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Spanish Wealth Tax: Are Non-EU Taxpayers Paying an Unfair Tax?

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According to the OECD's work "The Role and Design of Net Wealth Taxes in the OECD" (published on April 12, 2018, available here), very few OECD countries still apply net wealth taxes to individuals: in 2017, the list only comprises France, Norway, Spain and Switzerland. The report mentions that, in 2008, Spain introduced a 100% tax credit that *de facto* abolished Wealth Tax in Spain. However, since 2011, this credit's entry into force has been postponed year on year in the annual budget laws, which means the tax still applies.

The body of legislation on Wealth Tax has several remarkable factors. While the common aspects and main features of Wealth Tax are regulated by the central state legislature, the Spanish autonomous regions are in charge of levying and collecting the tax, and they also have the power to approve tax benefits. For example, the autonomous region of Madrid has approved a full exemption and does not levy Wealth Tax, while in other regions, the tax can be up to 3.75% of an individual's net wealth. As the reader can imagine, this situation causes striking asymmetries between Spanish taxpayers. Though all scholars have claimed for a full reform to end these distortions, the delicate balance of powers in Spain's political system has made this impossible.

Those asymmetries also affect non-resident taxpayers of the Wealth Tax because, to the extent they are subject to this tax with respect to their assets located in Spain, they are entitled to apply the regulations (including the tax benefits) approved by the autonomous region in which the majority of their Spanish-located assets are held. Obviously, this leads to a situation where a non-resident taxpayer faces an obvious incentive to locate their Spanish investments in regions like Madrid (which does not levy Wealth Tax), which means investing in assets in other regions is discouraged.

This contribution does not focus on the considerations that this situation can generate from an EU perspective, but special attention is paid to the crucial role the EU perspective plays when analyzing how non-resident taxpayers are taxed Wealth Tax.

The possibility for non-resident taxpayers to apply the regulations approved by the autonomous regions was introduced in Spain in 2014 (effective in 2015). At that time, the very same possibility was included relating to Spanish Inheritance and Gift Tax. This can be explained by the fact that Wealth Tax and Inheritance and Gift Tax share many characteristics, including the role autonomous regions play in its regulation and collection.

However, regarding Inheritance and Gift Tax, there is an important milestone that should be highlighted: the judgment of the European Court of Justice of September 3, 2014 (Case C-127/12, available here in Spanish) found that Spain breached the free movement of capital (guaranteed under article 63 of the Treaty on the Functioning of the European Union). This ruling was made because non-resident taxpayers were not granted the same possibility granted to Spanish taxpayers of applying the tax benefits approved by the autonomous regions. As the wording of the new law enacted in 2014 expressly mentions, the introduction of this possibility is an adaptation of Spanish legislation based on this judgment.

That said, a question still arises: did the Spanish legislature comply with the command given by the Court of Justice? Not exactly. The judgment was based on the principle of the free movement of capital, which guarantees this freedom to persons who are resident not only in the EU but also in other states. Therefore, one would assume that the possibility for non-resident taxpayers to apply the regulations approved by the autonomous regions would apply to all non-resident taxpayers (resident in the EU and outside the EU). Surprisingly, that was not the case: based on the wording of the ruling introduced in 2014, this possibility was only granted to residents in the EU or the European Economic Area, and residents in third countries were excluded.

It was the Spanish Supreme Court, through its judgement of February 19, 2018 (within a process that dealt with an action for civil liability against the Spanish State, discussed in Kluwer Blog here), that recently confirmed that taxpayers resident in third countries (in this case, Canada) should also be able to apply the tax benefits approved by the autonomous regions. This conclusion is also based on a judgment of the European Court of Justice (Case C-181/12, dated October 17, 2013, available here), which applied the same arguments to a case where a person resident in Switzerland inherited assets located in Germany.

There is already repeated case law of the Spanish Supreme court confirming that the EU free movement of capital obliges Spain to extend to third-country nationals all the regional tax breaks that apply to Inheritance and Gift Tax. So the question is quite straightforward: why have Spanish legislators still not approved a similar extension to Wealth Tax benefits? It may be argued that, in the reform approved in 2014, unlike Inheritance and Gift Tax, the article relating to Wealth Tax did not refer to the proceedings before the European Court of Justice. Therefore, at least in appearance, this could show that the introduction of the possibility of applying the regulations approved by the autonomous regions in the field of Wealth Tax is an internal decision in Spain, independent from EU parameters and the Court of Justice's scrutiny.

Is that a correct interpretation? We think it is not. First, because the Spanish Supreme Court has confirmed that tax benefits approved by the autonomous regions should be granted to any non-resident taxpayer through applying the free movement of capital. Second, because there are no grounds to argue that a different treatment should apply to Wealth Tax compared to Inheritance and Gift Tax when both taxes share an identical structure and shall be analyzed in light of the free movement of capital. The fact that the judgment of the Court of Justice of September 3, 2014, made reference only to Inheritance and Gift Tax is easily explained by the subject of those proceedings, which only concerned such a tax. However, this does not mean that the judgment's reasoning should not also apply to Wealth Tax.

Our conclusion is that, up until now, Spanish law does not allow taxpayers resident in third countries to apply the benefits approved by the autonomous regions relating to Inheritance and Gift Tax, nor to Wealth Tax. Regarding the former, the Spanish Supreme Court has already confirmed

that this outcome is unacceptable because it is contrary to EU law. Concerning Wealth Tax, currently, no case law refers to this tax, which, in our opinion, does not preclude taxpayers from applying the same reasoning and taking advantage of the tax reductions (or even exemptions), depending on the benefits approved by the autonomous region where the majority of their Spanish assets are located.

By way of example: any Wealth Tax paid in the past four years by an American, Swiss, Japanese, Australian, or Russian resident whose main Spanish assets are located in Madrid can be claimed and a full refund plus interest should be granted to the taxpayer. This taxpayer should no longer pay any additional Wealth Tax until the autonomous region of Madrid abolishes the current exemption of this tax. This issue is closely linked to the question about when Spanish politicians will agree on how autonomous regions should be financed, which is more a matter of state than a mere discussion on tax.

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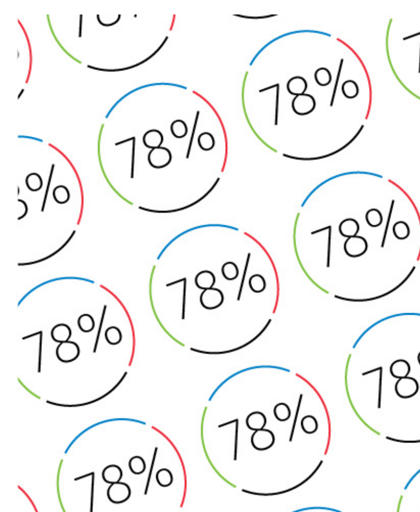

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