TAXATION OF NON-RESIDENT INDIVIDUALS IN SPAIN: HOT TOPICS AND OPEN QUESTIONS

Javier Arregui Bravo y Alex Pié Ventura

Abogados del Área de Fiscal y Laboral de Uría Menéndez (Barcelona)

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This article reviews various issues of interest in relation to the main wealth taxes affecting non-resident individuals who invest in Spain: Net Wealth Tax and Inheritance and Gifts Tax. Following a general overview of the taxation of non-residents, we also analyse the major judgments that have put an end to discriminating non-residents in the field of inheritance, the main nuances to be considered in non-residents applying family businesses tax benefits and some observations regarding characteristic investment structures in Spain.

Key words:
Taxation, Non-resident individuals in Spain, Net Wealth Tax, Inheritance and Gifts Tax, Family businesses.

La imposición patrimonial en España de no residentes: temas de interés y cuestiones pendientes

Este artículo revisa diversas cuestiones de interés en relación con las principales figuras impositivas de naturaleza patrimonial que afectan a los no residentes con inversiones en España; particularmente, el Impuesto sobre el Patrimonio y el Impuesto sobre Sucesiones y Donaciones. Entre las cuestiones analizadas, además de una aproximación general a la imposición de los no residentes, se encuentran los pronunciamientos que han puesto fin a la discriminación de los no residentes en el ámbito sucesorio, los principales matices a considerar en la aplicación de los beneficios de empresa familiar a no residentes o algunos comentarios sobre estructuras típicas de inversión en nuestro país.

Palabras Clave:
Impuestos, No residentes en España, Impuesto sobre el Patrimonio, Impuesto sobre Sucesiones y Donaciones, Empresa familiar.

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1. Introduction

The climate, prices, culture, infrastructure and good quality public services are some of the reasons that make Spain an attractive destination to live, work, travel, or simply invest.

In 2019, Spain was the fourth most invested in country in the European Union, behind only France, Germany and the UK, and in 2020 foreign investment rose slightly, contrary to the sharp falls recorded worldwide as a result of the COVID-19 pandemic[1]. Spanish companies attract international investors: specifically, the sectors that attracted most interest and investment in 2020 were financial and insurance activities, information and telecommunications, manufacturing and construction. In recent years, the real estate sector has also led investment figures in Spain, having absorbed 20% of total foreign investment between 2014 and 2019[2]. Although the pandemic has caused a significant decline in this field during 2020, the trend in 2021 has pointed to a rapid recovery. It is also remarkable that, of all housing acquisitions in Spain in 2020, non-nationals acquired 11.3%, a figure that is higher than the average in recent years and shows a growing interest in settling in Spain[3].

Naturally, taxation can contribute to boosting or discouraging investment decisions. Depending on the investor's profile and the type and purpose of their investment, its tax impact and thus strategy analysis may be different. For instance, institutional investors, banks, insurance companies, investment funds or pension funds, among others, would analyse how taxes affect their investments' profitability, whereas multinational companies that set up in Spain will seek attractive tax regulations to do business.

As regards non-resident individuals who invest their fortunes or savings in Spain, whether in real estate, financial products, businesses, etc., they will essentially focus on the taxation linked to generating income, as well as to holding and later transferring assets. In this respect, two relevant taxes apply in Spain, which are levied on owning assets and their transfer for no consideration, respectively: Net Wealth Tax ("NWT") and Inheritance and Gift Tax ("IGT"). This article explores important aspects of these taxes and how they may affect non-resident individuals who invest in Spain.

2. Tax residence in Spain

Analysing the tax status of any natural person requires first assessing their tax residence. Non-Spanish tax residents are those who either do not meet the Spanish-law requirements to be considered tax residents, or who do meet them but are not tax residents because the tie-breaker rules of a double tax treaty apply.

1 Bank of Spain (2021). La Balanza de Pagos y la Posición de Inversión Internacional en 2020.

2 National Statistics Institute (Instituto Nacional de Estadística). Inversión Extranjera Directa en España.

3 Caixabank Research (2021). Informe sectorial: El sector inmobiliario en la nueva normalidad.

The Spanish tax legislation provides an autonomous definition of tax residence, completely separate from residence for administrative purposes or nationality. The Personal Income Tax ("PIT") Law defines the concept of tax residence, setting out two alternative criteria:

i. The person spends more than 183 days in the calendar year in Spain – sporadic absences are considered days in Spain, unless the taxpayer proves their tax residence in another country (the "permanence criterion").

