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Carlos Gabarró is a partner with ALTALEX S.L. in Barcelona, Spain. Email: carlos.gabarro@altalex.es

In this article, the author discusses Spain's wealth tax and suggests 10 strategies taxpayers may use to reduce it.

Since its inception in 1977, Spain's wealth tax (*impuesto sobre el patrimonio*) has been controversial and the subject of debates between scholars and lawmakers. Spain instituted regulations on the wealth tax in 1991 under Law 19/1991, of June 6. These regulations remain in force today.

Upon introduction, the government justified the wealth tax as an "exceptional and transitory" measure. The harsh reality is that it remains in force 40 years later. In 2008, wealth tax was essentially abolished via a 100 percent tax rebate. But this lasted only a few years. In 2011, the government restored the tax, again calling it a "transitory" measure meant to last only until public finances would allow it to be "abolished" again. Yet there are no signs that Spain plans to finally eliminate it in the coming years.

In all likelihood, Spain will soon be the only EU member state to apply a specific tax on an individual's wealth — France has announced its intention to eliminate its *impôt de solidarité sur la fortune* in 2019. The Netherlands does apply a form of wealth tax on savings, property, and investments but this applies under so-called "box 3" of the personal income tax return. Making the situation even more shameful, the amount the Spanish government collects each year under the wealth tax is a mere 0.1 percent of Spanish GDP.

Spain's different autonomous communities can regulate specific aspects of the wealth tax, such as the progressive tax rates as well as the availability of rebates and exemptions. Interestingly, Madrid maintains a 100 percent rebate (that is, effectively no tax is paid) while a heavier tax burden applies in communities like the Balearic Islands, Andalusia, and Catalonia. Indeed, Catalonia has provided almost half of all wealth tax collected in Spain during recent years.

In this article, I will look at how the wealth tax works and then briefly comment on some alternative solutions to mitigate it.

How Wealth Tax Works

A resident individual is subject to wealth tax annually based on the value of his worldwide assets and rights less qualifying liabilities as of December 31. Unless a double-tax treaty provides otherwise, a nonresident individual is subject to wealth tax on Spanish-situs assets and rights less qualifying liabilities.

The tax payable for Spanish resident individuals is calculated by following the rules and rates applicable in the autonomous community of residence. For individual residents of other EU or European Economic Area member states, the rules of the community where the majority of their Spanish assets are located govern.

Top marginal rates can exceed 3 percent for net wealth of more than €10.7 million (for example, 3.03 percent in Andalusia or even 3.45 percent in the Balearic Islands). The first €500,000 to €700,000 of an individual's net wealth is tax-exempt, as is an allowance of up to €300,000 on the value of the person's main residence. Individuals who live outside the EU or EEA are subject to the general rules applied by the central government, with a top marginal rate of 2.5 percent.

10 Legitimate Ways to Reduce Wealth Tax

Depending on a taxpayer's circumstances, there are legitimate ways to avoid or limit the wealth tax. I focus on 10 of these opportunities. These or other solutions are rarely used in an isolated fashion; rather, they are usually used in combination. It is of the utmost importance for taxpayers to always consider any specific or general antiavoidance rules when crafting a wealth tax strategy.

1. Living in Madrid

Madrid provides a 100 percent tax rebate to its residents and to residents of other EU or EEA member states if the majority of their Spanish assets are in Madrid. For residency, individuals must live in Madrid for more than 183 days during the calendar year.

2. Having Bona-Fide Debt

Wealth taxation applies to all assets and rights that can be economically valued, less burdens, encumbrances, or debts. Specific requirements must be observed for a debt to effectively reduce the taxable base. Notably, a nonresident can claim a reduction based on debt incurred to invest in a Spanish property only if relevant criteria are observed and the debt is properly implemented.

3. Assigning Assets to a Business

Assets and rights of individuals that are necessary for the development of their business activity are tax-exempt, if the business is exercised regularly, personally, and directly by the taxpayer and constitutes his main source of income. Personal income tax law rules apply to determine whether a business activity is being carried on and whether the assets are assigned to such activity.

For example, for leasing real estate, generally a full-time employee must be on the payroll and must be dedicated to that activity, and these conditions must be duly evidenced. A similar rule applies if the real property leasing activity is conducted through a corporate entity.

4. Corporate and Holding Company Shares

Shares owned by an individual in a Spanish or foreign company are exempt from wealth tax if the following criteria are met:

- The majority of the company's assets are assigned to a business activity (as defined by the personal income tax law).
- The individual owns an interest of at least 5 percent in the entity. If close family members also hold an interest, the total stake should be at least 20 percent.
- The individual (or a close family member) effectively carries out management activities in the company. The remuneration received for this must be the source of more than 50 percent of the individual's (or the family member's) total business, professional, or employment income.

For holding companies, their shareholdings in subsidiaries are also assets that qualify for the exemption if:

- the shareholding represents at least 5 percent of the voting rights in the subsidiary;
- the holding company has the appropriate human and material means to manage and control its shareholdings; and
- the subsidiary also qualifies for the exemption (that is, the majority of the subsidiary's assets are assigned to a business activity).

5. Freezing the Value of Assets

Generally, this strategy involves transferring assets that are susceptible to increase in value into a corporate structure. If an increase in value does not need to be reflected in the company's accounts, the taxable base for wealth tax purposes would not increase, either.

6. Giving Gifts to Close Family Members

Because wealth tax is based on the value of the net assets held by the individual as of calendar year-end, one strategy may be to make gifts to close family members before that time.

This might be especially beneficial when specific autonomous communities are involved. Some communities (such as Madrid or Catalonia) provide a beneficial treatment for gift taxation between close family members when properly implemented. Obviously, when transferring assets other than cash, other tax obligations (including personal income tax in the hands of the donor) must be observed.

7. Using Life Insurance Policies

Some life insurance policies in which the policyholder has irrevocably waived his right to surrender all economic rights (thus, the policy has no surrender value) are not subject to wealth tax. Likewise, no current wealth tax applies to a Spanish tax resident who is a named life insurance beneficiary (that is, when the insured is still alive) if he does not have the right to surrender the policy.

Properly implemented, life insurance policies may also provide opportunities for personal income tax deferral, succession planning, and asset protection.

8. Monitoring the Amount of Income Generated

For Spanish tax residents, total tax payable can be reduced up to 80 percent if the combined total of wealth taxation and personal income taxation would exceed 60 percent of individual's taxable personal income. In other words, if specified criteria are observed, wealth tax could be reduced to 20 percent if the value of the individual's wealth is significant and the amount of income is relatively small.

Thus, some taxpayers should consider using investments in which the amount of income generated can be controlled.

9. Opting for the Inbound Expatriates Tax Regime

Under this regime, an individual assigned to work in Spain incurs a lower tax burden than a regular Spanish tax resident. If relevant criteria are met, the individual is generally taxed as a nonresident and wealth tax would apply only on Spanish-situs net assets. This election is effective for the first year of residence and for five consecutive years thereafter. The regime is not available if the individual was a Spanish tax resident during the 10-year period before relocating to Spain.

10. Investing in Tax-Exempt Assets

Wealth tax law provides that specified assets and investments are tax-exempt under specific criteria. These assets include intellectual property rights in the hands of the creator (and, in the case of industrial property, that has not been assigned to a business activity), pension plans, some dependency insurance schemes, and objects of art and antiques that have been ceded to museums for at least three years.

Conclusion

Spain is an attractive place to live and many foreign nationals reside in the country or contemplate doing so. However, high net worth individuals should not only consider the personal income tax or inheritance tax implications of a move, but also the nuances of the wealth tax and legitimate ways to reduce it. ■