SPANISH TAXATION FOR EXPATS

GARRIGUES

Álvaro de la Cueva González-Cotera

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Spanish taxation of individuals

Spanish taxation of individuals

Spanish individual tax system

- Three levels of taxation in Spain:
  - Central government
  - Governments of the 17 autonomous regions
  - Municipal governments
- Three main direct taxes:
  - Personal income tax
  - Net wealth tax
  - Inheritance and gift tax
- Taxes levied by the autonomous regions are relatively unimportant
- Local taxation is implemented through five basic minor taxes, mainly on real estate

Spanish taxation of individuals

Spanish personal income tax. Taxable persons

- Individuals are taxed as residents if:
  - Their "habitual residence" is in Spanish territory.
  - They are Spanish nationals who moved their residence to a tax haven in the last 4 years.
- For these purposes, habitual residence is determined by:
  - 183-day rule (including temporary absences);
  - Centre of economic interest criterion; and
  - Habitual residence in Spain of the individual's spouse (not legally separated) and underage dependent children

Spanish taxation of individuals
Spanish personal income tax. Taxable income

- To determine personal income tax payable, the taxpayer's worldwide income is broken down into:
  - General income: employment income + income from immovable capital + business income + capital gains/losses not deemed savings income.
    - General income is taxed according to a progressive scale of rates.
    - Maximum rate applicable at State level is 22.5%
    - Additional autonomous region rates may also apply. Typically, the maximum rate is also 22.5%, but regions can change it (e.g. Madrid 21%; Catalonia 25.5%)
  - Savings income: income from movable capital (dividends, interest and payments from life or disability insurance contracts) + capital gains/losses arising from transfer of assets.
    - Generally taxed at 19% on the first €6,000; 21% on between €6,000.01 and €50,000; and 23% on the excess over € 50,000

Spanish taxation of individuals

Spanish personal income tax. Taxable income

- Employment income
  - Comprises any emoluments, consideration or benefits in cash or in kind which arise, directly or indirectly, from dependent services and which do not constitute business or professional income.
  - Non-periodic income generated over more than 2 years benefits from a 30% reduction, applicable to a maximum income of €300,000, insofar as the same reduction has not been applied in the previous 5 years.
  - Special case of stock options:
    - First €12,000 are exempt under certain conditions;
    - 30% reduction applicable to a maximum of €300,000, limited to 1 out of every 5 years;
    - Possibility of applying the 30% reduction to stock options granted before January 1, 2015, even if the same reduction has been applied in the previous 5 years
- Income resulting from the economic activities (entrepreneurial or professional) of a taxpayer which are aimed directly at the production or distribution of goods or services.

Spanish taxation of individuals

Spanish personal income tax. Taxable income

- Income from movable capital, including:
  - Participation in a company's capital: dividends, profit-sharing rights and any other income derived from an entity by the taxpayer as member, shareholder or partner;
  - Receivables: interest payments, implicit and nominal yields;
  - Royalties;
  - Life or temporary annuities, where the taxpayer is both recipient and investor
  - Compensation received for "the right to exploit a person's image"
- Income from immovable capital
  - Includes both actual and imputed real estate income (unoccupied or holiday property triggers a fictitious item of income).
  - Income from rental of dwellings is reduced by 60% on the condition that the taxpayer has duly included it in his tax return.

Spanish taxation of individuals
Spanish personal income tax. Taxable income

- Capital gains:
  - Difference between transfer price and acquisition cost (i.e. acquisition price plus related expenses, other than interest, paid by the purchaser, minus any accumulated minimum depreciation)
  - Gains derived from the transfer of assets constitute savings income, while other gains (i.e. lottery prizes and unjustified increases of net wealth or indemnities) are deemed general income.
  - Capital losses are not deductible in certain cases.

Spanish taxation of individuals
Spanish personal income tax. Tax credits

- Tax credit for investment in newly or recently formed companies
- Tax credit on economic activities
- Tax credit for film and audio productions
- Tax credit for income obtained in the autonomous municipalities of Ceuta and Melilla
- Tax credit for the protection and sharing of cultural assets
- Tax credit on qualifying gifts
- Double taxation relief

Spanish taxation of individuals

Spanish personal income tax

State Budget Bill for 2019

- If the current State Budget Bill for FY 2019 is finally approved, the following changes will be implemented in personal income tax:
  - Increase of the maximum rate applicable at the State level to general income, to 26.5% on amounts exceeding €300,000
  - Increase of taxation on savings income: 23% on income of between €50,000 and €140,000; and 27% on the excess over €140,000.
  - The maximum withholding tax rate applicable to employment income is increased to 49%.

