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PRACTITIONERS' CORNER

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Spain is one of the highest ranked countries in the world in terms of quality of life. It is home to many of Europe's international schools, and its business schools are among the top worldwide. It offers an outstanding and modern health system plus an excellent climate, first-class gastronomy, and a wide range of cultural and leisure activities. Spain is the Florida of Europe.

However, both expatriates and high net-worth individuals should carefully consider their tax implications when relocating to Spain.

Becoming a Spanish Taxpayer

Special attention should be given to the date an individual moves to Spain. The fiscal year for individuals is coincident with the calendar year. An individual would become a resident taxpayer:

- if he is present in the country more than 183 days during the calendar year; or
- if his center of economic interests is located in Spain, whether directly or indirectly.

An individual moving to Spain generally would not be considered tax resident in his year of arrival if relocating to the country during the second half of the year. Similarly, if he effectively moves outside the country during the first half of the year, an individual may eventually not be considered a resident taxpayer in that year if he complies with other requirements. Obviously, when it is possible to plan for it, the effective date of the move may lead to tax planning possibilities in both Spain and the home country.

Even though the courts may admit other means of proof, the tax authorities generally request tax residency certificates issued by the foreign tax authorities as relevant evidence of tax residency abroad. This is also generally the case if one wants to consider breaking the 183-day test. Further, the certificate should be issued within the meaning of the relevant double tax treaty when contemplating the application of any of the 84 OECD-based Spanish double tax treaties currently in force. These certificates are valid for one year from the date they were issued.

Spain taxes residents on a worldwide basis. While the progressive tax rates and rebates vary slightly depending on the autonomous community of residence, currently the highest personal income tax rate is 56 percent in certain regions such as Catalonia. Taxation of so-called savings income (dividends, interest, and capital gains) is set at three progressive rates — 21 percent, 25 percent, and 27 percent — with the first €1,500 in dividend income being exempt.

However, it is worth noting that Spanish residents with overseas duties may apply a foreign-earned income exemption of up to a maximum of €60,100 per year under specific conditions. Considering the progressive nature of personal taxation and this being a full exemption regime, the applicable tax rate for the rest of the income may be eventually reduced when applying this exemption. An exemption to eliminate double taxation is also found in several of Spain's double tax treaties, though generally in this case with progression (foreign tax-exempt income is still considered to determine the progressive tax rate applicable). Taxation in the foreign country should be considered, but it might be possible to reduce overall taxation for work effectively performed abroad.

Many expatriates working in Spain receive employer-provided restricted stock units or other incentives such as stock options. When relevant criteria are met, stock options are taxed at the time of exercise (not the granting date) on the difference between the exercise price and the fair market value of the stock at the time of exercise.

Income derived may be tax exempt for active employees up to an annual limit of €12,000 if specific conditions are met. Further, if income is generated over a period exceeding two years and if the stock option is not granted annually, a 40 percent taxable income reduction may be available. This reduction only applies to a limited amount of stock option income per year. Any capital gains derived from the subsequent sale of the stock are subject to taxation.

Estate and Gift Tax

An individual moving to Spain should also consider the wealth tax and estate and gift tax. A Spanish tax resident is taxed on assets and rights acquired by inheritance or gift, regardless of where the assets or rights are located. If the recipient is not resident in Spain, estate and gift tax applies only to assets located in Spain or to rights that may be executed in Spain.

Estate tax must be paid by the legal heir, and gift tax must be paid by the donee. The taxable amount for estate tax purposes is determined by deducting specific amounts.

The estate and gift tax rate ranges from 7.65 to 34 percent (the latter for assets with a value above €815,000); these rates also vary from one autonomous region to another.

Spanish tax residents may currently benefit from considerable rebates, which could vary depending on the autonomous community of residence. Further, subject to strict criteria, Spanish or foreign assets or shareholdings that are duly affected by the performance of a business activity may benefit from a wealth tax exemption and from a material reduction of state and gift tax. In some cases or with proper planning, tax may be materially reduced.

Foreign Assets Declaration

Individuals moving or retiring to Spain should declare the value of their overseas assets as of December 31 if greater than €50,000 (for each type of asset); this should be done no later than March 31. This is an annual obligation for Spanish resident taxpayers who hold, are the ultimate beneficiaries, or are the authorized signatories of bank accounts, property, and other movable assets such as shares, life insurance policies, and annuity income out of the country.

Failure to file could result in fines that exceed the value of the assets. The minimum penalty for failing to declare an asset is €10,000, plus income tax on undeclared income and late-payment interest. The penalty may be as high as 150 percent of the total tax due on the unreported foreign asset.

