attractive means to obtaining more revenues, i.e. it is easy to administer, does not cause too strong popular opposition, etc., and the State's reaction is not too harsh, i.e. the introduction of the tax is not challenged by the State before the Constitutional Court or even if it is, the legal arguments for the lawsuit are not considered very strong, the other Communities may introduce a similar, in most cases identical, tax. Normally, Communities will wait for at least a year to see what the State's reaction will be. Examples of this behaviour are: in 1991, Baleares introduced a tax on certain facilities that may affect the environment[25]. Only six years later, Extremadura adopted an identical tax[26]. More recently, in 2000, Cataluña introduced a tax on certain shopping areas, such as big supermarkets[27]. The year after, Navarra adopted a similar tax and Asturias followed that example in 2003[28].

In view of the preceding examples, it is not surprising that the Communities have acted the same way with respect to PTSDT. The result is almost identical Community legislation which, in this case, only differs in one or two percentage points, as can be seen in the following chart:

Community	**Special tax rates in Stamp Duty** (State's rate: 0.5%) To be applied when the supplier opts for VAT	**Special tax rates in Property Transfer Tax** (State's rate: 6%) To be applied when all conditions for the option for VAT are fulfilled, but the supplier does not exercise the option
Andalucía	2%	-
Aragón	1.5%	2%
Asturias	1.5%	2%
Baleares	1.5%	3%

Washington DC, 1988, p. 65.
25 *Impuesto sobre determinadas instalaciones que inciden en el Medio Ambiente.*
26 These two taxes were established, respectively, by Law No. 19/1991 of 20 December 1991 (Baleares), and by Law No. 7/1997 of 29 May 1997 (Extremadura). The Balearic tax was declared void by the Constitutional Court (Decision 289/2000). Although the ruling cannot be extended to the tax established by Extremadura, this probably explains why no other Community has created another similar tax.
27 *Impuesto sobre Grandes Establecimientos Comerciales*.
28 The laws regulating these three taxes are: Law No. 16/2000 of 19 December 2000 (Cataluña); Law No. 23/2001, (Navarra) and Law No. 15/2002 of 27 December 2002 (Asturias).

Cantabria	1.5%	4%
Cataluña	1.5%	-
Extremadura	2%	3%
La Rioja	1.5%	2%
Madrid	1.5%	-

The following example may serve to clarify the relationship between VAT and PTSDT.

A and B are both traders in the property development business. B buys a used house from A for EUR 200,000 for the purpose of transforming it into a residence and subsequently sells it to a third party. All conditions for exercising the option for taxation are fulfilled, including the express acceptance by B. The transaction is reflected in a notarial deed that has seven sheets of paper.

The tax consequences of this transaction vary considerably depending on whether A exercises the option for taxation and whether Community legislation applies.

First scenario: A opts for taxation

Supplier A opts for taxation and charges VAT to B. In addition, B must pay Stamp Duty.

- **VAT:** The tax rate for housing is 7%, so the amount of VAT that will be charged to B is (EUR 200,000 x 7%) EUR 14,000. That amount will be deductible from B's output VAT.

- **Stamp Duty:** The tax burden for Stamp Duty will be as follows:

  - A fixed tax rate of EUR 0.30 per sheet of official paper: 7 x EUR 0.30 = EUR 2,10.

  - Because the transaction is subject to VAT, the deed is also subject to Stamp Duty at the proportional rate. The Communities may set that rate.

In the absence of Community legislation, the State's tax rate of 0.5% will be applicable. The amount of Stamp Duty is (EUR 200,000 x 0.5%) EUR **1,000.**

If Community legislation applies, the amount of Stamp Duty will be substantially higher, and, therefore, constitutes a "penalty" on the option. The tax rate would be 1.5% in the Communities of Asturias, Aragón, Balearic Islands, Cantabria, Catalonia, Madrid and La Rioja, and 2% in Andalusia and Extremadura.