Spanish taxation of individuals

Spanish non-residents income tax

- A non-resident individual is anyone in Spain who does not meet the criteria to be deemed a resident pursuant to the residence rules mentioned above.
- Non-residents are liable to tax in respect of Spanish-source income and capital gains.
- Final withholding tax system, unless the income is obtained through a permanent establishment.
- Certain exemptions apply, mainly to EU residents, although non-EU residents may also enjoy exemptions on:
  - Government debt securities;
  - Gains from shares listed on Spanish markets; and
  - Interest on certain bank accounts.

Spanish taxation of individuals

Spanish non-residents income tax. Tax rates

- Employment income → taxation at a flat 24% rate without deduction of expenses or allowances.
  - Special rule for stock options: Spain has taxing rights on stock options generated while the employee was Spanish resident, even if vesting/exercise takes place while the individual is resident abroad.
- Business and professional income → 24%
- Dividends, interest income → 19% on the gross amount received
  - Interest paid in kind → 22.8%
- Royalties → 24%
- Capital gains → 19%

Spanish taxation of individuals

Special inbound expatriate regime

- AKA “Beckham Law”
- An individual who moves to Spain to work may choose to be taxed, for the tax year in which he moves to Spain and for the following 5 tax years, under either:
  - personal income tax rules (i.e. taxation at progressive rates but with deduction of certain expenses and allowances), or
  - non-resident income tax rules (i.e. taxation at a flat 24% rate for the first €600,000 and at a 45% rate for the excess, but without deduction of expenses or allowances).
    - The current State Budget Bill for FY 2019 provides for an increase to 49% of the rate applicable to the excess.
- This choice is available to an individual who has:
  - Not been resident in Spain during the preceding 10 years; and
  - Moved to Spain due to employment contract or directorship in a company in which he owns less than a 25% stake.
- This regime does not apply to professional athletes.
- Important: That choice must be communicated to the Spanish tax authorities within 6 months from the individual’s registration in the social security system.

Spanish taxation of individuals
Special expatriates regime

- Employment income earned in a foreign country by residents of Spain is exempt for up to €60,100 per year, provided that:
  - the income is earned for services physically performed abroad;
  - the recipient of those services is either a non-resident company or a foreign situs permanent establishment of a Spanish company; and
  - the foreign country is not a tax haven.
- If any of the above conditions is not met, employment income earned by a resident of Spain in tax treaty countries will be taxed exclusively in Spain if the time spent abroad <183 days and the income is paid entirely by employer resident in Spain.
- The special tax regime is also applicable whenever the employee maintains the employment contract with the Spanish company, insofar as the recipient of the services performed abroad is the non-resident company or permanent establishment. In order to avoid being challenged by the Spanish tax authorities, the expat's functions and responsibilities abroad should be clearly defined.
- In the case of directors, however, the Spanish Directorate-General of Taxes generally denies the applicability of the expatriates regime.

Spanish taxation of individuals

Spanish net wealth tax

- Spanish tax residents are taxed on their worldwide net wealth. Non-resident individuals are taxed exclusively in respect of their assets in Spain.
- Net wealth tax is a regional tax, and each region sets its own tax rates and allowances within certain limits.
  - Standard allowance of €700,000 (the allowance may vary by autonomous region).
  - Where a region does not set its own rates, the standard progressive rates range from 0.2% (on the first €167,129.45) to 2.5% (on the excess over €10,695,996.06).
  - Certain regions have increased the rates (e.g. 2.75% in Catalonia) while others have reduced them or even eliminated the tax (e.g. Madrid).
  - If the current State Budget Bill for FY 2019 is finally approved, the maximum rate would be increased to 3.5%.

Spanish taxation of individuals
Spanish net wealth tax

- There are exemptions on certain assets, including:
  - Assets and rights linked to an entrepreneurial or professional activity.
  - Habitual abode, with a maximum of €300,000 per taxpayer.
  - Unlisted shares and comparable interests in companies (other than portfolio or real estate management companies) in which the taxpayer (i) owns more than 5% of the capital and (ii) performs a managerial function which is the source of more than 50% of his total income.

Spanish taxation of individuals

Inheritance and gift tax

- Inheritance and gift tax is levied on the acquisition of property and associated rights through inheritance, bequest or inter vivos gift, as well as on the acquisition of the proceeds of a life insurance policy where the beneficiary and the policyholder are not the same individual.
- Residents of Spain are liable to tax with regard to property and associated rights located in Spain or abroad. Non-resident recipients are subject to this tax:
  - in regard of assets located in Spain or rights which may be exercised in Spain; and
  - in respect of proceeds under a life insurance policy taken out with a Spanish insurance company or a Spanish branch of a foreign company.
- Anti-abuse rules exist in order to avoid dilution of inheritance through prior inter vivos transfers.

