SPAIN: An Introduction to Spain

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THE 2015 SPANISH TAX REFORM: PRACTICAL IMPLICATIONS FOR NATIONAL AND INTERNATIONAL PRIVATE CLIENTS

The Spanish tax reform, largely in effect from 1 January 2015, has brought about a wide array of changes of special importance to both domestic and international private wealth clients. Amendments with substantial economic impact have been made to all personal taxes – income tax, corporation tax, wealth tax and inheritance and gift tax.

In terms of Spanish tax resident individuals, the most immediate outcome of the reform has been a decrease in tax rates – under mainstream rules, the marginal income tax rate for regular income for 2015 is down 5 points to 47%, and will decrease further to 45% in 2016. The marginal income tax rate for investment income and gains for 2015 is down 3 points to 24%, and will decrease further to 23% in 2016.

For income tax purposes, shareholder funding arrangements is an area of specific focus; distribution of share premium reserves and proceeds from share capital reductions in unquoted companies now generally trigger a 24% tax charge – under old rules, these distributions were generally not taxable but only reduced the tax base cost of the shares.

This tax charge may be substantially minimised in a number of cases with careful planning, particularly by reference to the interaction between accounting and tax provisions, transactions stepping up the base cost of shares for income tax purposes and funding alternatives via leverage arrangements.

The new income tax legislation also limits abatement relief on capital gains derived from assets acquired on or before 31 December 1994, which may now only be applied to gains where the overall proceeds for all pre-1994 assets do not exceed € 400,000. From 2015 onwards, large gains on pre-1994 assets attract a 24% tax charge.

In practice, phase-out of abatement relief will typically affect real estate properties and shares in family owned companies. Joint income tax and inheritance and gift tax planning is a basic tool going forward, given the income tax exemptions attached to protected gifts.

Spanish tax resident individuals with investments abroad also need to consider the implications of the very significant amendments to the International Controlled Foreign Corporations (CFC) provisions in the Spanish income tax law. In practice, Spanish resident individuals falling under CFC provisions now bear a 47% income tax charge on their share of the underlying income and gains. From 1 January 2015, EU resident entities in low tax jurisdictions (i.e. those subject to a corporation tax of less than 21% and 18.75% in 2015 and 2016 respectively) will fall under the scope of CFC rules, unless the foreign vehicle is supported by valid economic reasons and has business substance.

This has a special impact on individuals with Dutch, Luxembourg, Belgium, Irish or similar holding structures in place for their passive investments. Potential alternatives are complex and may involve the transfer of tax residence of the vehicle, the transformation of the entity into an EU resident UCIT governed by EU Directive 2009/65/CE (e.g. a Luxembourg SICAV) or its dissolution.

Finally, the income tax reform has brought about the introduction of an exit tax. This now applies to individuals who move abroad if they have been Spanish tax resident (irrespective of domicile, citizenship or nationality) for 10 out the last 15 years prior to the year of expatriation and either own shares and stocks (whether quoted, unquoted, investment funds, UCITS and similar) with a market value in excess of € 4 million or own more than 25% of shares in companies with a market value in excess of € 1 million.

The exit tax charge takes the form of a deemed taxable gain arising on 31 December of the last year of tax residence prior to expatriation, taxable at the rate applicable to investment income and gains (23% in 2016 onwards).

This exit tax charge may be postponed in a number of situations and there are special provisions for intra-EU transfers of residence, allowing taxpayers to waive the charge but provide for a 10 year claw-back period if the taxpayer disposes of the tainted shares and stock, loses his/her EU tax residence or is not compliant with the information requirements under the regime.

Income tax planning is therefore essential for long-term Spanish tax residents who are considering relocation abroad. Alternatives include investments in debt instruments or life insurance products, as well as setting up holding or umbrella structures for those seeking to relocate to an EU jurisdiction.

For 2015 onwards, individuals holding financial interests in non-Spanish assets must continue to file Form 720 Information Returns. Penalties for late filing and failure to report are extremely burdensome; the Spanish tax authorities also have the power to overrule the current four-year statute of limitations on unreported assets in certain situations.

The technical stance adopted by the Spanish tax authorities, deeming a capital gain tax charge at the regular rate (currently 47%) on assets not reported strictly on time in most situations, is still currently in place. However, given that this puts into the same position compliant (albeit late) and non-compliant taxpayers, and the mounting pressures coming from the EU Commission on potential discriminatory elements in the legislation governing 720 returns, there may be some amendments softening the impact of this interpretation in the short to medium term. Therefore, individuals contemplating late or amended 720 filings should obtain specific advice on their current and future position.

