Temporary solidarity tax on large fortunes and other changes to wealth taxation

Tax Alert

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Tax on large fortunes and other changes to wealth taxation

On 10 *November, during the passage through parliament of the Proposed Law for the Establishment of Temporary Levies on Energy and on Credit and Financial Credit Institutions,* a number of amendments were tabled that will have a significant impact on wealth taxation in Spain.

Background

As advanced by the Finance Minister on 29 September, the socialist parliamentary group and the confederate parliamentary group Unidas Podemos-en Comú Podem-Galicia en Común have tabled certain amendments to the *Proposed Law for the Establishment of Temporary Levies on Energy and on Credit and Financial Credit Institutions*, one of which is the creation of a **temporary solidarity tax on large fortunes** (*amendment 1*).

A further proposal concerns amending **wealth tax** for non-residents who are indirect owners of property in Spain (*amendment 3*).

1. New temporary solidarity tax on large fortunes

The temporary solidarity tax on large fortunes (**"ITSGF"**, per its Spanish acronym) is conceived as a direct personal tax that will supplement wealth tax ("WT") and be levied at central government level (i.e. it will not be devolved to the autonomous regions). As such, it will stand as an additional levy on the wealth of natural persons with **fortunes exceeding Euros 3,000,000**.

What are its aims?

According to its rationale, the proposed amendment is primarily conceived as a means of **increasing tax revenues**. Its second aim is **harmonisation**, i.e. to reduce the differences currently existing in the way in which wealth tax is levied in the different autonomous regions.

What will it tax?

This tax will reflect both the structure and some of the essential components of wealth tax.

Thus, it will tax the **net wealth** of natural persons, which is taken to mean all of the financial assets and rights owned by them, minus any such liens or other encumbrances as may reduce the value thereof and any debts or personal obligations for which they are liable.

When will taxable wealth be calculated?

As with wealth tax, the date to be used to calculate the tax accruing will be **31 December each year** and it will be levied on any net wealth owned by natural persons at that date.

Who will be subject to ITSGF?

As with wealth tax, ITSGF will be payable by Spanish **residents** in respect of their worldwide wealth, and by **non-residents** in respect of any wealth located, or related rights that may be exercised or fulfilled, in Spain.

Nonetheless, the amendment states that non-residents will not be required to file returns *"unless the result of the relevant tax assessment is tax payable*".

Assuming that where the amendment says "the relevant tax" it is referring to ITSGF, non-residents will also be required to file tax returns in this regard where application of the related regulations results in tax payable.

The new tax is applicable throughout Spain, notwithstanding the foral economic agreements and tax regimes applicable in the Historic Territories of the Basque Country and the Foral Community of Navarre, and the provisions of the international treaties and conventions in this regard.

Provision is made for this tax to be applied in the Foral Territories, although this will be subject to agreement by the relevant coordination bodies.

How long is it expected to last?

ITSGF is envisaged as a temporary tax that will be applicable in the **first two years** in which it becomes chargeable, as of its entry into force.

Nonetheless, the amendment includes a clause whereby, upon conclusion of the validity period for this tax (after 2 years, in principle), the Government will perform an evaluation to gauge the impact of the tax and propose that it either remain in force or be dropped.

When will it enter into force?

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According to the wording proposed by the amendment, ITSGF will enter into force **the day after** the date of its publication in the Official State Gazette.

Note in this regard that the Law that under amendment is currently pending approval. However, if it is passed by 30 December, **it will be effective for 2022** and we therefore recommend keeping track of its passage through parliament.

How will the cost be quantified?

Assets owned by natural persons will be quantified on 31 December, by applying the **valuation rules** used to calculate wealth tax.

Assets and rights that are **exempt** from wealth tax will also be exempt from ITSGF.

In this connection, the principal WT exemptions concern:

- **Family businesses** (both companies and individuals).
- Permanent residences (up to **Euros 300,000**).
- Vested rights in certain welfare schemes (pension plans, insured pension plans, corporate employee welfare plans, pan-European individual pension products, etc.).
- Assets forming part of Spanish or regional historical heritage, and certain art objects and antiques.
- Household effects.
- For non-residents: securities the returns on which are exempt from non-resident income tax (e.g. fixed income securities for EU residents).

