Spain: An attractive and tax-efficient destination

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For years, Spain has been identified as a destination where wealthy foreigners owned properties for private use or where they retired. The main tax concerns for such investors were net wealth tax, inheritance tax, personal income tax and non-resident income tax, but amendments to Spanish legislation have significantly changed these concerns.

These wealthy people never considered moving the headquarters of their business groups to Spain, but recent changes to Spanish legislation are encouraging that move, with Spain now attracting company headquarters for various reasons, including (i) the participation exemption regime applicable to Spanish holding companies, (ii) the abolition of the net wealth tax, (iii) the impatriates regime, which establishes a low tax burden for employees, and (iv) the reasonable taxation of individual shareholders.

Abolition of the net wealth tax

Historically, the net wealth tax was a concern for non-resident individuals becoming tax residents in Spain. Under this tax, residents were taxed on their worldwide assets, if their taxable base exceeded €108,182 or if their assets were valued at more than €601,012. However, non-resident individuals were taxed only on assets located or deemed to be located in Spain, regardless of their value.

If assets were valued at more than €10,695,996, progressive tax rates applied, with a top margin of 2.5%. Even though several allowances and a tax limit could apply, depending on the wealth composition and the nature of the income, respectively, tax liability could be high.

On December 25, 2008, the abolition of the net wealth tax was announced, with retroactive effect as from January 1, 2008. Therefore, both Spanish tax residents and non-residents no longer need to pay net wealth tax or disclose their assets every year.

Inheritance and gift tax

Spanish tax residents receiving property and rights (i.e. heirs and donees) must pay inheritance and gift tax on their worldwide assets.

On the other hand, non-tax residents receiving property and rights are only taxed on assets located or rights that can be exercised in Spain. Consequently, although the deceased would be resident in Spain, heirs that are non-tax resident are not taxed in Spain on assets located or rights exercised outside Spain.

The taxable base is the net value of the property and rights received, with deductible debts and expenses. The tax is calculated at progressive rates, the top marginal rate of 34% applying to taxable amounts exceeding €797,555. Tax liability depends on (i) the net wealth of the individuals before receiving the inheritance or gift and (ii) their relationship with the deceased or donor.

However, in recent years, autonomous regions have introduced certain provisions, some of them establishing, for example, a 99% tax rebate when descendants, ascendants or the spouse of the deceased or donor receive the property or rights (e.g. Madrid, Mallorca and Valencia).

There are also exemptions and allowances that substantially reduce tax liability. For shares in active entities, a 95% allowance is granted when the heirs are the spouse as well as direct and legally adopted descendants, provided the entity is considered a family entity and the shares are held for 5 years immediately after the death.

An entity is considered a family entity, if (i) its main activity is not wealth management (in other words, it must not be a passive holding entity), (ii) the taxpayer owns at least 5% of the company or 20% jointly with his or her spouse and close relatives and (iii) the taxpayer performs management activi-

ties in the entity, earning for these services more than 50% of his or her business, professional and employment income.

Consequently, tax planning is crucial to optimize the tax burden on inheritance and gift tax, depending on the type of assets and the place of residence within Spain.

Personal income tax

Spanish tax residents must pay personal income tax on their worldwide income and capital gains. This tax has been modified, and taxation of savings income (e.g. dividends and interests) has been considerably improved.

The concept of income includes income from five categories, according to its source or origin: (i) employment income, (ii) investment income, (iii) business or professional income, (iv) capital gains and (v) imputed income.

Taxpayers' incomes are broken down, where applicable, into two bases: (i) the general taxable base, which includes employment income, business income and imputed income, and (ii) the special taxable base, which includes investment income (e.g. dividends and interest) and capital gains. The general base is taxed progressively, with a top marginal rate of 43%. The special base is taxed at an 18% flat rate. Therefore, being tax resident and having income from only certain sources (e.g. dividends, interest and capital gains) limits the personal income tax burden to 18%.

Impatriates tax regime

In 2004 Spain introduced a very appealing regime for individuals moving to Spain to work *(impatriates)*. It is an optional regime under which individuals, in the tax year in which they move to Spain and the following 5 tax years, are taxed under the rules on income tax for non-residents. Under these rules, only Spanish-source income is taxed, investment income and capital gains at 18% and remaining income at 24%.

To apply it, individuals moving to Spain must (i) not have been resident in Spain at any time during the preceding 10 years, (ii) move to Spain because of an employment contract, (iii) work physically in Spain for a company or entity that is resident in Spain or for a Spanish permanent resident of a non-resident entity and (iv) have a salary income that is not exempt from non-resident income tax.

Improvements in corporate income tax

Corporate income tax has also improved gradually and now includes (i) a tax rate of 30%, (ii) an exemption applicable to foreign dividends and capital gains and (iii) the Spanish holding regime (Entidad de Tenencia de Valores Extranjeros or ETVE), which is very advantageous for non-resident shareholders and makes the Spanish holding regime as attractive as most European holding regimes.

Improvements have given rise to anti-fraud measures, such as the amendment to the Corporate Income Tax Act of December 1, 2006, under which Spanish tax authorities can now consider entities located in tax havens as tax residents in Spain, if their main assets are, directly or indirectly, located on Spanish territory or if they carry out their main activity in Spain. Consequently, although there are exceptions, tax structures using tax havens to hold Spanish real estate should be reviewed. We will look at these issues in more detail in future articles.

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The Swiss perspective

In the last couple of months the reading of the political and business sections of the newspapers was not much fun. As far as taxes are concerned, the impression could be gained that all member states of the European Union were about to increase tax rates or to raise new taxes. However, the news mainly covered Germany, France and the United Kingdom.

The adjacent article on the development in Spain shows that even in the European Union tax competition is in full swing. The abolition of the net wealth tax is in line with the developments in Europe as well as on other continents. Apart from Spain other European countries, such as Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg and the Netherlands do not or no longer levy net wealth taxes. In this respect Switzerland is – together with France and Norway – more and more the odd one out. For many (retired) high net worth individuals wealth taxes as well as inheritance and gift taxes are key factors for the choice of their future residence. Whereas the position of Switzerland is rather weak with regard to taxes on wealth, Switzerland is still very attractive concerning inheritance and gift taxes. Even if there is still some room for improvement as far as inheritance and gift taxes are concerned, e.g. regarding gifts to private (family) foundations and trusts, Swiss politicians should at least overcome the temptation to introduce federal inheritance and gift taxes – not even at the price of an abolition of the taxes on net wealth, because an attractive inheritance and gift tax regime is in many cases the decisive point for the choice of a residence.

The adjacent article of our Spanish colleagues furthermore describes the interesting and apparently very attractive Spanish impatriates tax regime. Especially some of the absolute conditions, which have to be fulfilled in order to apply for the regime (i.e. initial move to Spain or move to Spain after an absence of 10 years) seem to be very similar to the conditions of our Swiss forfeit tax regime. Whereas Spain, as member state of the European Union, introduces new tax regimes for individuals, which apparently are fully compliant with the guidelines of the European Union, Switzerland abolishes more and more its attractive tax regimes (e.g. the abolition of the lump-sum tax regime in the Canton of Zurich or the legislative initiative initialized by the Canton of St. Gallen). Do we really move in the right direction?

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