   The concept of sporadic absence is not defined by law and its interpretation has been widely debated[4]. In general, it could refer to temporary trips outside Spain for holidays or professional matters, among others, if they do not result in a tax residence being acquired in another territory.

ii. The core business or the person's main economic interests are directly or indirectly located in Spain (the "centre of economic interests criterion").

   Again, the centre of economic interests is an undefined concept, which requires an overall assessment of the taxpayer's circumstances. Factors to be considered include where their main sources of income (place of work, investments, etc.) and the bulk of their wealth are located.

Both criteria are alternative, so it is sufficient for either of them to be met in order to be considered tax resident in Spain.

Likewise, Spanish law establishes the rebuttable presumption that a taxpayer is tax resident in Spain when, according to the aforementioned criteria, their non-legally separated spouse and their dependent children are tax resident in Spain. This presumption, however, can be proved otherwise (*iuris tantum* presumption).

A lack of coordination between various States may result in the same person being considered tax resident in several countries, causing the taxpayer an obvious detriment, since, in most cases, tax residence entails taxation in a State on worldwide income (and sometimes also on worldwide wealth). In order to avoid these double taxation situations, Spain has signed agreements to prevent double taxation with numerous States. These bilateral treaties establish tie-breaker rules to determine the sole State of tax residence when a double taxation situation arises.

The aforementioned criteria mostly derives from the OECD Model Tax Convention on Income and on Capital ("OECD Model Tax Convention") and are therefore essentially the same in most of the double tax treaties Spain has signed. These criteria are the following (in strict order): (i) the person will be a tax resident in the State where the taxpayer has a permanent home available; (ii) if the person has a permanent home in both countries, in the State where the person's closest personal

4 For further details on the concept and how the Spanish Supreme Court has interpreted sporadic absences, we refer to an article published in 2017 in this very journal titled "Las ausencias esporádicas en el sistema tributario español: análisis a la luz de las recientes sentencias del Tribunal Supremo" (which loosely translates as "Sporadic absences in the Spanish tax system: analysis in light of new judgments by the Spanish Supreme Court"). Link: https://www.uria.com/documentos/publicaciones/5662/documento/esp04.pdf?id=7552.

and economic relations are located (centre of vital interests); (iii) if the first two criteria are inconclusive, in the State where the person habitually lives; and finally (iv) in the State of their nationality. Ultimately, both States are obliged to reach an agreement on the individual's tax residence.

Proof of tax residence in a certain jurisdiction is often a contentious matter. In this context, and although other means of proof are allowed, tax residence certificates issued by the tax authorities are very important. In the case of a double tax treaty, applying the benefits provided in the treaty (such as the tie-breaker rules) will require providing a certificate of residence for the specific purposes of the treaty.

To conclude these general considerations on the concept of tax residence, the COVID-19 situation merits a mention. In the context of the global pandemic, many people were forced, largely in 2020, to stay in a certain territory due to government-approved movement restrictions. This may be important to determine their tax residence in that tax period. Traditionally, the Spanish General Taxation Directorate ("SGTD") had been inflexible, considering the permanence criterion to be met by the mere presence of a taxpayer in Spain even when this was due to reasons beyond their control (see, in this respect, binding ruling V2516-15 of 5 August). Similarly, in relation to the health-crisis situation that began in 2020, the SGTD maintained in binding ruling V1983-20 of 17 June, that presence in Spain forced by movement restriction stemming from the state of emergency the Spanish Government approved should be considered for the permanence criterion purposes.

Yet, in a more recent binding ruling (V0862-21, of 13 April), the SGTD admits that, when an individual is forced to stay in Spain as a result of COVID-19 restrictions, the application of the tie-breaker rules provided in double tax treaties will generally lead to Spain not being considered the taxpayer's country of tax residence. Through this ruling, the Spanish authorities followed the OECD's stance in its report "OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis" dated 3 April 2020[5].

3. Non-resident taxation in Spain

Being a Spanish tax resident entails taxation in Spain on the person's worldwide income, which is subject to PIT, and worldwide assets, which is generally subject to NWT.

Non-residents' Spanish-source income income can also be taxed in Spain (either subject to Non-Resident Income Tax —"NRIT"— or to IGT), as is them owning assets or rights located in Spain, which may be subject to NWT. The applicable double tax treaties play a prevalent role in determining whether the person actually has to pay these taxes.

