CHAMBERS AND PARTNERS

Avantia asesoramiento fiscal y legal

SPANISH INTERNATIONAL PRIVATE WEALTH PLANNING IN 2016: NATIONAL AND INTERNATIONAL DEVELOPMENTS

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

The personal tax landscape in Spain during 2016 has remained relatively stable so far, following substantial Spanish tax reform in 2015. However, in 2016 there are significant developments of great relevance to international high net worth clients with Spanish connections.

On the one hand, under the provisions of the Royal Decree 1021/2015 in effect from 1 January 2016, Spain has fully implemented in its domestic legislation the automatic exchange of information mechanisms of both the EU Directive 2011/16/UE and the OECD Common Reporting Standard (CRS) for the Automatic Exchange of Financial Account Information. This, together with the US FATCA provisions already in place, brings about dramatic changes for certain international high net worth clients, as discussed below.

On the other hand, as of 4 April 2016, Spain has yet to form a government following the Spanish general election of 20 December 2015. Given the current fragmentation of the Spanish parliament, this is proving to be complex and may even lead to new elections in June 2016. It is impossible to predict at present the political profile of the eventual incoming government, but a change in the governing party would very likely result in important changes in the personal tax arena.

Under the new international tax transparency and exchange of information rules introduced by CRS and the EU Directive, financial institutions will report the full name and address, jurisdiction of tax residence, tax identification numbers and financial information of individual clients to their local tax authorities, who will then automatically exchange it with the countries where the individuals are tax resident. As of 27 January 2016 there are 79 participating jurisdictions, with Spain as one of its 54 early adopters.

In practice, this will mean that individuals who the financial institutions from participating jurisdictions (including the British Virgin Islands, Gibraltar, Guernsey, the Isle of Man, Jersey and all EU states) identify as tax resident in Spain as a result of their required due diligence procedures under CRS, will have their Spanish tax residence status and financial information disclosed and automatically exchanged to the Spanish tax authorities from as early as 2017 onwards, in respect of 2016 and going forward.

Consequently, international high net worth individuals who currently report themselves as non-tax resident in Spain, but have substantial presence or investments in this country and are not tax resident in any other jurisdiction, are highly likely to be considered Spanish tax

resident and reported as such under CRS. Immediate tax residence review and planning is therefore of key importance to individuals who are uncertain about their current tax residence status.

Individuals who are found to be Spanish tax residents, or those who have not fully disclosed their assets, income and gains in their Spanish personal tax returns (including settlors or beneficiaries of trusts and foundations), need to evaluate their Spanish tax situation and ascertain the steps to take towards full compliance.

Voluntary disclosures in Spain are usually done by means of late filings of all personal taxes concerned for all years not covered by the Spanish statute of limitations; in practice, at present this generally means late tax filings for years 2011 to 2014 (generally 2010 to 2014 in cases of tax fraud).

Taxes concerned with voluntary disclosures include income tax (with marginal rates ranging from 45-56% on regular income and 21-27% on investment income and gains), wealth tax (with rates generally ranging from 0.2-2.5%, with tax exemption for Madrid residents), inheritance and gift tax where applicable, and Foreign Asset Information returns (Form 720) for 2012 onwards.

Voluntary disclosures also entail in most cases interest on overdue tax and surcharges of up to 15% in cases of full and prompt settlement. In addition, in the case of Form 720, foreign assets reported late are generally subject to formal penalties as well as a 45-56% income tax charge on the value of assets which the taxpayer cannot prove were acquired out of income declared for Spanish tax purposes or acquired in the years of non-tax residence in Spain.

Voluntary disclosures by means of late filings enable non-compliant taxpayers to avoid potential Spanish tax fraud charges, applicable where the individual taxpayer has more than EUR120,000 wilfully unpaid in any given tax in any given year not covered by the Spanish statute of limitations – a figure easily reached considering the provisions of the previous paragraph. It also entails a substantial reduction in penalties; the overall cost of a voluntary disclosure is generally significantly lower than the cost of tax assessments raised by the Spanish tax authorities during the course of an audit.

The likelihood of a full Spanish tax audit on individuals who either declare themselves non-tax resident but are reported as resident under CRS, or who have failed to make a full disclosure of their foreign interests (including settlors and beneficiaries of trusts and foundations) in their Spanish returns, will be very high once information begins to flow under CRS.

