

## Spanish Tax Facts

<b>Introduction</b>	Taxation in Spain occurs at a national level and at a regional ('Autonomous Community') or municipal level. The Spanish taxation system was subject to a significant review in 2007 which resulted in the introduction of a new Personal Income Tax Act. The tax regime in Spain is controlled by the Ministry of the Treasury.
<b>Tax Year</b>	1 <sup>st</sup> January to 31 <sup>st</sup> December.
<b>Assessment Basis</b>	Spanish residents are taxed on their worldwide income (earned and unearned), capital gains from all sources and on their worldwide assets. Spain operates a self-assessment regime.  For personal income tax purposes, married couples may choose to file tax returns jointly or separately.
<b>Income Tax</b>	Spanish residents are subject to Spanish Personal Income Tax ('IRPF'). Individuals and couples benefit from personal allowances which reduce their liability to tax and which increase in line with the number of dependent children.  A new structure has been created for the taxation of income, which now falls into two categories: the general base and the savings base of income.  The general base includes salary and other benefits from employment, income from economic activities, and property rental income (either actual or deemed). Such income is reduced by applicable deductions and allowances. It is subject to a progressive scale which is applied to successive portions of taxable income with rates ranging from 24% to 43%.  The savings base is subject to a fixed tax rate of 18% and includes interest, dividends, and capital gains/losses, together with life and disability insurance proceeds paid by a Spanish entity to residents in Spain. Any investment income received will form part of the taxpayer's income tax calculation and any withholding tax deducted will be held as a credit against the final calculation of income tax due. Generally an annual exemption limited to €1,500 is granted to resident individuals in respect of all dividends.
<b>Taxation of Investment Income</b>	
<b>Premium Taxes</b>	Life insurance in Spain is exempt from premium taxes.
<b>Tax on Property Rental Income</b>	Property rental income, after the deduction of certain expenses, forms part of taxable income. Property which is not used for rental or economic activity and is not the taxpayer's permanent residence will be taxed on a deemed income basis at 2% based on cadastral value (equivalent to a rateable value in the UK).
<b>Wealth Taxes</b>	Wealth tax was technically abolished with effect from 1 January 2008. An allowance equal to 100% of the wealth tax due has been introduced and reporting obligations have been eliminated.
<b>Capital Gains Tax</b>	Capital gains are included in the savings base. There are some capital gains exemptions, e.g. the sale of the primary residence of the taxpayer is granted full or partial rollover relief, as are the capital gains for the sale of qualifying collective investments. Capital gains from investment funds are subject to a flat withholding tax of 18%, unless rollover relief applies.  Collective investments from jurisdictions included in the list of tax havens issued by the Spanish tax authorities are deemed to have a minimum net capital gain of 15% of the acquisition value.
<b>Inheritance and Gift Tax</b>	Inheritance and Gift tax is payable by the recipient of the assets at rates of between 7.65% and 34%. Residents are taxed on their worldwide assets and non-residents are only taxed on the assets and/or rights located in Spain.  The amount of tax paid depends upon the value of assets received. Tax rates are subject to a further multiplication factor (ranging from 0.5 to 1.4) based on the relationship of the recipient to the donor or deceased, and the existing wealth of the recipient. Different tax rates may apply in each Autonomous Community.  Various reductions to the tax base on inheritance apply and are dependent on the relationship between the recipient and the deceased, and the age of the recipient. For example, where a recipient is a dependent child over the age of 13 but under 21 the taxable base is reduced by €15,956.87 and a further €3,990.72 for each year under 21 taking the maximum reduction to over €90,000(2009).

**Inheritance and Gift Tax (cont.)**

No reduction is available for more distant relatives or unrelated parties. Additional reductions in each Autonomous Community may apply.

The Law also provides reductions to the taxable base for life insurance, the inheritance of the habitual dwelling of the deceased and the inheritance and gift of assets and shares of a family business.

**Regional and Municipal Taxes**

Inheritance and gift tax, capital and property transfer tax, as well as a proportion of income tax, are raised by the Autonomous Community/Region in which the taxpayer is resident.

**Property Taxes**

An annual real estate tax is payable to the local municipality. The tax is based upon a percentage of the cadastral value of the property. The value is adjusted every 8 years. The rate varies from 0.4% and 1.1% on urban properties and 0.3% and 0.9% on rural properties. Municipalities may, within certain limits, increase or decrease these rates.