5 Available in https://www.oecd.org/coronavirus/policy-responses/oecd-secretariat-analysis-of-tax-treaties-and-the-impact-of-the-covid-19-crisis-947dcb01/.

4. The Spanish NWT: main features

Non-Spanish residents are only taxed on the assets they own at 31 December of each year and which have a nexus with Spain (when "they are located, can be exercised or must be fulfilled in Spanish territory", in the terms used by the law itself). On the other hand, Spanish tax resident individuals are taxed on their worldwide assets, regardless of where they are located (i.e. in Spain or abroad).

In both cases, the assets' value must be determined in accordance with the valuation rules laid down in the NWT Law, the most relevant of which are the following:

i. Real estate property: the higher of the following three values must be taken: cadastral value, acquisition value or the reference value which the Cadastre publishes based on information taken from real estate transactions formalised before a notary public (applicable only to real estate acquired after 1 January 2022).

ii. Shares in listed companies: average trading value in the fourth quarter.

iii. Shares and other equity of unlisted companies: if their accounts have been audited, the underlying book value resulting from the last approved balance sheet should be taken. Otherwise, the higher of the following three values: nominal value, underlying book value or value resulting from capitalising at 20% the average profits of the last three financial years.

iv. Bank accounts: the higher between the balance at 31 December and the last quarter's average balance.

v. Other assets: market value must be considered.

The value of the assets and rights may be reduced by the value of the taxpayer's debts and charges. Non-Spanish resident individuals are only entitled to deduct those charges and encumbrances that affect the assets located in Spain, as well as the debts for capital invested in those same assets.

Once the net wealth value has been determined, only the part exceeding the exempt minimum of EUR 700,000 (or the amount approved by the corresponding autonomous region) will be taxed. The scale of taxation can vary depending on the autonomous region where the assets are mainly located, but it can reach maximum marginal rates of 3.75% for high net worth individuals.

For Spanish tax residents, the NWT calculation scheme includes a limitation rule intended to prevent this tax from being excessive or confiscatory. In essence, this limitation rule or "tax shield" allows the taxpayer to reduce their NWT liability so that the sum of the NWT and the PIT quotas do not exceed 60% of the income obtained in the year. However, this rule does not apply to non-Spanish residents (who are not subject to PIT in Spain), leading to a comparative disadvantage that could be considered contrary to the EU freedoms and discriminatory.

Finally, the autonomous regions have legislative power to approve tax relief that can reduce the tax quota up to zero, as the Madrid Region has done.

The Spanish NWT is a *rara avis* among neighbouring countries, whose legal systems generally have no similar tax. However, in countries that do have a similar tax (essentially, Switzerland and Norway), double taxation situations could arise when residents of these jurisdictions own assets in Spain. On occasions, double tax treaties will prevent this burden by allowing only one of the countries to tax such wealth.

In other cases, even when there is no risk of double taxation (because the State of residence has no wealth tax), the applicable double tax treaty may limit Spain's power to tax assets located in its territory (tax treaties take precedence over Spanish domestic legislation). A significant number of the treaties Spain has signed only allow it to tax the ownership of real estate property located in its territory (sometimes, also shares in companies whose assets are mainly made up of real estate located in Spain), while they attribute the exclusive power to tax the ownership of any other asset to the tax residence jurisdiction.

5. The IGT: brief considerations

The Spanish IGT plays an important role in the generational transfer of assets with ties to Spain. Two types of situations can occur:

i. Unlimited tax liability (*obligación personal*). When the person receiving the assets (heir or legatee, in inheritances, or donee, in donations) is tax resident in Spain, they will be subject to IGT for the value of all the assets and rights received, regardless of where they are located.

ii. Restricted tax liability (*obligación real*). If the person receiving the assets is not tax resident in Spain, they will be subject to IGT only if they acquire assets and rights located in Spain.

Therefore, it is important to consider the eventual IGT taxation on the transfer of assets located in Spain either by inheritance or donation, irrespective of the recipients' tax residence. We analyse which autonomous region's IGT regulation applies to such transfer in section 6.

In general, the IGT taxable amount is determined based on the assets' market value. State and regional legislation provides a series of reductions of the taxable amount that may apply depending on personal circumstances (e.g. degree of kinship) and the type of asset being transferred (family business, habitual residence, etc.).