In the case of residents (individuals who have their permanent residence in Spain) subject to the unlimited tax regime, their taxable income will be eligible for a **Euros 700,000** reduction in respect of the **exemption threshold**. Unlike the related provisions concerning wealth tax, the amendment makes no mention of application of this reduction to non-residents, and there is thus some question as to whether or not the sweeping reference in the provisions introducing ITSGF to WT legislation is sufficient to infer that the reduction may be applied. The general principles of tax law preclude the use of analogies for the purposes of extending exemptions. Nonetheless, failure to remedy this discrimination against non-residents (as the WT Law does) would raise serious questions as to the observance or otherwise of European Law.

Once taxable income has been calculated, a progressive rate will be applied, based on the following scale;

Net taxable income – Up to Euros	Tax charge – Euros	Remainder of net taxable income – Up to Euros	Applicable rate – Percentage
0.00	0.00	3,000,000.00	0.00
3,000,000.00	0.00	2,347,998.03	1.7
5,347,998.03	39,915.97	5,347,998.03	2.1
10,695,996.06	152,223.93	Upwards	3.5

How are potentially confiscatory effects to be avoided?

As we know, article 31 of the Spanish Constitution provides that the tax system may not be confiscatory in nature.

Indeed, in past rulings of the Constitutional Court the above prohibition has taken the form of a limit that precludes the application of certain tax mechanisms depriving taxpayers of income and properties (Constitutional Court Judgment 150/1990).

The failure by a tax on the personal ownership of wealth to factor in the income obtained by the owner of the taxable assets in any given year could lead to a confiscatory scenario whereby, for example, a person who has no income but owns assets subject to wealth tax would in fact have to surrender the assets comprising their taxable income in order to pay the applicable wealth tax.

To remedy this, the Wealth Tax Law provides for a combined limit on the tax due in respect of WT and PIT.

The relevant rule provides that the tax due for WT and PIT may not exceed 60% of a taxpayer's taxable income for PIT purposes. Where this amount is exceeded, the wealth tax due is reduced by any excess, subject to a maximum reduction of 80% of the original calculation of wealth tax due.

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A number of other factors provided for in the WT Law must be taken into consideration for the purposes of this rule:

- Regard is not had, for personal income tax purposes, to capital gains generated over more than one year.

- Dividends from the asset-holding companies provided for in the former (repealed) Corporate Income Tax Law (the transitional regime provided for under transitional provision 22 of RDL 4/2004) are added to taxpayers' taxable income for PIT purposes, even though they are not subject to PIT.

- The portion of wealth tax that corresponds to capital assets which, owing to their nature or allocated use, do not generate taxable income for PIT purposes, is not taken into account.

While its alignment with EU law may be called into question, the fact is that this rule on a combined limit on tax due only applies to taxpayers subject to the unlimited tax regime for Spanish residents.

The **combined limit rule will apply to ITSGF in the same way** as to WT.

Where applicable, the combined limit on tax due will thus be applied by adding together the three taxes:

- PIT due.
- WT due.
- ITSGF due.

The amendment also proposes that the **WT due for the year that is actually paid be deductible** from the cost of ITSGF.

How will ITSGF be managed?

The proposed amendment provides that **competence** for the management, assessment, collection, inspection and review of this tax lies with the **central government**.

Accordingly, the central government authorities are expected to include this tax as one of the **priority areas for inspection or verification** in future tax control plans, as competence for ITSGF will lie exclusively with the central government with no devolution of collection powers to regional authorities. Nonetheless, as the amendment itself states, "*it will be allocated to financing policies to support the most vulnerable*"

The amendment also states that "*taxpayers with tax payable must file a tax return, perform a self-assessment and, as the case may be, pay the tax debt in the place and manner and by the deadlines established by the Ministry of Finance and Civil Service*".

Which non-residents must appoint a representative?

Non-residents from **outside the EU** must appoint a natural or legal person resident in Spain to represent them before the tax authorities in relation to their ITSGF obligations before the filing deadline for the relevant tax return.

Resident taxpayers who **leave** Spain for a third country (a country that is not an EU or EEA member state that has in place regulations on mutual assistance for the exchange of tax information and collection) after performing the taxable event and before filing the relevant self-assessment and tax return must also appoint a representative, **unless they plan to return prior to** the **regulatory filing deadline**.

The above shall not apply to non-EU member states forming part of the EEA, where the states in question have in place regulations governing mutual assistance for the exchange of tax information and collection on the terms provided for in General Taxation Law 58/2003 of 17 December 2003.

