



Wealth Tax on non-residents from outside the EU

Latest developments in the *Law on Measures to Prevent and Combat Tax Fraud.*

Property valuation and applicable regional legislation.

Tax Alert

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Wealth Tax on non-residents from countries from outside the European Union or the European Economic Area.

The recently passed *Law on Measures to Prevent and Combat Tax Fraud* allows for the application of regional Wealth Tax legislation to residents of countries outside the European Union or the European Economic Area (EEA) -Iceland, Norway and Liechtenstein-.

30 June 2021 saw the passing of the Law on Measures to Prevent and Combat Tax Fraud. Among an array of other developments, the above piece of legislation includes modifications that may affect the Wealth Tax (WT) of non-residents from outside the EU and the EEA.

Prevailing WT legislation in Spain

WT in Spain is governed by both **central government** and **regional** legislation (notwithstanding the “foral” regimes in place in the Basque Country and Navarre).

WT-related legislative powers with respect to the exempt minimum, the tax rate and credits and **allowances** have been devolved to the autonomous regions.

For example, Regional WT legislation in Madrid provides for significant benefits (**100% reduction to the tax charge**) that have in practice eliminated the cost of this tax.

Tax residents in Spain are entitled to apply the WT legislation of the autonomous region in which they reside.

Until the passing of this Law, individuals who were **not tax-resident** in Spain were entitled, **provided they were resident in the EU or the EEA**, to apply the WT legislation of the autonomous region that was home to the assets accounting for the greatest value with respect to their total assets in Spain.

DGT rulings and administrative precedents

In line with the legislation in force prior to this new Law, the Directorate-General of Taxes (DGT) had hitherto ruled out the possibility of applying regional WT legislation to non-residents from outside the EU, in contrast to the approach taken to Inheritance and Gift Tax (IGT) in such cases (*whereby the DGT itself and the Supreme Court, under Judgment TS19-2-18, allowed for such application*).

This is borne out by DGT Binding Rulings V0241-21 and V0676-19:

“... , the requesting taxpayer is tax resident in Mexico, and is therefore liable for Wealth Tax in Spain under the limited regime for non-residents, in respect of the assets and rights owned in Spain. As a resident of a third country from outside the European Union or the European Economic Area, Additional Provision Four of the Wealth Tax Law shall not apply. With this in mind, the applicable legislation shall be that of the central government only, and the regional legislation of Madrid may not be applied.”

Thus, prior to the new Law, and unlike in the case of IGT, past administrative decisions had ruled out eligibility for the tax breaks envisaged in regional WT legislation for non-residents from outside the EU or the EEA.

New development under the *Law on Measures to Prevent and Combat Tax Fraud*

The latest **development** following approval by the Upper House of the *Draft Law on Measures to Prevent and Combat Tax Fraud* consists of extending the potential application of regional WT legislation to non-residents from outside the EU or the EEA.

The recently passed Law amends the wording of Additional Provision Four of Wealth Tax Law 19/1991, granting **all non-residents** the right to apply regional legislation.

Non-residents are thus entitled to choose to apply either central government or regional legislation, which may entail very significant differences in certain cases. However, It is not possible to rectify the chosen option outside the voluntary filing period. The annual filing period for WT returns ends on 30 June of the year following the year to which the return corresponds.

Location of assets and rights for Wealth Tax purposes

The Spanish Civil Code draws a distinction between two types of assets:

- Immovable property

The property provided for and listed in article 334 of the Civil Code, such as land, buildings, constructions, etc. These assets are located in the region in which they are situated.

- Moveable property

Property capable of appropriation, not deemed immovable and, in general, all property that may be transported from one place to another without affecting the immovable object to which it may be joined (article 335 of the Civil Code).

The tax legislation does not specify the relevant location,

and it has thus fallen to the administrative authorities to rule in this regard in the various cases that have arisen.

Particularly noteworthy are those relating to financial assets such as security portfolios or bank deposits, with numerous rulings having been requested in relation to IGT (subject to a similar provision concerning the location of the greatest value of assets inherited by a non-resident in Spain).

- DGT Ruling V2660-15 notes that, rather than the registered office of the bank at which a deposit has been made, regard should instead be had to the factual reality of where the assets are located (e.g., branch at which the relevant account is held):

“For such purposes, in order to determine the regional IGT legislation applicable to the tax assessment, regard must be had to the place in which the assets accounting for the greatest value with respect to the total assets comprising the estate are located in Spain. In other words, regard must be had to the physical circumstance (the location of the assets and rights), as opposed to formal circumstances such as the tax domicile, registered office or place of effective management of the person or entity acting as depositary in respect of such assets and rights.”

- DGT Ruling V3310-20 had the following to say for IGT purposes with respect to current accounts:

“...the crux of a current account agreement is the availability of funds and the provision of the cash management service by the financial institution. Nonetheless, such services may be provided by various branches of the credit institution, making it difficult to identify the place in which the funds are deemed to be located, above all where the various branches are establishments subordinate to the principal credit institution, without their own legal personality, but rather one shared by all of the branches; namely, that of the credit institution, albeit with autonomy of action.

(...), a reasonable criterion should be established for identifying the location of the money deposited under a current account agreement (...)

(...), current account balances shall be deemed located in Spain where the current account pertains to a branch of a credit institution located in Spain and, at the same time, the services comprising the core elements of the current account banking agreement (such as the availability of funds, cash and payment and collection services) are mainly provided by that branch.