Once the taxable amount is determined, the taxpayer must apply the taxation scale, which depending on the specific autonomous region's legislation can reach marginal rates of up to 34% (although some regions have passed reduced tax scales under certain circumstances, such as Catalonia for donations between close relatives). Lastly, the tax quota must be corrected by the so-called "multiplier coefficients", which in turn depend on the degree of kinship and the acquirer's pre-existing wealth (ranging from 1 to 2.4, which could lead to effective taxation rates of up to 80%).

Similarly to NWT, the autonomous regions have the power to approve tax relief that can result in a significant reduction of the IGT quota. For instance, Madrid, Andalusia, Murcia or Castille and León offer 99% relief for both inheritances and donations between spouses and between parents and their descendants, while Catalonia offers 99% relief for inheritances between spouses and a progressive relief for inheritances between parents and their descendants. These regional differences have caused much public debate and harmonising the IGT legislation also seems to be in the Spanish Government's agenda.

Double taxation situations could also arise in the field of IGT due to the disparity of criteria between the different national legal systems involved. This could happen, for example, if one country were to tax an inheritance or donation according to the tax residence of the deceased or donor and, another country, according to the residence of the heir or donee. Although Spain has only signed bilateral agreements to prevent double taxation on inheritances (not on donations) with France, Greece and Sweden, the domestic IGT legislation provides a mechanism to avoid international double taxation by deducting the analogous tax paid abroad, up to the limit of what would have been payable in Spain.

Finally, in the case of donations, we note that the donor will be taxed on any capital gains accrued, based on the difference between the market value of the donated asset and its acquisition value. When the donor is not tax resident in Spain and the donated assets are located in Spain, such taxation will be subject to NRIT at a rate of 19%, although the provisions on capital gains contained in the applicable double tax treaty may provide exclusive taxation at the donor's State of residence depending on the kind of asset.

In view of the above, non-residents considering investing in Spain should first analyse the global tax implications (in Spain and in other States) of any potential future transfer of the assets (either *mortis causa* or *inter vivos*).

6. Storyline of the NWT and IGT discrimination against non-residents

Both NWT and IGT are taxes assigned to the autonomous regions. This means that, in accordance with the provisions that regulate the financing system of the autonomous regions, they have powers to manage, inspect and collect these taxes, as well as legislative authority to regulate certain elements relating to quantifying tax debt.

The autonomous regions' power is limited to taxable events occurring in their territory. As to NWT, the regional legislation applies when the taxpayer has resided in that region for a greater number of days in the calendar year. In relation to IGT, the regional legislation applies when the deceased person or the donee (depending on the nature of the taxable event) has resided in that region for a greater number of days in the five-year period prior to the taxable event. Exceptionally, when it comes to real estate gifts, the applicable regional legislation will be that of the place where the donated properties are located.

As regards non-residents, the legislation of both taxes had traditionally established that non-Spanish tax residents could only apply the State common legislation regarding NWT or IGT regulations. In other words, when the taxpayer of NWT (who owned the assets in Spain) or IGT (the heir or donee) was not tax resident in Spain, the law prevented them from applying the most beneficial regional provisions.

The autonomous regions, exercising their regulatory power, play a very significant role in quantifying these two taxes. With regard to NWT, they can increase the minimum threshold of assets exempt from taxation, reduce the tax rates and regulate tax deductions and allowances. As regards IGT, they can improve the tax reductions provided by Spanish national legislation, approve their own reductions, regulate the tax rate and multiplier coefficients and approve tax deductions and allowances. This can have a very significant impact – for example, citing some of the autonomous regions that receive more foreign investment, the Madrid Region has approved a 100% NWT reduction, both Madrid and Andalusia provide a 99% reduction in IGT for gifts and inheritances in favour of close relatives, and inheritances between spouses in Catalonia benefit from a 99% reduction, inheritances between other close relatives can be reduced up to a maximum of 60% and gifts between close relatives can benefit from a reduced tax rate ranging from 5% to 9%.

Therefore, the differences between regional regulations may incentivise investment in some regions over others. For example, a taxpayer would not have to pay NWT for owning a property in Madrid, while the cost of owning a similar one in other autonomous regions could reach 3.75% of the property value (determined according to the rules described in section 3(i) above).

At the time of writing this article, it is uncertain for how long these regulatory differences between autonomous regions will remain. As we have already mentioned, for some time now the current Government has stated that it intends to harmonise these taxes in order to put an end to tax competition between regions.

