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NEWSLETTER

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Effects of judgment on inheritance and gift tax in Spain

Dear Sir or Madam,

This guest newsletter by our Morison International partners in Madrid gives you an overview of the current situation regarding inheritance and gift tax in Spain. This issue could be of interest to both Swiss people and people living in Switzerland who either own property in Spain or perhaps one day might inherit. Should you have any specific questions regarding this issue we are more than happy to connect you with our Spanish partners.

In Spain the inheritance and gift tax is a national tax, but its administration was transferred to the Autonomous Communities, so these bodies are able to create specific tax reductions and substitute the national regulation. As all of the 17 Autonomous Communities regulations are closely linked to the territory of the Autonomous region, these regional reductions only apply to cases where the successor or donee are tax resident in the Autonomous Community, respectively where the real estate is located in the region.

Already in 2007 there were warnings from the European Commission regarding incompatibility of the Spanish inheritance and gift tax rules with EU law. Spain did not see any discrimination and pointed out that this was in line with the grant of regional autonomy. As of September 3rd, 2014, the Court of Justice of the European Union gave judgment, since Spanish law in force violates the EU law in some aspects.

In the last years different Autonomic Communities have approved important bonuses that practically eliminate the tax when the income is obtained in their territory, bonuses that do not exist in the national regulation applicable to non-residents.

Let's show the differences with an example: Three brothers, all of them older than 21 years, acquire by mortis causa a house situated in Palma de Mallorca. One of them is living in Costa Rica, the other one is living in Germany and the youngest lives in Mallorca. The late was a Madrid's resident.

Under the current regulation the two brothers living outside Spain are non-resident tax payers so they cannot profit from any deductions, but the youngest living in Mallorca will be beneficiary of the autonomic deductions of the Madrid Community (the community of the late), that may considerably reduce the final tax to be paid.

In the opposite sense if the father (still living) would decide to donate the house in Mallorca to his three children, the economic benefit occurs in the Autonomic Community where the real estate is situated. In this case the son living in Mallorca will be affected by the deductions applicable to the residents in Mallorca (Community of Islas Baleares), but the other two brothers will not have the right of deductions because they are non-residents.

A closer look at the Judgment of the Court of Justice makes it clear why these regulations cannot be applied. Since the tax benefits could not be reached by the non-residents, the inheritance or gift will be reduced, and this is in breach with the free movement of capitals provided for in Articles 63 of the Treaty on the Functioning of the European Union ("TFEU"). Due to the bilateral contracts this therefore also applies to Switzerland. It also concluded that the situations between resident and non-resident and real estate located in Spain or abroad are comparable and therefore the tax treatment should be the same.

The Experts Commission for the Modification of the Spanish Tax System, concludes that "In order to obtain an improvement in equality, we should avoid all deductions to the tax that do not have a strong support in the economic point of view." Taken into account that the Spanish inheritance and gift tax rates are the highest in Europe, (rising in some cases up to 81.6%), another problem is the over-taxation of non-residents, to whom the tax advantages are non-applicable.

Spanish Administration decided not to face the challenges right now, and delay the responsibility until at least 2016. The judgment can nonetheless be applied from now on.

This opens the possibility to request a refund for taxes unduly paid within the 4 years statute limitation since the term for voluntary payment ended. Even beyond this 4 years statute limitation period there is a possibility to file a complaint - within one year from the publication of the judgment - against the Spanish State for having kept in force a legislation that was clearly in breach with the Fundamental Freedoms of the EU. If you were affected by Spanish inheritance or gift taxes, it is advisable to seek professional advice.

Kind regards
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