The current account agreement shall be deemed to pertain to the branch located in Spain where the IBAN (...), contains the numerical characters corresponding to such branch. Nonetheless, as regards the provision of the services comprising the core elements of the current account bank agreement, the DGT cannot rule on this matter, constituting as it does a matter of fact, and it falls to the requesting taxpayer seeking to enforce its rights against the competent tax management authority to provide the relevant evidence.

Valuation of assets and rights for WT purposes. New development as regards property valuation.

As a **further new development**, the *Law on Measures to Prevent and Combat Tax Fraud* rewords the rule on the valuation of immovable property for wealth tax purposes so that rural or urban property shall be valued:

*“At the greater of the following three values: The cadastral value, the value **determined** or reviewed by the authorities for the purposes of other taxes or the price, consideration or value of the acquisition.”*

The **determined value** is the new value to be compared with the pre-existing values: (i) the cadastral value (ii) the reviewed value and (iii) the acquisition value.

The highest of all of the above values will be used for WT purposes.

To date, the *reviewed value* was the value attributed to the property by the authorities following valuation review proceedings in respect of *inheritance and gift tax* or *transfer tax and stamp duty* (TTSD).

By introducing the term “**DETERMINED ... by the authorities for the purposes of other taxes**”, the Law introduces the **reference value** to be determined by the authorities each year based on the cadastral value for IGT and TTSD purposes to reflect the market value of the properties.

The new determined value is likely to be the highest in numerous cases, based as it is on the authorities’ estimate of the market value of the property and area, in light of actual transactions reported each year by public officials.

Given that the reference value (*determined by the authorities for the purposes of other taxes*) may exceed the value previously used for WT purposes (cadastral, acquisition or reviewed value), this may lead to an overweighting of property values and, in turn, to a **change in the regional legislation applicable to a NON-resident**, due to an increase in the value of the assets located in one region with respect to another.

EXAMPLE:

Take, for instance, a resident of the **United Kingdom** (non-EU) whose sole property or rights in Spain are:

- a bank account located in Madrid (*because the financial institution at which the account is held is located in Madrid*)
 - ✓ Balance at 31.12.2021: →€3,100,000
- A property in Marbella (in the region of Andalusia) the details of which are as follows:
 - ✓ Acquisition value: →€ 3,000,000
 - ✓ Cadastral value in 2021: →€750,000

WT cost under the former legislation

Prior to the latest reform, Madrid's regional WT legislation could not be applied, as the taxpayer in question is not resident in the EU. Although assets accounting for the greatest value of all of the taxpayer's assets were located in Madrid (€3.100.000 bank deposit in Madrid > Property worth €3,000,000 in Marbella) it could not apply Madrid's regional legislation. Until the new Law was passed, in our example, the WT for 2021 WOULD HAVE AMOUNTED TO **€72,454.37**.

WT cost following the passing of the new Law:

With this reform, non-EU residents may, if they wish, apply the legislation in force in the autonomous region in which the assets accounting for the greatest value with respect to their total assets in Spain are located.

In principle, in our example, the asset accounting for the greatest value of the taxpayer's assets in Spain would be the bank deposit located in Madrid (with a balance of €3,100,000 at 31.12.2021) rather than the property in Marbella (valued for WT purposes, in principle, at €3,000,000).

The WT costs for 2021 WOULD THUS AMOUNT TO **€0,000**, if Madrid's regional legislation is applied.

However, regard must also be had to another effect of the new Law: the new valuation of property for WT purposes.

If for example, as of 2021, the new value DETERMINED by the authorities for the purposes of other taxes corresponding to the property in MARBELLA were higher than the value of the assets located in Madrid, the taxpayer would not be entitled to apply the Madrid legislation but rather the Andalusia legislation.

Let us imagine that the new determined value of the Marbella property were €3,200,000 and the balance of the Madrid bank deposit at 31.12.2021, €3,100,000.

In such a case, the regional legislation of Madrid could not be applied and the taxpayer could only apply that of the central government (secondarily) or Andalusia (which has its own (higher) WT rate for 2021).

In the above example, the WT cost for 2021 would be: **€76,654.37** if the central government legislation is applied, or **€84,612.39**, if the Andalusia regional legislation is applied.

Entry into force of the reform and 2021 WT return

In general, the *Law on Measures to Prevent and Combat Tax Fraud* provides that it will enter into force on the day following the date on which it is published in the Official State Gazette (BOE), with none of the transitional provisions envisaging different deadlines affecting the subject matter of this alert

Having been approved and published in the Official State Gazette, and following its entry into force (before 31 December 2021, the date on which WT accrues for 2021), it will be effective for the purposes of the 2021 Wealth Tax return.

IMPLICATIONS

Non-resident individuals who own (or are looking to acquire) properties, assets or rights in Spain should seek advice on the application of regional legislation, having regard to the location of the assets accounting for the greatest value of all of the assets or rights they own in Spain.

As of the entry into force of the new Law, non-EU or EEA residents (e.g. residents of the United Kingdom, the Americas, Asia, Oceania, and Africa) will be entitled to apply the regional WT legislation of the autonomous region in which the assets accounting for the greatest value of all of their assets and rights in Spain, valued according to the valuation rules envisaged in the WT legislation, are located.

The composition, valuation and location of the property of non-residents located in Spain may entail major differences in the cost of WT.

Non-resident individuals are thus strongly recommended to seek advice on the most suitable asset structure, in view of the wealth taxes that may be levied in such connection.

Please do not hesitate to contact KPMG Abogados, S.L.P.'s Private Client and Family Business team if you wish to discuss any of these matters.

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