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Spain
Wealth Management

Spain : AN INTRODUCTION

Contributed by Javier Estella Lana and Patricia García Mediero, Avantia Asesoramiento Fiscal y Legal S.L.

2014: Spanish tax reform and the importance of Form 720

For private clients with Spanish links, in many respects 2014 will continue to be shaped by familiar coordinates. However, important changes are expected in the year ahead.

Form 720 on declaration of foreign assets, now in its second year of existence, needs to be filed before the Spanish tax administration by all Spanish residents and companies with financial interests in qualifying foreign assets (with certain *de minimis* exemptions). "Financial interests" is defined very broadly - outright ownership, signatories, representatives, those with powers to dispose, beneficiaries of foundations and/or trusts, usufructuaries, insurance holders, etc. Qualifying foreign assets comprise bank accounts, securities, deposits, fund units, shares and stock, life insurance, annuities, private pension payments and foreign real estate.
The filing deadline for 2013 was 31 March 2014. Penalties for late filing and failure to report are extremely burdensome. The law also gives the Spanish tax authorities the power to overrule the current four-year statute of limitations on unreported assets in certain situations.

2013 saw one crucial development: a statement of practice issued by the Spanish tax authorities in response to a taxpayer's query stated that any assets not reported strictly on time (i.e. 31 March 2014 for 2013 filings) may be treated as capital gains subject to the marginal income tax rate (currently 52%), unless the taxpayer has proof that the assets were acquired through income or gains duly declared Spanish for tax purposes, or otherwise originated when the taxpayer was not resident in Spain.

This interpretation of the law and enhanced tax compliance protocols in offshore jurisdictions are placing non-compliant taxpayers under increasing pressure to act. These taxpayers should review their tax situation and past risks, with a view to finding the best way forward towards full compliance. Tax fraud, a criminal offence in Spain, remains applicable to taxpayers who wilfully defraud taxes in excess of EUR120,000 per annum, a level easily reached among private clients.

Information returns aside, the personal tax landscape in Spain in 2014 remains largely similar to 2013. There is still a distinction between investment income or gains, subject to a marginal rate of 27% for income or gains in excess of EUR24,000, and regular income, which is taxed progressively at a marginal rate in the region of 52% for income exceeding EUR300,000.

Wealth tax will also continue to apply in 2014. Under the general regime, the marginal rate will remain at 2.5% for individuals with a net asset value in excess of EUR10.7 million (with a EUR0.7 million *de minimis* exemption). This tax is fully transferred to the Spanish regions, so situations must be assessed individually.

The Inheritance and Gift Tax regime remains mostly unchanged. Under general regulations, the rate of tax will continue to be determined by kinship with the transferor, the pre-existent wealth of the recipient and the value of the assets transferred. Transfers exceeding EUR800,000 to spouses and descendants with pre-existent wealth below EUR400,000 will be subject to a 34% rate of tax. Again, this tax is fully transferred to the Spanish regions in certain cases, so situations must be assessed individually. In any event, value minimisation strategies and application of Business Property Relief remain important tax planning techniques.

The beneficial regional regimes for close family transfers may at present not be applied where the transferor and/or transferee are non-resident. However, this issue is currently sub judice under the pending case European Commission v Kingdom of Spain, on non-discrimination grounds (C-127/12). A sentence is expected shortly, possibly before this summer.

2014 has seen another major development in terms of taxation. In March 2014, a full report was issued by the Tax Experts Commission appointed by the Spanish government setting out 125 recommendations towards a major Spanish tax reform, one of the public objectives of the current government before the next general election in late 2015. The recommendations cover the main Spanish taxes, including income, corporation, wealth and inheritance tax as well as VAT and transfer tax.

Recommendations of special relevance to international private clients with Spanish interests include a decrease in income tax rates (to a flat rate of around 20% on investment income or gains and a 43-44% marginal rate on regular income), the abolition of wealth tax, enforcement of *de minimis* inheritance and gift tax rates across most Spanish regions, modification of the general inheritance and gift tax rates to a range of 4-11% (which would mean a very substantial decrease for most international clients), a substantial increase in yearly municipal real estate taxes (Impuesto sobre Bienes Inmuebles or IBI) and a drive towards an eventual reduction and elimination of transfer taxes and stamp duty (relevant to investors in Spanish real estate).

As a significant development, recommendation 32 of the Experts Commission calls for an overhaul of the current special impatriation regime (commonly referred to as the “Beckham clause”) providing a beneficial tax regime to certain individuals who impatriate to Spain.

This regime has severe limitations at present, as it only applies to individuals (not spouses or children) who take up Spanish residence as a result of an employment contract with a Spanish company or a foreign company operating in Spain, with certain relevant limitations.

Recommendation 32 calls for very significant amendments to this regime to make it more attractive to individuals who are considering impatriation to Spain. Proposed changes include opening up its applicability to a substantially broader range of taxpayers, to include employees, professionals, entrepreneurs, company directors, substantial shareholders, pensioners and passive investors in general. For qualifying employees, it also calls for the elimination of all current limitations in terms of the nature of employment and remuneration limits. It recommends modifying certain timing requirements, so that qualifying individuals must not have been tax residents in Spain in the five years prior to impatriation (currently ten) and extending the applicability of the regime to the first 11 years of tax residence in Spain since impatriation (currently six).

The benefits of the regime would essentially remain the same as at present, limiting the individual's exposure to Spanish income tax to Spanish situs income and gains, therefore escaping Spanish tax even on remittances from abroad. Wealth tax would be limited to Spanish situs net worth or otherwise fully abolished. Exemption from foreign asset information Form 720 returns would also be provided.

If finally implemented, this would undoubtedly make Spain a serious contender as a potential jurisdiction to relocate to among foreign taxpayers. For non-EU/EFTA citizens, this special tax regime, together with the new 2013 provisions under Law 14/2013 easing the obtention of Spanish legal residence permits to certain individual investors to Spain, would certainly become an attractive proposition. Developments on this specific recommendation must therefore be closely followed.