If there is a change in land title, a municipal tax ('land appreciation tax' or 'Plus Valia') is raised based upon the increase in value of the land since it was last sold. The rate is set by the Municipality and varies depending upon the cadastral value and the length of time since the preceding transfer.

**Stamp Duty/Transfer Tax**

The general rate of Stamp Duty/Transfer tax is 6%-7% (depending upon the Autonomous Community) on 'second hand' property transactions. Lower rates apply to the acquisition of other assets. Documentary stamp duty is typically 0.5%, or 1% for most regions. No Stamp duty applies if the transaction is subject to VAT.

**Sales Tax**

Sales tax (IVA) of 16% is generally added to the sale price of goods. Some items are exempt from sales tax or are taxable at a reduced rate. 'New build' properties capable of being used as dwelling are subject to a sales tax of 7%, which is charged in place of a transfer tax.

**Social Security Contributions**

An employee is liable to pay social security contributions as a percentage of earnings. The rate is generally 6.35%, but contributions are capped at €3,166 for the year 2009. Compulsory social security contributions made are deductible from taxable income.

## Taxation of Expatriates Living in Spain

Expatriates living in Spain will be classified as either resident or non-resident. An individual is considered resident if:

- They spend more than 183 days in Spanish territory in a calendar year or,
- Their principal place of business, professional or economic interest is based in Spain or,
- Their spouse and/or dependent children are habitually resident in a Spanish territory (unless the individual is separated from their family, or can prove tax residence elsewhere)

In Spain there is no concept of a part tax-year. An individual will be considered to be resident or non-resident for the whole tax year according to the above rules and taxed accordingly.

Income tax is raised in two parts: the majority is raised by the central government, with a smaller percentage being raised at a regional level by the 'Autonomous Community' in which the individual is living. The 'Autonomous Communities' also control inheritance/gift tax rates. If the 'Autonomous Community' does not establish its own tax scales then a default tax scale is applied.

Income generated from employment for services rendered in a foreign country is tax exempt up to a limit of €60,100 (2009), provided that the work is performed for a company or entity non-resident in Spain, or for a permanent establishment located in a foreign country and provided that a tax similar to the Spanish Personal Income Tax is applied in the territory where the work is performed. In addition, the territory must not be considered a 'tax haven' by the Spanish tax authorities. At present, the UK Dependent Territories of the Channel Islands and the Isle of Man, as well as the UAE, Hong Kong and Singapore, are all included on a 'blacklist' of tax havens maintained by the Spanish Tax Authorities.

International assignees moving to Spain, may, if certain conditions are met, choose to be taxed under the Special Taxation Regime for Expatriates described below.

## Taxation of 'Non-Residents' Living in Spain

From 1<sup>st</sup> January 2004 individuals who acquire tax residence in Spain as a result of their transfer to Spain may opt to pay Non-Resident Income Tax in the tax period in which the change of residence takes place and for the following five tax years when the following conditions are met:

- The taxpayer cannot be considered tax resident in Spain in the 10 years prior to their assignment to Spain.
- Their transfer to Spain results from an employment contract. The individual needs to have a local contract with a Spanish company. In case of a group of companies, an employee can maintain a home country employment contract and be seconded to work for a Spanish entity.
- The work is effectively carried out in Spain. The work must be performed physically in Spain. This requirement will not be met if the employee works out of Spain and the income related to the duties performed out of Spain exceeds 15% of their annual employment income. In case of employees who work for other foreign entities of the group, the above percentage will be 30%.
- The work is for a company or entity resident in Spain, or for a permanent establishment located in Spain of an entity not resident in a Spanish territory.
- The earned income derived from the employment contract is not exempt from Non-Resident Income Tax.

Expatriates living in Spain who choose to be taxed under the Non-Resident Income Tax regime are taxed only on income and gains obtained or generated in a Spanish territory, compared to worldwide income and gains for residents. Non-residents may only file individual tax returns, unlike residents who may file joint returns in respect of a married couple.

The tax rates applicable to non-residents were amended with effect from 1<sup>st</sup> January 2007 in line with those applicable to residents:

- 24% on general income, including salary and royalties
- 18% in respect of interest and dividends and capital gains

A non-resident does not normally benefit from tax free allowances/deductions. However, certain exemptions may apply to non-residents, in particular residents of other EU countries are not normally subject to Spanish tax on Spanish sourced interest income, or capital gains realised on the sale of certain personal property.