2. Changes to wealth tax for non-residents indirectly owning real estate in Spain

Amendment 3 to the Proposed Law for the Establishment of Temporary Levies on Energy and on Credit and Financial Credit Institutions, submitted by the socialist parliamentary group and the confederate parliamentary group Unidas Podemos-en Comú Podem-Galicia en Común, proposes changes to the taxation of non-residents who own real estate in Spain via non-resident entities.

Background

Generally speaking, non-residents are subject to wealth tax on any real estate directly owned by them in Spain.

However, until now, Wealth Tax Law 19/1991 contained no express provisions concerning the indirect ownership of such real estate.

Non-residents are also subject to wealth tax on transferable securities located or exercisable in Spain.

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By contrast, the indirect ownership of real estate in Spain via foreign entities was not provided for in the WT Law. It was, however, referred to in certain treaties regulating tax sovereignty.

A number of treaties signed by Spain (e.g., those with Germany, Saudi Arabia, Armenia, Egypt, Slovenia, France, Georgia, India, Iceland, Israel, Kazakhstan, Kuwait, Luxembourg, Mexico, Moldova, Norway, Panama, United Kingdom, South Africa, Uruguay and Uzbekistan) contain a provision regarding WT on indirect real estate holdings, which grants sovereignty to tax the indirect ownership of real estate to the country in which the property is located.

Nonetheless, the impact of any applicable treaty will need to be examined on a case-by-case basis.

Note the recent ratification of the multilateral convention on the implementation of double taxation treaties, which affects the manner in which such treaties are interpreted.

Court and administrative findings

In **Judgment 621/2020**, the Balearic Islands High Court of Justice held that properties owned indirectly by non-residents via non-resident entities did not give rise to a taxable event for WT purposes in Spain as the relevant assets or rights were neither located nor exercisable in Spain.

At the time of this judgment, Spanish domestic legislation had yet to expressly implement the powers of taxation granted by the treaties, and it was thus not possible to tax the relevant scenarios.

According to recent rulings by the Directorate-General of Taxes (see **V3178-19, V2070-21** and **V1947-22**), the prevailing WT legislation **lacked the regulatory power** to tax the ownership by non-residents of foreign securities, even where the underlying asset is real estate located in Spain and irrespective of the provisions of certain double taxation treaties on the matter.

What is to be achieved by the proposed WT amendment?

The aim of this amendment is to **grant powers of taxation** over the aforementioned capital assets, i.e. shareholdings in non-resident entities with underlying real estate assets located in Spain.

With this in mind, it advocates the inclusion of such capital assets under the definition of securities located in Spain, by regulating taxpayers liable for WT under the limited regime for non-residents.

What is proposed?

The amendment proposes that securities representing holdings in the equity of any kind of entity, not traded on organised markets, be deemed to be located in Spain where **at least 50 percent** of the relevant assets consist, either **directly or indirectly**, of real estate assets located in Spain.

How will the value of a foreign entity's real estate be measured in order to ascertain whether the law applies?

To measure the value of the asset, the carrying amounts of all of the recognised assets will be replaced by their respective market values, determined at the date on which the tax becomes chargeable.

In the case of **real estate**, the carrying amounts will be replaced by the values constituting the tax base in each specific case, pursuant to the rules on the valuation of real estate assets.

Note that, for WT purposes, real estate assets are measured at the highest of the following three values:

- ✓ the cadastral value;
- ✓ the value determined or established by the authorities for the purpose of other taxes; and
- ✓ the acquisition price, consideration or value.

3. Conclusions

- The impact that the future introduction of ITSGF might have on individuals with non-exempt net wealth in excess of **Euros 3,000,000** should be examined.

- It is also advisable to consider personal and family circumstances, sources of income, the type of assets held, family business requirements, the location of assets and any unrealised corporate gains **prior to making any tax planning decisions**.

- Residents of autonomous regions -other than the Basque Country and Navarre- where the WT legislation provides for tax relief with respect to WT (or marginal tax rates that are lower than the proposed rate) stand to be **most affected** by ITSGF, if it is ultimately approved.

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- **Non-resident** individuals that own (or are considering acquiring) real estate in Spain should seek advice on how best to **structure their assets** and review existing holding structures involving foreign entities to evaluate the manner in which they may potentially be affected by the proposed WT amendment.

The above two legislative amendments have yet to complete their passage through parliament and, accordingly, may be modified. The discussion, voting and potential adoption process should thus be closely monitored.

Please do not hesitate to contact KPMG Abogados, S.L.P. if you wish to discuss any of these matters.

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