Therefore, depending on the Community where the property is located, the tax burden will be:

Communities	**Stamp Duty**	
	Rate	**Amount**
Andalucía	**2%**	**EUR 4,000**
Aragón	**1.5%**	**EUR 3,000**
Asturias	**1.5%**	**EUR 3,000**
Baleares	**1.5%**	**EUR 3,000**
Canarias	**0.5%**	**EUR 1,000**
Cantabria	**1.5%**	**EUR 3,000**
Castilla y León	**0.5%**	**EUR 1,000**
Castilla-La Mancha	**0.5%**	**EUR 1,000**
Cataluña	**1.5%**	**EUR 3,000**
Comunidad Valenciana	**0.5%**	**EUR 1,000**
Extremadura	**2%**	**EUR 4,000**
Galicia	**0.5%**	**EUR 1,000**
La Rioja	**1.5%**	**EUR 3,000**
Madrid	**1.5%**	**EUR 3,000**
Murcia	**0.5%**	**EUR 1,000**

Second scenario: A does not opt for taxation

Although all conditions for the option for taxation are fulfilled, A decides not to waive the VAT exemption. Consequently, purchaser B will have to pay Property Transfer Tax and the fixed rate of the Stamp Duty.

- **Property Transfer Tax:**
  - In the absence of Community legislation, the State's tax rate, which amounts to 6%, will be applicable.

– If Community legislation is applicable, the tax burden will be substantially lower, as it aims to encourage taxable persons not to waive the VAT exemption. The tax rate will be 2% (for Aragón, Asturias and La Rioja), 3% (for Balearic Islands and Extremadura) or 4% (in Cantabria).

Therefore, depending on the Community where the property is located, the tax burden will be:

Communities	**Property Transfer Tax**	
	Rate	**Amount**
Andalucía	**6%**	**EUR 12,000**
Aragón	**2%**	**EUR 4,000**
Asturias	**2%**	**EUR 4,000**
Baleares	**3%**	**EUR 6,000**
Canarias	**6%**	**EUR 12,000**
Cantabria	**4%**	**EUR 8,000**
Castilla y León	**6%**	**EUR 12,000**
Castilla-La Mancha	**6%**	**EUR 12,000**
Cataluña	**6%**	**EUR 12,000**
Comunidad Valenciana	**6%**	**EUR 12,000**
Extremadura	**3%**	**EUR 6,000**
Galicia	**6%**	**EUR 12,000**
La Rioja	**2%**	**EUR 4,000**
Madrid	**6%**	**EUR 12,000**
Murcia	**6%**	**EUR 12,000**

– **Stamp Duty:**
  – A fixed tax rate of EUR 0.30 per sheet of official paper: 7 x EUR 0.30 = EUR 2,10.
  – As the transaction is subject to Property Transfer Tax, it is not subject to Stamp Duty at the proportional rate.

4. Evaluation of the Community tax measures

Having examined the two scenarios, the question rises: *when will the second scenario be a good option for the taxpayers?* According to the VAT logic, the answer is crystal clear: *never*. Lower rates of the Property Transfer Tax do not constitute an adequate incentive not to waive the VAT exemption. The second scenario is an unrealistic choice, for it implies that they lose the right to deduct input VAT.

The next question would be: *why have the Communities reduced the rate of the Property Transfer Tax?* There does not seem to be a clear answer to this question. The Community legislation that reduced those rates does not provide an indication as to why such measures have been adopted. Furthermore, it is also quite surprising that the Communities are still establishing different rates in PTSDT in order to attract the VAT revenues, considering that, since January 2002, *35*% of VAT revenues accrue to them. Why should they adopt legislation whose objective it is to reduce VAT revenues in favour of PTSDT? A possible explanation for this is that, as opposed to PTSDT, they receive VAT revenues in an indirect way. While PTSDT revenues accrue to Communities on the basis of criteria that are directly linked to the territory, such as the place where the immovable property is located, VAT is transferred to the Communities on the basis of statistical data relating to the average consumption in a given Community as provided by the National Statistics Institute (*Instituto Nacional de Estadística*). That criterion is quite similar to that employed in other federations, for example, the Canadian *Harmonized Federal-Provincial Sales Tax*[29]. This tax is collected by the Federation and then distributed among the Provinces using the criterion of the aggregate consumption, as calculated by *Statistics Canada*[30][31].

At any rate, although the above legislation will probably fail to actually obtain further revenues in the form of Property Transfer Tax, it is in my view clear that it still creates confusion for the taxpayer, that may be deluded to think that not waiving the exemption could represent a benefit, when it is clearly not so. It is not, however, a clear case of tax competition or piracy, for it is unrealistic to believe that taxpayers would opt for taxation under the Property Transfer Tax in the circumstances explained above.