In any event, the fact that Spanish legislation prevented non-residents from applying regional legislation in the field of IGT prompted the European Commission to file, after several warnings to the Spanish authorities, a complaint before the Court of Justice of the European Union ("CJEU"), which ruled in its judgment of 3 September 2014, Case C-127/12, that this distinction with Spanish residents entailed a restriction on the free movement of capital. The Court held that Spain had failed to fulfil its EU law obligations by unjustifiably imposing different gift and inheritance taxes for residents and non-residents in Spain, as well as for taxing gifts involving immovable property differently depending on whether they were located in or outside Spain.

Following that ruling, the Spanish legislator sought to put an end to this discrimination by introducing an Additional Provision in the IGT Law which allowed residents in European Union ("EU") or European Economic Area ("EEA") Member States to apply regional tax benefits. It also introduced an Additional Provision with similar effects in the NWT Law, which recognised the same restrictions for that tax. Nonetheless, Spanish legislation continued to treat non-EU/EEA residents differently for tax purposes.

Subsequently, the Supreme Court handed down, among others, the judgments of 19 February 2018, 21 March 2018 and 22 March 2018[6], all resulting from appeals that non-EU and non-EEA citizens brought. In these cases, the Supreme Court ruled that the effects of the CJEU judgment of 3 September 2014 apply to third-country residents. Since then, the SGTD changed its criteria in its binding rulings V3151-18 of 11 December and V3193-18 of 14 December, and allowed the newly introduced Additional Provision of the IGT Law to apply to non-EU and non-EEA citizens.

The Supreme Court has more recently issued two judgments, dated 19 and 30 November 2020[7], directly ruling that Spanish IGT legislation treating third-country residents differently is a violation of the free movement of capital. The Court concluded that the allowances provided in the regional IGT legislation must apply irrespective of where the taxable person resides, even if they reside outside the EU or EEA.

Based on this Supreme Court case law, the recent Law 11/2021 of 9 July on measures to prevent and combat tax fraud has amended the IGT and NWT regulations. The regional benefits now apply to tax residents in third countries. This reform puts an end to a long history of discrimination.

7. Non-Spanish residents applying the tax benefits for owning and transferring family-owned companies

In the field of wealth taxation, the tax benefits for owning and transferring family businesses are quite significant; we are referring to the NWT exemption for holding shares in family-owned companies and the 95% IGT reduction for transferring these companies, either *inter vivos* or *mortis causa*. These benefits result in practically no tax cost in both owning and transferring family businesses, provided the applicable legal requirements are met.

In summary, the following requirements apply to shares in companies:

i. The entity is not a mere asset manager (i.e. more than 50% of its assets must be assigned to an economic activity or consist of shares representing at least 5% of the share capital of other entities, provided they are held to control and manage the shares and have the material and human resources for this purpose);

ii. The taxpayer's individual shareholding in the entity is at least 5% or, jointly with the family group, 20%; and

iii. The taxpayer or a person in the family group (for joint holdings) performs remunerated management functions and this constitutes their main source of income from work and business activities.

6 Proceeding numbers 62/2017, 2893/2016 and 15/2016, respectively.

7 With proceeding numbers 6318/2018 and 4456/2018, respectively.

Non-Spanish tax residents who own or receive a family business in Spain can also apply these tax benefits, although a number of special features should be considered. We describe the main ones below.

7.1. Being subject to NWT as a condition for applying the 95% IGT reduction

The IGT Law establishes that the 95% reduction applies to company shares *"to which the exemption regulated in section eight of Article 4 of Law 19/1991 of 6 June on Wealth Tax"* applies. Thus, it seems to require that the shares transferred by inheritance or donation be subject to and exempt from NWT as a precondition to apply the 95% IGT reduction.

This is particularly relevant where the transferor of the shares is not tax resident in Spain and the company whose shares are being transferred is not located in Spain, but the heir or donee does reside in Spain, and is therefore subject to IGT on all the assets they receive, regardless of where they are located. A question that arises is whether this transfer can benefit from the 95% IGT reduction if the NWT exemption could not be applied because the transferor was not subject to NWT for share ownership. What is more, even where non-resident individuals hold the Spanish companies' shares, the applicable double tax treaty may restrict Spain's power to tax share ownership, thus preventing it from being subject to NWT as the IGT Law requires.

Although the literal wording of the law requires that the shares transferred be subject to and exempt from NWT, it could also be interpreted that the provision is referring to assets that simply meet the material requirements established by law, without the exemption actually having to be applied.

