

SPANISH INTERNATIONAL PRIVATE WEALTH PLANNING IN 2020/2021: SUBSTANTIAL SPANISH PERSONAL TAX INCREASES AHEAD, POST-COVID

In the current economic climate and the impact of COVID-19 on the public finances, a general increase in personal taxes is highly likely to take place in Spain before 31 December 2020. This may take the form of an increase in the existing Wealth Tax or the introduction of a new tax on wealth, and an increase in Inheritance and Gift Tax. Although it is yet unknown how this widely expected increase will materialise in practice, these upcoming changes will likely have a substantial impact for international private wealth clients with Spanish connections.

In terms of the current basics of Spanish personal tax for 2020, resident individuals remain taxed on a worldwide basis. At present, the general marginal income tax rate for regular and investment income for 2019 is set at 45% and 23% respectively. Potential developments include an increase in marginal rates to around 50% and 27% for regular and investment income, respectively.

Individuals holding financial interests in non-Spanish assets must continue to file Form 720 Information Returns. In an important development, the European Commission has taken action against Spain before the European Court of Justice on potential discriminatory elements in the legislation governing 720 returns (Case 2019/C432/35). This case is in its preliminary stages and therefore no court resolution is expected shortly.

In terms of corporation tax, the general tax rate remains at 25% for 2020. The legislation excludes from tax, under participation exemption rules, most dividends and capital gains derived by any Spanish tax resident corporation. Potential likely developments include a curtailment of the current participation exemption regime, totally or partially. Taxpayers affected by these potential developments are strongly recommended to consider this issue and obtain advice on short-term tax planning alternatives.

In terms of impatriation planning alternatives, the Special Impatriation regime continues to apply to certain individual impatriations in 2020. Qualifying individuals (employees or company directors/members of the board of a Spanish company with no or less than a 25% shareholding) limit their Spanish personal income tax liability to Spanish source income and gains, plus employment income worldwide. Spanish wealth tax is limited to net Spanish situs assets and there is no obligation to file 720 Information Returns. However, no protection is provided against Spanish inheritance and gift tax. The regime applies for the first six years of tax residence.

A growing number of individuals applying this Special Impatriation regime are being subject to Spanish tax audits. Consequently, international private wealth clients currently applying the Special Impatriation regime are strongly advised to perform an urgent analysis of their eligibility to their regime with a view to determining their potential exposure to Spanish personal tax assessments and even potential Spanish tax fraud charges under current inspection practices.

Wealth tax continues to apply in 2020. 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 EUR700,000 tax-free allowance). This tax is fully transferred to the Spanish regions, so situations vary significantly, with Madrid applying a full exemption.

This situation is however highly likely to change in the short to medium term, before 31 December 2020. Barring a completely new tax on wealth, potential developments include a full reintroduction of the tax in all Spanish regions, including Madrid, amendments in provisions resulting in a significant increase in asset valuations, and provisions bringing to the tax certain foreign unit-link insurance wrappers.

As for inheritance and gift tax, regional benefits on spousal and close family free transfers may be applied to cross-border estates and gifts, both EU and non-EU, by application of a complex set of rules.

Again, there is a strong probability that these tax benefits will be substantially curtailed in the short term, likely before 31 December 2020, reintroducing a full inheritance and gift tax with rates which could be in the region of 28% to 32%.

Consequently, taxpayers with interests or ties to Spain are strongly advised to perform a specific full inheritance and gift tax review, including planning for a full implementation before 31 October 2020.

Tax planning possibilities include free transfers of bare ownership; as an example, the free transfer of bare ownership (legal title) of a property located in Marbella by an ascendant to his/her descendants, retaining a usufruct (right of use) during his/her lifetime, would at present enable the transfer of this property virtually free of Spanish inheritance and gift tax, without losing the exclusive right of use of the property.

For Spanish tax resident taxpayers, short-term planning possibilities include free transfers of bare ownership of shares (even in non-Spanish entities) from ascendants to descendants, shifting a significant portion of the family's wealth over to the next generation. Regulating the legal and mercantile aspects of political rights over shares would be of critical importance for a successful generational transition.

These tax planning possibilities require a careful global analysis from a tax perspective, including analysing the capital gains implications and the municipal taxes involved.

The Spanish tax authorities continue to be particularly active in tax enforcement and tax audit activities, following the creation of the Central Unit for Private Wealth, which is now fully operational and acting upon information obtained from national and international information exchanges. Individuals affected include settlors and vested beneficiaries or have any other reportable connection to a trust or foundation.

Tax residence has been identified by the Spanish tax authorities as one of the key focus areas of Spanish personal tax audits. These tax inspections usually end in substantial tax assessments, leading to lengthy court procedures and, in certain cases, criminal prosecutions under tax fraud charges.

The likelihood of a Spanish tax audit on individuals (including settlors and beneficiaries of trusts and foundations) who declare themselves as non-tax resident but are in practice spending a substantial amount of time in Spain, or have a substantial Spanish asset base or activities, or have been reported as resident under CRS or have failed to make a full disclosure of their foreign interests in their Spanish returns, is currently very high. A full analysis of their Spanish tax situation is therefore of critical importance.

Individuals who are not tax compliant or have applied questionable technical criteria in their Spanish tax returns should consider entering into a voluntary disclosure procedure.

Taxes concerned on voluntary disclosures include income tax (with marginal rates under general rules ranging from 45% to 46% on regular income and 23% to 23.5% on investment income and gains), wealth tax (with rates generally ranging from 0.2% to 2.5%, with tax exemption for Madrid residents at present), inheritance and gift tax where applicable, and Foreign Asset Information returns (Form 720).

Full voluntary disclosures enable uncompliant taxpayers to avoid potential Spanish tax fraud charges. They also entail a substantial reduction in penalties.

International private wealth clients are therefore recommended to undertake an urgent review of their Spanish overall personal tax situation, bearing in mind the very likely increase in taxes in the short to medium term before 31 December 2020. Clients are strongly encouraged to make use of the current tax favourable environment in most Spanish regions in order to shift wealth over to the next generation in an orderly, flexible and Spanish tax effective manner.

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