

# JC&A update report

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*Bringing our Clients up to date on relevant national and international fiscal matters.*

## **Spanish Inheritance and Gift Tax**

In this issue we focus on Inheritance and Gift Tax (ISD in Spanish), a controversial and historical tax, in force in almost all OCDE countries with the exception of Australia, Canada, Slovakia, Estonia, Israel, Mexico and Sweden.

In Spain, it is not the estate of the deceased which is taxed but each and every one of the beneficiaries of the estate, according to their share in the state, relationship, current residence, existing wealth in Spain, etc. The heirs are the taxpayers.

Resident heirs are subject to ISD on worldwide assets to be inherited (personal obligation). Non-residents are subject only on Spanish assets or rights (real obligation).

ISD is under State jurisdiction when the deceased or the heirs are not resident in Spain. Taxation of residents is transferred to each of the Regional Governments with different rules applicable.

There are 8 of the 17 Regional Governments in which parents, children and spouses of the deceased practically pay nothing (e.g., in the *Basque Country* there is no ISD for those relatives, in *Navarra* there is a flat rate of 0,8%, in *Madrid* the final tax bill has a 99% bonus, etc.). In *Andalucía*, there is no tax to be paid if the value of the share on the estate does not

exceed the amount of 175.000 Euros and the existing wealth of the heir in Spain is lower than 402.678,11 Euros. But if the estate exceeds 175.000 Euros, there is no threshold applicable. Regional policies for tax competition have created a discriminatory regulation for residents.

## **Regulations governing ISD**

ISD is governed by State Law 29/1987, developed by RD 1626/1991. The tax was transferred to Regional Governments developing their own regulations.

Internationally, ISD is regulated only in 3 Double Taxation Treaties: France, Greece and Sweden.

The EU has no competence to regulate ISD but some rules have a substantial impact, like Regulation EU/650/2012 on jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments in matters of successions and on the creation of a European Certificate of Succession. Or the applications of the provision for free movement of capital between Member States avoiding double taxation or discrimination on tax benefits applicable because of the place of residence or location of assets.

## **Regulation changes adapting to European Court of Justice resolution**

The Spanish Government made a tax reform in 2014 modifying Personal, Corporate and Non-resident Income Tax Act, and VAT. Inheritance Tax was initially included in the project but its reform was shifted to future Regional Governments Financing reform.

The ECJ ruled on 3 September 2014 against Spain for breaching the Treaty on the functioning of the EU as well as the Agreement on EEA, considering that Spanish legislation for inheritance tax discriminated between residents and non-residents.

On 25 September 2014, the Government submitted a number of amendments in urgency partially modifying the Law of ISD applicable to non-residents, approved by Law 26/2014 on Personal Income Tax, in force on 1 January 2015. The reason for such haste probably lies in the fact that once the Spanish law that contravened EU rules was declared invalid, it was null and void since its origin and not from the judgment, meaning that it was not possible to request this tribute to the taxpayers.

Prior to the tax reform, if the deceased was non-resident in Spain, the State Tax Law was applicable. After the reform, the Tax Law applicable when the deceased is resident in EU/EEA is the Law of the Region where the asset of higher value is located.

This way, spouses, children and parents that inherit from a non-resident in Spain pay now the same as those inheriting from residents. ISD is still under State jurisdiction but the heir can choose applying for the most favorable Tax Law, State or Regional as follows:

- a) Deceased resident in Spain
  - Heirs resident in the EEA: regional regulations corresponding to the residence of the deceased.
  - Heirs Non EEA residents: State regulations.
- b) Deceased resident in EEA but not in Spain
  - Heirs resident in the EEA: regional regulation where the assets of highest combined value are located.
  - Heirs Non EEA residents: State regulations.
- c) Deceased resident out of the EEA: State Law regardless of the residency of the heirs.

But the regulations applicable from 1 January 2015 could still be discriminatory. A practical example:

A Dutch national resident in Madrid dies leaving his properties in Madrid and The Netherlands to his three children, one resident in NL, one in Marbella and one in US. The heir resident in Spain will settle the tax in Madrid paying almost nothing for both properties. The heir resident in NL will settle the tax on the Spanish property to the State but under Madrid regulations, paying nothing. The heir resident in US will be subject to State settlement under state law, with almost no reductions.

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## **Proposals of tax reform issued by the Committee of Experts in March 2014**

At the end of 2013 the Government entrusted a Committee of Experts to study our complete domestic legislation to help them with the tax reform, comparing with the legislation of other countries and proposing measures and actions. The proposals 55 to 60 on ISD can be summarized as follows (non-binding):

- To harmonize national and regional legislations
- To introduce a threshold of 20.000 to 25.000 Euros
- To reduce the groups of relationship to three: family members, collateral relatives and others
- To apply a reduced, medium and high tax rate to each of the above groups
- To set a reduced tax rate at 4-5%, medium at 7-8% and high at 10-11%.

## **The Outlook**

The Treaty on the Functioning of the European Union also prohibits restrictions on the movement of capital between Member States and third countries, which has been ignored by our lawgiver so this reform does not fully comply with the mandate or its jurisprudence.

The discrimination in tax treatment between residents and Spaniards may be unconstitutional for violating our principles of equality, tax justice and legal security.

The Government plans to reform the Inheritance Tax in 2015 within the Regional Finance system, as announced.

Therefore, it is expected that there will be substantial changes in the Inheritance Tax in Spain. And 2015 is an electoral year so popular measures could be taken to attract votes.

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