According to the SGTD criteria (e.g. binding ruling V3238-17 of 15 December), if the transferor or donor were not subject to NWT for share ownership, their transfer could not benefit from the IGT reduction. This is, in our view, an excessively literal interpretation of the law and leads to the most unfavourable scenario for taxpayers.

However, in some autonomous regions, such as Catalonia, the regional IGT law regulates the family-owned business reduction without directly referring to the application of the NWT exemption (as article 20 of the IGT Law does). In these regions, the NWT exemption does not need to have actually been applied, but only the requirements for its application need to have been met.

In this context, there are concerns as to whether the requirement that the deceased or the donor of the shares be subject to the NWT for the acquirers to be able to apply the IGT reduction is in accordance with EU law. Why should a Spanish resident be able to apply the IGT reduction to shares in a Spanish company acquired from their father who resides in Italy, but not be able to apply that same benefit if the company was Italian? Is this not contrary to the EU freedoms?

7.2. Can a non-Spanish resident individual be part of the family group to meet the 20% shareholding requirement?

In line with the aim of protecting family businesses, one of the requirements to apply the NWT exemption and the IGT reduction is that the person hold shares representing at least 5% of the company's capital or, as an alternative, reach a 20% stake together with their spouse, ascendants, descendants or siblings.

The law does not establish any requirement with respect to the tax residence of the taxpayer's relatives, so that could *a priori* be interpreted to mean that they need not reside in Spain. On the other hand, the Spanish tax authorities have interpreted in several binding rulings (e.g. V0313-19, of 14 February) that the shareholding of those family members who are not subject to Spanish NWT cannot be taken into account to determine whether the 20% joint shareholding requirement is met. Specifically, the SGTD states, without further elaboration, that "*the requirement of joint participation in the kinship group would not be met, since the rest of the family participants are not taxable persons for Net Wealth Tax purposes and therefore the applicant does not form a 'family group' with them for the purposes of the exemption in the Spanish Net Wealth Tax*".

Again, this circumstance may be relevant in situations where the family member does not reside in Spain and the company is located outside Spain, as well as where a Spanish company and a family shareholder resident in a country with which Spain has signed a double tax treaty prevents Spain from taxing share ownership. The only certainty is that the law makes no reference to the family member having to be subject to Spanish NWT to fall within the family perimeter.

In our opinion, not only is this a *contra legem* interpretation, which adds requirements that the law does not establish, but it may also be deemed contrary to EU law.

7.3. Can a non-Spanish resident individual exercise the remunerated management functions?

Another requirement to apply the NWT exemption (and, by extension, the IGT reduction) is that the taxpayer themselves (or one of their relatives, if the joint shareholding reaches 20%) performs management functions in the entity, in exchange for remuneration representing more than half of their total income from work and economic activities.

In line with the above, this requirement being fulfilled by a family member who is not tax resident in Spain has been controversial. Once again, the majority of the administrative decisions favour requiring the family member who exercises management functions to be subject to NWT, although this requirement is not mentioned in some of the rulings on this matter (e.g. V3284-17 of 27 December).

The prevalent administrative position, which in our opinion is flawed for the reasons mentioned in the preceding section, also seems inconsistent with the Supreme Court case law, which ruled on 26 May 2016 that anyone belonging to the kinship group, regardless of whether such family member owns shares in the company, can exercise the management functions.

The Catalan General Tax Directorate (*Direcció General de Tributs de Catalunya*), who issues IGT binding rulings in Catalonia, stated that a non-resident family member who is not subject to NWT in Spain can exercise the management functions (V240/19 of 12 June). Unfortunately, this administrative position does not apply to NWT, as the national tax authorities have exclusive power to issue binding rulings regarding this tax.

7.4. Is the capital gain obtained by a non-Spanish resident who donates shares of a family-owned company subject to NRIT?

The PIT Law provides that capital gains or losses a Spanish resident donor makes from transferring shares that benefits from the 95% IGT reduction are not taxable. This is a tax deferral measure, as the donee subrogates in the donor's acquisition cost and date for the purposes of quantifying future capital gains.

However, if the donor is a non-Spanish resident, and the applicable double tax treaty allows Spain to tax the capital gain obtained as a result of the donation, the Spanish NRIT Law contains no similar provision to that of the PIT Law, which raises the doubt in this section's heading.

Fortunately, the SGTD has interpreted (binding ruling V0151-11 of 31 January) that provided the NRIT Law refers to the PIT Law to determine the taxable amount of capital gains, this reference should be extended to the non-taxation of the donor's capital gains or losses in donations of family businesses.