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Spanish taxation of individuals
Inheritance and gift tax

- Autonomous regions can set their own rates (e.g. Madrid, from 7.65% on the first €8,313.20 to 34% on the excess over €798,817.20; Catalonia, from 7% on the first €50,000 to 32% on the excess over €800,000)
- If a region does not set its own rates, the standard progressive rates currently range from 7.65% (on the first €7,993.46) to 34% (on the excess over €797,555.08).
- Surcharges apply to the tax liability depending on preexisting net wealth.
- In any case, tax relief is available:
  - Family businesses allowance (95%)
  - Habitual abode allowance (95% allowance, with a maximum of €122,606.47)
  - Personal relief (ranging from €7,993.46 to €150,253.03)
- Autonomous regions are entitled to grant further allowances from the final tax liability (e.g. the autonomous region of Madrid provides for a 99% allowance).

Exit tax

Exit tax

Article 95 bis of the Spanish pit law

- Individual income taxpayers who have been tax resident in Spain for 10 out of the last 15 years and who forfeit their status as such due to a change of residence, will be taxed on underlying capital gains on shares if:
  - the combined market value of the shares > €4 million; or
  - Stake > 25% and market value > €1 million. In this case, this regime will only apply to the shares in these specific entities.
- These capital gains shall be included in the savings income of the last tax period for which the individual income tax return was filed, by filing a supplementary tax return. No penalties or interest in arrears will be due.
- Where the change of residence is to another EU or EEA Member State with which Spain has an effective exchange of tax information, the tax is generally deferred, but may be triggered where, in the 10 years following the change of residence (i) the shares are transferred inter vivos, (ii) the status of resident of an EU or EEA Member State is forfeited, or (iii) certain reporting obligations are breached.

Exit tax

Article 95 bis of the Spanish PIT Law

- Where the individual's residence is changed to another State (even outside the EU) with which there is an effective exchange of tax information (e.g. the US) and it is due to employment reasons, he may request the deferral of the exit tax for a period of 5 years. A 5-year extension may also be requested if the circumstances warrant a longer assignment abroad.
- In cases where resident status is restored before the deferral period expires and the shares are still owned by the taxpayer, the deferred tax liability will be extinguished, along with the corresponding interest in arrears.
  - If the exit tax had already been paid at the time of recovery of Spanish residence, the taxpayer would be entitled to a refund of the aforementioned taxes paid.
  - A similar regime may apply in cases where the taxpayer contributes shares to a holding company under a "tax neutrality" regime

Reporting of foreign situs assets: Tax Form 720

Tax form 720

Introduction

- Spanish residents are obliged to report any real estate, bank accounts or securities held abroad before the end of the month of March of the next year.
- No taxes are due as a consequence of filing Tax Form 720. Nonetheless, failing to file that form on time may entail the imposition of:
  - Formal penalties: A <u>penalty of €5,000 per item of data</u> that should have been reported in the tax form or that was included in an incomplete, inexact or untruthful way, <u>with a minimum penalty of €10,000 per category of assets</u> (accounts, immovable property and securities). In other words, failure to file Tax Form 720 where the individual owns assets in the 3 categories would result in a minimum penalty of €30,000.
    - Penalties would be reduced to €100 per item of data, with a minimum penalty of €1,500 per category of assets when the Tax Form is filed late but without administrative injunction.
  - A <u>penalty of 150%</u> of the unreported amount of unjustified capital gains.

Tax form 720

Obligation to file

	FIRST DECLARATION	SUBSEQUENT DECLARATIONS	
Accounts	Balances at 12/31 or average balances exceed, jointly, **€50,000**	Joint balances increase by more than **€20,000** compared to the last declaration	Loss of the status of account holder, beneficiary, authorized person or representative
Securities, rights, annuities and insurance	Value at 12/31 exceeds, jointly, **€50,000**	Joint value increases by more than **€20,000** compared to the last declaration	Extinguishment of ownership
Immovable property	Value by 12/31 exceeds, jointly, **€50,000**	Joint value increases by more than **€20,000** compared to the last declaration	Extinguishment of ownership

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Application of Spanish tax treaties

Application of Spanish tax treaties

Entitlement to benefits

- In order for taxpayers to enjoy benefits provided by tax treaties, tax residence must be proven.
- Residence abroad is proven through a tax residence certificate issued by the competent foreign tax authority (i.e. for US taxpayers, form 6166). The certificate must explicitly state that the taxpayer is resident for purposes of the Spain-US tax treaty.
- Residence in Spain is proven through a tax residence certificate issued by the Spanish tax authorities (form 01).
- However, Spanish taxpayers applying the special tax regime for inbound expatriates (i.e. taxation under the Spanish Non-resident Income Tax Law, exclusively for income obtained in Spain, instead of worldwide income) are not entitled to obtain a tax residence certificate for the purpose of the tax treaty. In lieu thereof, these special taxpayers can obtain generic tax residence certificates.

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