With regard to capital gains arising from the transfer of real property from non-residents, the purchaser is required to withhold 3% of the agreed consideration. This amount is paid to the Spanish fiscal authorities on account against the seller's potential liability to capital gains tax. In addition, dividends and interest are paid to non-residents net of withholding tax. Dividends paid to non-residents are exempt up to €1,500 pa, but withholding tax applies and a refund must be requested. The amount of the tax withheld will depend on the terms of any double taxation treaty with the payee's country of residence. Spain has negotiated over 50 double taxation treaties.

Inheritance tax applies to non-residents only in receipt of assets and/or rights located in Spain.

## Expatriate Financial Planning

The approach to an expatriate's financial planning will be determined by whether the individual becomes resident in Spain or can qualify as a non-resident for tax purposes.

While, as a whole, the Spanish tax regime for non-residents is less onerous than the regime for residents, with only Spanish sourced income and gains being subject to tax, an expatriate should take care over the number of days spent in Spain during any tax year, although under certain conditions some individuals can elect to be taxed as Non-Residents even if they become Resident in Spain.

If you are an expatriate currently living in Spain, you should review your finances with a suitably qualified financial adviser who is either authorised directly by the Spanish regulator or is based in another EU market and recognised by the Spanish regulator following prior notification by the adviser under the Insurance Mediation Directive. If you are planning a move to Spain, you should review your finances with a suitably qualified and experienced financial adviser and/or tax adviser who is familiar with Spanish tax matters before making the move.

Expatriates who are non-resident in Spain for tax purposes may be advised to use offshore investments, including offshore life products, rather than domestic Spanish investments, to keep their assets outside of Spain to avoid future inheritance tax liabilities and to avoid creating Spanish-sourced investment income.

## Expatriate **Financial Planning** cont.

While the tax treatment of life insurance and mutual funds is on a level footing in Spain, expatriates who become tax resident may wish to consider offshore investments to manage their tax liability and/or control when tax charges are made. In particular, life insurance still provides an effective way of housing and switching multiple collective investments in a tax efficient manner. However, care should be taken when selecting the underlying investments held in portfolio bond structures in particular, as the authorities require that, in order to benefit from more favourable tax treatment, only certain assets (i.e. UCITs) may be held within wrapper products.

With Spanish residents liable to inheritance tax on their worldwide assets, tax resident expatriates may also wish to consider estate planning options, such as an offshore bond held in an appropriate trust or foundation.

Whilst the specific benefits of an offshore life product will depend upon an individual's circumstances, they do offer a number of potential benefits:

- Investments in an offshore life product grow virtually free of tax throughout the time the product is held, suffering only a small amount of irrecoverable withholding tax on investment funds located in certain countries.
- They allow you, in general, to manage when you take benefits and potentially to defer the benefits to a period that may be more advantageous to you from a taxation perspective.
- Offshore products can offer significant benefits over and above what might be available in the local domestic market, particularly in relation to product features, investment flexibility and investment choice.
- Offshore bonds often feature a range of the life company's own individual offshore funds and managed offshore funds specifically tailored to fit with the spread in clients' attitudes to risk, but also offer access to household name fund managers, including many international and specialist fund managers, which may not be available in local domestic fund and insurance markets. Spanish residents need to ensure that their investment choices conform to Spanish tax rules to ensure the tax efficiency of their offshore bond.
- An offshore product has the flexibility to adapt to changes in your individual circumstances, including changes in your residency status.
- Most companies offering offshore life products are subsidiaries of global financial services companies.
- The offshore life companies are regulated in first class jurisdictions which benefit from strong regulatory controls.
- Tax rules are subject to change and there is currently uncertainty over a tax ruling for unit-linked insurance in Spain, particularly if it is classed as a "privately-managed" portfolio. Individuals should seek detailed tax advice before making any decision that affects their tax planning.

***Your independent financial adviser can help you ensure that you maximise the financial benefits of your expatriate status and help you to assess if offshore life products are right for your individual circumstances.***

***Further information about offshore life products and their use in financial planning can be found on AILO's website at [www.ailo.org](http://www.ailo.org)***

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