8. Tax issues regarding certain typical investment structures

As mentioned, non-Spanish tax resident individuals are only subject to NWT and IGT for their assets and rights located in Spain. On the contrary, indirectly owning Spanish investments through foreign vehicles is in principle not subject to NWT, nor is transferring the foreign vehicle's shares subject to IGT. However, this has not always been a clear-cut issue, as some of the administrative and court decisions referred to below show.

8.1. Does indirectly owning real estate in Spain through non-resident entities trigger NWT?

Pursuant to the literal wording of the law, a non-resident individual is subject to taxation for the assets and rights that "*are located, may be exercised or must be fulfilled in Spanish territory*". Thus, indirectly owning real estate in Spain should not be taxed.

However, some double tax treaties that Spain has signed (notably those with Germany and the UK) provide that Spain can tax share ownership in a foreign company if its assets consist mainly of real estate located in Spain. Based on this rule of allocating taxation rights and (arguably) reasons of non-discrimination, and although no provision of the Spanish NWT Law allows taxing indirect ownership of assets located in Spain, the SGTD has issued several binding consultations in recent years (e.g. V1995-20 of 17 June) confirming that such indirect ownership is subject to NWT.

This interpretation, which in our judgement is contrary to the law, had an honourable but isolated exception in binding consultation V3178-19 of 14 November, which decided that a person who resided in Gibraltar and owned a Gibraltarian company which, in turn, held shares in a Spanish company whose only asset was a property in Spain, did not have to pay NWT.

Likewise, the High Court of Justice of the Balearic Islands, in a judgment issued on 3 December 2020, ruled in a similar case that a non-resident individual was not subject to NWT, although both the individual and the foreign company were tax resident in Germany and the double tax treaty between Spain and Germany allowed such potential taxation.

Following this judgment, the more recent binding ruling V2070-21 of 9 July also concluded that two individuals who indirectly owned a property in Spain through a UK company were not subject to NWT, which represents a change of approach by the SGTD. Time will tell if, as taxpayers hope, this criteria is finally consolidated.

8.2. Can a non-Spanish resident deduct a mortgage from the value of a property in the NWT?

NWT legislation allows non-resident taxpayers to deduct from the value of their Spanish-based assets and rights the following items: (i) liens and encumbrances over such assets and (ii) debts to invest in such assets.

Accordingly, the value of a mortgage should in principle be tax-deductible from the non-resident's NWT amount. However, the SGTD held in its binding ruling V0590-13 of 26 February that mortgages could only be deducted when they secured debts used to acquire the Spanish-based property. This criteria, which is contrary to the literal wording of the law (which does not establish this requirement) hardly seems compatible with the very nature of a mortgage, which constitutes a lien over the real estate asset and results in a decrease of its market value. On the contrary, Spanish tax residents are undoubtedly allowed to deduct the mortgage from the value of the property, irrespective of the use of the secured debt.

Fortunately, a recent judgment of the High Court of Justice of the Balearic Islands dated 28 April 2021 (case 610/2020) stated that "*if the legislator's intention was for non-resident taxpayers to only deduct mortgages if the secured debt was used to acquire the underlying property, it would have been more precise*" (as it is explicitly required for unsecured debts). This interpretation, with which we agree, is in accordance with the literal wording of the law and avoids unjustifiably discriminating against non-residents who own Spanish properties.

Nevertheless, we do not expect the tax authorities to change their criteria until the Supreme Court decides on the matter, especially in cases where the mortgage is only granted to reduce the NWT tax liability (as in the case of binding ruling V0590-13).

8.3. Some observations regarding trusts and private foundations

The legal concept of trusts does not exist under Spanish law nor has Spain ratified The Hague Convention of 1 July 1985, regarding the law applicable to trusts and their recognition. This makes it very difficult to qualify the nature of the underlying relationships from both a civil and tax perspective.

Both the Spanish tax authorities and the courts have generally considered trusts tax transparent instruments, the transactions being directly carried out between the settlor, the beneficiaries and the trustee, as if the trust did not exist at all. The SGTD supports this criterion in binding rulings V3316-20 of 6 November, V2033-20 of 19 June, V1256-2020 of 5 May and V3394-19 of 11 December, among others. As a consequence, identifying the owner of both the assets and the income for Spanish tax purposes requires analysing the trust deed of incorporation, the articles of association and any other relevant documents, the settlor's potential right to revoke the contributions made to the trust and the settlor's and beneficiaries' power to use, decide over and dispose of the assets.