In terms of corporation tax, in addition to the decrease in tax rates (down two points to 28% in 2015 and a further three points to 25% for 2016 onwards), the most relevant change for private wealth individuals is the introduction of a corporation tax exemption on capital gains derived by any Spanish tax resident corporation on the disposal of shareholdings over 5% (or shares with an acquisition value in excess of € 20 million) held for more than one year in either Spanish resident or non-resident entities.

Although the legislation contains some limitations in specific cases, the regime is extremely advantageous from a tax perspective and opens up for major tax planning opportunities going forward, particularly for family owned companies contemplating potential M&A and other divestment scenarios.

As regards non Spanish tax resident individuals, income tax rates have also decreased; the general rate (24.75% in 2014) is now, for EU residents, down to 20% and 19% for 2015 and 2016 respectively (24% for non EU residents). The rate on investment income and gains is down to 20% and 19% for 2015 and 2016 respectively (21% in 2014).

As for Spanish income and corporation tax planning for non-resident Private Wealth individuals, special focus needs to be put on real estate property arrangements, either held personally, through a single tier Spanish or foreign corporation or through double tier structures. Issues to be considered include the loss of abatement relief on pre-1994 properties held personally with substantial pregnant gains, the new anti-avoidance corporation tax provisions on leveraged Spanish companies with intra-group loans (a frequent situation in properties for private use held through a Spanish SL), the amended rules regarding Spanish withholding tax on constructive dividends on properties used privately for no or little consideration held through a Spanish company, and the new Double Tax Treaties (notably with the UK and Germany) containing anti-avoidance provisions on envelope/corporate wrapper schemes.

In terms of impatriation planning alternatives, non-resident individuals looking to relocate to Spain should consider the improvements made to the Spanish Special Impatriation regime. From 2015 onwards, individuals who take up Spanish tax residence under this program will limit their Spanish personal income tax liability to Spanish source income and gains, plus employment income worldwide (consultancy fee arrangements and similar are not deemed employment income for tax purposes). Spanish wealth tax is limited to net Spanish situs assets and there is no obligation to file 720 Foreign Asset Reporting forms. The regime will apply for the first six years of tax residence, provided that the individual has not been Spanish tax resident for 10 years prior to impatriation.

Before 2015, this regime only applied to impatriations by reason of employment and there were severe limitations on the activities which could be performed abroad. These limitations have now been mostly lifted and the regime may now also be applied by individuals who come to Spain to become a company director or a Member of a Board in a Spanish company, provided that the individual does not own more than 25% of its shares.

Wealth tax will continue to apply in 2015. Under general rules, the marginal rate remains at 2.5% for individuals with a net asset value in excess of €10.7 million (with a €0.7 de minimis exemption). This tax is fully transferred to the Spanish regions, so situations vary significantly (e.g. Madrid applies a wealth tax exemption and Catalonia and Andalusia charge higher rates). 2015 is however an election year, and given that wealth tax and inheritance and gift tax are a bone of contention in terms of electoral pledges and the current uncertainties on the outcome of the elections and post-electoral agreements, Private Wealth clients, particularly those resident in Madrid, Balearics, Catalonia, Valencia, Canary Islands and Andalusia, should obtain advice on their exposure to these taxes going forward.

In addition, from 2015 onwards non-Spanish tax resident individuals resident in an EU jurisdiction, who up to now were liable to the tax by application of the general rules, may now apply the wealth tax regulations of the region where most of the value of their Spanish assets is located. This is a very significant change and opens up substantial wealth tax planning opportunities to those owning high-value properties in high-tax regions (including Andalusia, Catalonia and to some extent Majorca, Ibiza and the Balearics).

As for inheritance and gift tax, this has been subject to a major overhaul as regards International Private Wealth clients following the European Court of Justice sentence of 3 September 2014, invalidating the Spanish Inheritance and Gift tax provisions applicable to cross-border estates and gifts.

Regional benefits on close family free transfers (which are very significant in certain regions, including Madrid, Catalonia, the Balearics and Valencia) may now be applied to cross-border estates and gifts under a complex set of rules which distinguish between estates and gifts on the one hand, and EU and non-EU resident individuals on the other. Clients should obtain advice on the applicability of the new provisions going forward, the possibilities for substantial inheritance and gift tax planning opportunities under the new law in situations where most Spanish wealth is located in a high-tax region (e.g. Andalusia and Canary Islands) and their right to file refund claims for overpaid past taxes, by reason of the sentence and by reference to the current rules.

In practice, given the scope and depth of the changes in the Spanish personal tax laws, private wealth individuals need to reassess their situation in order to accommodate their personal tax arrangements to the new provisions of the law – in most situations, this will entail amendments and changes in their existing structures with a view to avoiding the new pitfalls but also benefiting from new – and significant- tax incentives.