Consequently, international high net worth clients with substantial links to Spain are strongly advised to immediately perform an analysis of their exposure to the new international framework on multilateral automatic information exchange for Spanish tax

purposes, in order to take any action required towards full and complete Spanish tax compliance during the course of this year.

In terms of the basics of Spanish personal tax for 2016, resident individuals remain taxed on worldwide income and gains. The marginal income tax rate for regular and investment income for 2016 is set at 45% and 23% respectively.

Spanish tax resident individuals with investments abroad remain affected by the International Controlled Foreign Corporations (CFC) provisions in the Spanish income tax law. In practice, Spanish resident individuals falling under CFC provisions bear a 45% income tax charge on their share of the underlying income and gains of foreign entities in low tax jurisdictions (ie those subject to a corporation tax of less than 18.75% in 2016, even if EU resident), 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 or its dissolution.

The Spanish exit tax, introduced in 2015, continues to be enforced in 2016. This 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 EUR4 million or own more than 25% of shares in companies with a market value in excess of EUR1 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).

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 ten-year claw-back period if the taxpayer disposes of the tainted shares and stock, loses his or her EU tax residence or is not compliant with the information requirements under the regime.

In addition, 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. Although the EU Commission is investigating potential discriminatory elements in the legislation governing 720 returns, no EU resolution is expected in the short to medium term.

In terms of corporation tax, the general tax rate is set at 25% for 2016. The legislation continues to provide for 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 EUR20 million) held for more than one year in either Spanish resident or non-resident entities. This regime is extremely advantageous from a tax perspective and opens up major tax planning opportunities, particularly for family-owned companies contemplating potential M&A and other divestment scenarios.

As regards non-Spanish tax resident individuals, general income tax rates on Spanish source income are 19% and 24% for EU and non-EU residents respectively. The rate on investment income and gains is set at 19%.

In terms of repatriation planning alternatives, the Special Repatriation regime continues to be a popular alternative for individual repatriations in 2016. Qualifying individuals (employees or company directors/Members of the Board of a Spanish company with no or less than a 25% shareholding) who take up Spanish tax residence under this program limit their Spanish personal income tax liability to Spanish source income and gains, plus employment income worldwide (consultancy fee arrangements and such like 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 applies for the first six years of tax residence, provided that the individual has not been Spanish tax resident for ten years prior to repatriation.

Wealth tax continues to apply in 2016. Under general rules, the marginal rate remains at 2.5% for individuals with a net asset value in excess of EUR10.7 million (with a EUR0.7 de minimis exemption). This tax is fully transferred to the Spanish regions, so situations vary significantly (eg Madrid applies a wealth tax exemption and Catalonia and Andalusia charge higher rates).

As for inheritance and gift tax, this applies on the same basis as 2015; regional benefits on close family free transfers still apply (including Madrid, the Canary Islands, Valencia, the Balearic Islands and Catalonia) but with some important changes in some cases in respect of 2015. These regional benefits may 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 inheritance and gift tax planning alternatives, particularly if located in a high-tax region (eg Andalusia) or in cases of non-EU cross-border estates and gifts.

As mentioned earlier, once a new Spanish government is eventually formed, there will be changes to the personal tax landscape, which may be substantial if there is a shift in its political profile. Early negotiations between the Spanish Socialist Party and the centre-right Ciudadanos, new to the Spanish Parliament, include provisional agreements on a potential new Extraordinary Tax on Wealth, an amendment to the existing tax fraud provisions (with stronger penalties and a longer statute of limitations) and the introduction of minimum and

maximum limits for regions in respect of both wealth tax and inheritance and gift tax rates, which would in practice likely do away with the wealth tax exemption in Madrid and substantially minimise the current regional inheritance and gift tax benefits.

International high net worth clients are therefore advised to keep a close eye on developments, with a view to ascertaining the best way forward in terms of their Spanish personal tax planning, should a change of government materialise in the short term.

Patricia García Mediero
Partner

Avantia Asesoramiento Fiscal y Legal
Rodríguez Arias, 6
48008 Bilbao
Spain

Tel: (+34) 94 423 2156
Fax: (+34) 94 423 1126

Javier Estella Lana
Lawyer
Partner

Avantia Asesoramiento Fiscal y Legal
Plaza de Colón, 2 -Torres de Colón
Torre II - Planta 18ª
28046 Madrid
Spain

Tel: (+34) 91 310 2217
Fax: (+34) 91 310 2411

www.avantiaasesoramientofiscalylegal.com