This requirement, which was introduced in 2013, affects individuals who may naturally hold property and savings in their home country, such as expatriates, high net-worth individuals, or retirees living in Spain. As a matter of fact, the U.K. Foreign Office estimates that 800,000 British nationals live all or part of the year in Spain, of which an estimated 250,000 to 400,000 are tax resident.

This reporting requirement has generated much debate, and it has been questioned on several grounds. It may infringe several provisions of the Spanish Constitution and, in many cases, could violate the free movement of capital within the EU.

Foreign Entities

If a Spanish tax resident holds an interest in overseas entities, there are several issues that should be carefully considered. These include the tax authorities' aggressive attitude and the restrictive rules against listed tax haven jurisdictions, Spanish controlled foreign corporation rules (though those could be quite flexible with proper planning), and corporate tax residency rules.

In this last respect, under both domestic provisions and double tax treaties' tiebreaker rules, an entity incorporated in a foreign jurisdiction eventually could be regarded as a Spanish corporate taxpayer if management and control (the effective place of management) of the foreign entity is located in Spain.

The Beckham Law

To better attract qualified workers, the Spanish government in 2004 approved a special tax regime for expatriates known as the ''Beckham'' law. Under this regime, an employee assigned to Spain who qualifies as a Spanish tax resident may elect to be subject to tax under the nonresident taxpayer rules.

This election is subject to several conditions, the most important of which are the following:

- The individual was not a Spanish tax resident in the 10 years preceding the tax year of his arrival in Spain.
- The assignment in Spain must be based on a labor contract (Spanish local contract or letter of assignment).
- The employment must be physically performed in Spain and for the benefit of a Spanish company.
- The individual must apply for the special regime within six months of the date his activity starts in Spain. This six-month period cannot be extended.
- The expected compensation derived from the labor contract must not exceed €600,000 per year.

If the individual elects for the special tax regime, he is subject to tax on Spanish-source income only at a flat rate of 24.75 percent, instead of the progressive resident tax rates of up to 56 percent. The election is effective for the first year of residence and the following five consecutive years.

To opt for this regime, the individual clearly must come to or be assigned to Spain for a labor reason rather than voluntarily. Further, as a result of that assignment, he must remain in the country more than 183 days in the calendar year. Even though the individual would be subject to Spanish tax as if he were a non-tax resident (with some peculiarities to be observed), he would be considered a Spanish resident taxpayer for most purposes except, in general, for purposes of Spain's double tax treaties. This could give rise to negative consequences (such as not being able to benefit from Spanish double tax treaty provisions, unlike other nonresidents) or even a situation in which the individual could still be considered a tax resident in his home country because of domestic rules in that country (U.S. citizens or green card holders are used to facing this issue because of U.S. tax residency rules).

To qualify for the special regime, an individual must perform his work within Spain for the benefit of a Spanish company (or permanent establishment). He may only perform a limited amount of his duties outside Spain. Foreign work cannot represent more than 15 percent of his total remuneration (or number of working days in a year outside the country). This threshold is extended to 30 percent if his duties are performed for the benefit of foreign group companies.

However, unlike similar regimes in other countries, the individual need not be tax resident in Spain at any time during the 10-year period before his arrival.

If the individual ceases to work during the period when the special regime applies, the regime will cease to apply, and he shall notify the tax administration. However, we deem that a mere and immediate job change to another Spanish company (or permanent establishment) should not preclude applicability of the regime.

In a nutshell, individuals are taxed at a flat rate of 24.75 percent only on a Spanish-source income basis as long as relevant criteria are met. It is an interesting tax regime but with pitfalls that need to be carefully considered.

Tax Reforms

On March 14, 2014, an experts' committee appointed in the summer of 2013 by the government issued a report on Spanish tax reform. The government will decide the specific timing and final composition of the reform later this year.

In line with recommendations made by the IMF, EU, and OECD, the report recommends reducing direct taxes (including social contributions) and increasing indirect taxes. For example, the experts suggest gradually reducing the nominal corporate tax rate from 30 percent to 20 percent, while broadening the tax base. The report also recommends broadening the personal income tax base and reducing the number of tax rate brackets to four and the maximum marginal rate to less than 50 percent.

The report recommends eliminating the wealth tax and broadening the tax base with suggested amendments to estate and gift tax provisions, but with relatively low progressive rates ranging from 4 to 10 percent (the maximum marginal rate currently is as high as 34 percent).

Conclusion

The Spanish individual income tax has high rates but offers many possibilities to reduce effective taxation. Rates are expected to be reduced soon while several exemptions and rebates disappear. ◆