With respect to the proportional rate of the Stamp Duty, the conclusion must be different. The increased rate that applies where the taxpayer legitimately opts to waive

[29] So far, only the Provinces of New Brunswick, Newfoundland and Nova Scotia have entered into the HST system, by which, starting with a flat rate of 15%, 7 points accrue to the Federation and the other 8 to the Provinces.
[30] *Statistics Act*, 1985, chapter S-19 *Canada Statutes*.
[31] R.W. BOADWAY and H.M. KITCHEN: *Canadian Tax Policy*, Canadian Tax Foundation, Toronto, 1999, pp. 18 *et seq.*

the VAT exemption, may, in my view, constitute a way of tampering with the VAT option. In short, Communities obtain a *benefit,* in the form of higher revenues, which derives from the exercise of an option –the waiver of the VAT exemption - that forms part of the VAT system. In this respect, I believe it feasible to maintain that the Community legislation may imply an infringement of the Spanish Constitution, and, in an indirect way, of the laws that bestow taxation powers to the Communities, and of the Sixth Directive.

Possibly, the main argument to maintain the unconstitutionality of the Community provisions, is an infringement of the solidarity principle, enshrined in Secs. 2 and 156(2) of the Constitution. As interpreted by the Spanish Constitutional Court, the solidarity principle implies the interdiction for the Communities to "*take or carry out decisions that harm the general interest of the Nation*", and it compels them to take into account "*the community of interests that bind them together*" (Opinion No. 64/1990, FJ. 7th). Thus, as the Court put it, one of the main aspects of the solidarity principle is the realization of the "*duty of loyalty to the Constitution*" (Opinion No. 11/1986, FJ. 5th).

As the Spanish Constitutional Court has acknowledged, the interpretation of the solidarity principle is, to a certain extent, equivalent to the German "*Bundestreue*", or to the Italian principle of "*leale collaborazione*"[32]. The *Bundestreue* is based upon the idea that the "*federal structure implies the combination of two tiers of government that support mutually each other*"[33], and imposes the obligation, for both the *Bund* and the *Länder*, to take into account the general or common interests, in order to guarantee both a certain unity and the basic harmony of the system[34].

In a nutshell, and according to numerous Decisions of the Spanish Constitutional Court on this matter, the solidarity principle implies obligations, both for the Communities and for the State, that go well beyond the formal legal framework. Thus, in the exercise

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[32] F. PUZZO: *Il federalismo fiscale, L'esperienza italiana e spagnola nella prospettiva comunitaria*, Giuffrè, Milano, 1995, pp. 70-71.
[33] H.A. SCHWARZ-LIEBERMANN VON WAHLENDORF: "*Une notion capitale du Droit Constitutionnel Allemand: la bundestreue (fidélité fédérale)*", *Revue du Droit Public* (France), 1979, p. 770.
[34] K. HESSE: *Grundzüge des Verfassungsrechts der Bundesrepublik Deutschland,* C.F. Müller Verlag, Heidelberg, 1995, p. 117.

of their legislative powers on ceded taxes, the Communities must respect not only the formal framework that sets the boundaries for their powers, but also its *spirit*, which implies the obligation of respecting the rest of the tax system.

5. Conclusion

Although they will probably fail to affect the exercise of the option to waive the VAT exemption, the Community provisions on PTSDT, in particular, Stamp Duty, provide the Communities with a benefit that is *beyond* the spirit of the law, and constitute an undue extra burden for taxpayers as well. In making it “more expensive” to waive the VAT exemption, it is an indirect way of tampering with the neutrality of the VAT system.

Because the Community provisions on Stamp Duty do not aim to directly compete in a clear and transparent way, they probably do not fall in the category of “Tax competition”, but in another category, which I would call “Tax piracy”. Tax competition is traditionally understood as the behaviour of certain States or subnational governments, to attract taxable transactions from other jurisdictions by reducing the tax burden, i.e., in order to *compete* with other countries or tiers of government the tax system is made more attractive to taxpayers[35]. Although the Community provisions on PTSDT do not directly affect the relationship with the State or other Communities, they punish or reward the behaviour of taxable persons in the context of VAT. The taxable person's choice to apply or waive the VAT exemption should not be influenced by Community tax measures, as this choice merely serves to maintain the neutrality of the VAT system. Therefore, although the *means* are different – the Communities take advantage of choices that taxpayers make for VAT purposes only -, the results are identical to those of tax competition: they generate greater tax revenues for the Communities.

[35] OECD: *Harmful Tax Competition, An Emerging Global Issue*, Paris (France), 1999, pp. 14 *et seq.*