In practice, this means that the transactions are treated very differently for tax purposes than in other jurisdictions. For instance, the contribution of Spanish-based assets to a trust could qualify as a donation by the settlor to the beneficiaries and thus be subject to Spanish IGT. Similarly, creating a trust as a result of the settlor's death could be considered a *mortis causa* acquisition of the Spanish-based assets, which would again be subject to IGT. One final example: given that trusts are not recognised in Spain for tax purposes, the settlor or the beneficiaries could be subject to Spanish NWT for owning assets located in Spain and to Spanish NRIT for the income those assets generate (although this will depend on the provisions of the applicable double tax treaty between Spain and the tax residence jurisdiction, if any).

In sum, in view of the above it would be greatly advisable to carefully review these fiduciary structures before using them to invest in Spain, and if any of the persons involved is (or intends to become) tax resident in Spain.

Another typical legal instrument in certain jurisdictions but unknown in Spain are private interest foundations (e.g. the *anstalt* or *stiftung* in Liechtenstein, the *stichting* in the Netherlands or the private interest foundations in Panama). Generally, these instruments aim to manage protected wealth, created with the founder's contributions, for the benefit of its beneficiaries. Unlike trusts, however, private foundations have their own legal personality and can therefore have rights and obligations.

Therefore, unlike trusts, foundations are not considered tax transparent from a Spanish tax perspective. Consequently, contributions in favour of foreign foundations of assets located in Spain will be effective, provided that the contributing founders actually dispose of the assets and do not retain ownership or any control over them. Thus, for example, the SGTD has held that the founders will not be taxed under the NWT for assets contributed to a private interest foundation if they do not retain any rights over such assets, nor will the beneficiaries of the foundation, as any rights they hold are a mere expectation that cannot be quantified economically (binding ruling V0820-14 of 24 March).

Therefore, once again, we should analyse whether the founders have definitively divested from the assets, with the foundation's board having to administer and decide how the assets are to be used in accordance with the articles of association and the founding deed.

If the conclusion is that the assets have left the founder's sphere of ownership and control, but have not yet reached that of the beneficiaries, the tax effects that may arise in future when the beneficiaries of the foundation actually receive the assets or rights located in Spain will need to be considered. According to the SGTD's binding rulings (see V0781-16 of 25 February, relating to a Liechtenstein foundation) transferring assets in favour of the beneficiaries, either during the founder's lifetime or after their passing, would be subject to IGT as a donation made between strangers, as there is no kinship relationship between the foundation itself and its beneficiaries. On the one hand, the fact that there is no kinship means that the relief provided in the IGT regulations depending on the type of asset transferred (family business, habitual residence, etc.) cannot be applied; and on the other, it triggers the application of the most onerous multiplier coefficients provided in the IGT regulations (which can be as high as 2.4).

As with trusts, asset ownership schemes through private interest foundations should be carefully analysed whenever any of the parties involved is or intends to become Spanish tax resident or if any of the assets the founder contributes is located in Spain. Otherwise, there could be adverse tax consequences.

9. Final comments

The Spanish law taxes not only Spanish residents, but also non-resident individuals who have economic ties with Spain. While NRIT is also taxed in most other countries and should come as no surprise for non-resident investors, NWT and IGT may have more particular features that should be analysed carefully. Its is advisable to thoroughly review wealth taxation that may arise from holding investments in Spain and their potential future transfer, either *mortis causa* or *inter vivos*.

And this is not only because of these taxes' implications, which may be significant, but also because their laws are regularly amended, Spain's territorial organisation is complex (often resulting in significant differences between autonomous regions) and because the administrative authorities and courts have adopted conflicting criteria.

As mentioned throughout this article, some of the tax authorities' interpretations may be considered *contra legem*, particularly as they introduce additional requirements that are not in the law. Although the courts are reversing some of these criteria, some of the analysed matters will continue to be uncertain until the Supreme Court decides on the matter.

Regarding the law itself, some provisions still appear to unjustifiably differentiate between residents and non-residents. Although some historical discriminations have been progressively resolved, there are still doubts as to whether other aspects of NWT and IGT respect EU freedoms.

Finally, both taxes are again at the centre of public debate, which might lead to new legal developments in the near future. While the suppression of the NWT — as some players have long been calling for — does not currently seem to be the majority position, harmonising wealth taxation to do away with disparities between autonomous regions has openly been included in the political agenda.