Chambers AND PARTNERS

SPAIN: An Introduction to Private Wealth Law

SPANISH TAX PLANNING FOR INTERNATIONAL PRIVATE WEALTH CLIENTS: A 2021/22 OUTLOOK

After a long period of stability, owing to a succession of minority governments with limited capacity to pass tax reforms followed by the dramatic shift in priorities imposed by COVID, 2021 has started off with some substantial personal tax developments with significant impact on international private wealth clients. Personal tax changes will continue to take place during the current parliamentary term.

In terms of the basics of Spanish personal tax for 2021, Spanish tax resident individuals remain taxed on a worldwide basis. In 2021, the marginal income tax rate for regular and investment income and gains is around 50% (depending on the region of residence) and 26% respectively – an increase of five and three percentage points from 2020.

Further developments in terms of income tax have taken place under the Anti-Tax Fraud Act, published into law on 11 July 2021. These include changes to the existing CFC regime, in line with ATAD (EU Directive 2016/1164). We strongly recommend reviewing taxpayers' holding structures to assess their vulnerability under these new provisions.

The Anti-Tax Fraud Act just passed also includes an overhaul in the definition of "Tax Havens", to be reclassified as "Non-Cooperative Jurisdictions" – states (including Treaty jurisdictions) defined as opaque, with no effective exchanges of tax information and/or UBOs, imposing zero or low taxes or with offshore regimes for passive investments.

Crucially, the definition will allow the inclusion of "Harmful Tax Regimes". The existence of tainted regimes in an otherwise cooperative jurisdiction theoretically opens the way to the potential inclusion of special impatriation regimes for individuals (including Portugal, Italy or the UK). Developments on this matter will need to be followed up closely and expatriation plans outside Spain must be carefully examined.

Individuals holding an interest in non-Spanish assets (now including cryptocurrencies) must continue to file Form 720 Information returns. The most burdensome aspects of its penalty regime are under appeal before the European Court of Justice (Case 2019/C432/35). Conclusions from the EU Advocate General will be released on 15 July 2021, and it is widely expected to rule against Spain.

Individuals relocating to Spain may still opt to apply the Special Impatriation regime in 2021. This is a six-year regime available to employees or directors of a Spanish company (with less than a 25% shareholding). Qualifying individuals 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 from Spanish inheritance and gift tax and it does not extend to spouses and/or dependant children.

At present, there are some initial Parliamentary initiatives aimed at improving the regime, to favour the relocation to Spain of "digital nomads" (entrepreneurs in digital businesses and remote workers). However, these are still in their very early stages and no developments are expected short term.

One of the focus areas of the Spanish tax inspection is the review of "sham" Special Impatriations, generally questioning the reality of employment arrangements, resulting in large tax assessments and even tax fraud charges. We strongly encourage individuals applying this regime to review their specific basis of application by reference to current inspection practices.

Wealth Tax continues to apply in 2021. Under general rules, the marginal rate has increased to 3.5% for individuals with a net asset value in excess of EUR10.7 million (with a EUR700,000 tax free allowance). This is a full one-point increase from 2020. This tax is fully transferred to the Spanish regions, so situations vary significantly, with Madrid applying a full exemption. Exposure to this tax may be reduced significantly with efficient tax planning.

The Anti-Tax Fraud Act just passed contains important additional changes – life insurance policies with no redemption rights (including unit-link insurance products) are now fully taxable. As a result, many International Private Wealth clients will see a substantial increase in their Spanish Wealth Tax which we recommend planning for in advance.

In addition, the Act includes provisions amending the valuation of Spanish real estate for Wealth Tax, Inheritance and Gift Tax and Transfer Tax purposes. The Spanish Administrative Valuation has now become the minimum taxable value, determined by the Spanish administration by reference to Spanish public deeds of sale. This will trigger significant tax increases on transfers of real estate affecting both resident and non-residents, so intergenerational gifts or sales will now require particularly careful planning.

Finally, as a positive development, the Act allows non-EU residents to apply regional Wealth Tax provisions. This is of particular relevance to non-EU tax resident taxpayers qualifying to apply Madrid regulations, as they are now allowed to benefit from the current wealth tax exemption.

As for inheritance and gift tax, regional benefits on spousal and close family free transfers continue to be of application to cross-border estates and gifts, both EU and non-EU, by application of a complex set of rules. Mid-term, these may be substantially curtailed, reintroducing a full inheritance and gift tax, potentially with rates which might be in the region of 28% to 32%.

In this scenario, taxpayers with interests or ties to Spain are strongly advised to perform an Inheritance and Gift Tax review to make use of current exemptions which may be phased out or curtailed during the current Parliamentary term. Tax planning possibilities include free transfers of bare ownership of assets, retaining a legal right of use, shifting a significant portion of the family's wealth to the next generation. Planning for the best legal way to allocate and manage rights post-transfer is of critical importance.

Due to the substantial number of foreign individuals with a stable presence in Spain (including those overstaying due to COVID restrictions on mobility), tax residence is one of the main target areas of Spanish tax inspections. These investigations often result in large tax assessments and lengthy court cases – even under tax fraud charges.

Individuals, including settlors, grantors and/or beneficiaries or trusts or foundations, who declare themselves as non-tax resident in Spain but spend time in this country, even below 183 days, or have a substantial Spanish asset base or activities (directly or indirectly), or have been reported as

tax resident under CRS, FATCA or other regimes, are strongly recommended to examine their tax residence status, particularly if they are “tax nomads”.

Likewise, uncompliant taxpayers or those applying untenable technical positions (e.g. vested beneficiaries of trusts who fail to disclose their interests in their Spanish returns) are strongly suggested to consider filing remedial returns to avoid potential Spanish tax fraud charges. Under the new Anti-Tax Fraud Act, surcharges on voluntary disclosures have been materially reduced.

International Private Clients should therefore undertake a review of their Spanish personal tax situation in view of the changes already introduced, the amendments only just introduced under the Anti-Tax Fraud Act and other potential tax increases mid-term. Clients are strongly encouraged to make use of the current (but already diminishing) tax favourable environment in most Spanish regions in order to shift wealth over to the next generation in an orderly, flexible and overall tax effective manner.

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