PERSONAL TAXATION IN SPAIN – DOUBLE TAXATION

This is a series of notes about personal taxation in Spain covering

- Am I tax resident and do I need to submit a return
- Rates and allowances
- Double Taxation
- Installing the PADRE system
- Completing and Submitting the Padre System
- Completing the Form 210 (for non-residents)

This note covers Personal taxation in Spain – Double Taxation

Introduction

The first principle of taxation is that income (pensions, salary, capital gains, savings etc.) are always taxed in the country of receipt. However, some people live and work in different countries. Others receive income (pensions, interest etc.) in one country, but live in another.

The second principle of taxation is that if you are considered tax resident in a country, then you will be subject to the tax laws of that country, and be subject to taxation on your income and assets. It is possible therefore to receive income which is taxed in one country, which is also liable to tax in another. A number of countries tax residents on their worldwide income and assets.

Consequently, in 1963, the Organisation for Economic Co-operation and Development (OECD) published a draft model double taxation agreement (DTA) which was intended to form the basis of double taxation agreements between member countries. The purpose of this was to ensure that even though income could be taxed in both countries, the agreements were designed to ensure that credit was received for the tax already paid. The model has been revised a number of times.

Both Spain and the UK have agreements with each other, and with other countries. This note considers the DTA in place between them, although, because they are generally based on the ECD model, other agreements are generally similar.

The current DTA between Spain and the UK was signed on 21st October 1975 and came into force on 25th November 1976, but was effective from 1st January 1976. The reason this is important is that a new agreement was signed between the two countries on the 14th March 2013, but is still awaiting parliamentary approvals. It is likely that this will be sometime this year. The agreement is broadly similar, with a lot more detail, but there some changes that will be touched upon later in the note.

Scope of the Double Taxation Agreement (DTA)

The DTA covers the following taxes: Income tax (individuals), Corporation tax, Income tax (non-residents), Capital tax, Income tax (non-residents), Local taxes on income and capital. The latter two relate to Spain only.

It also covers the following income streams Immovable Property (including rent), Business Profits, Dividends, Interest, Royalties, Capital Gains, Employment, Fees, Pensions Government Service Income, Students, Other Income

This note focuses on Income tax for individuals and the relative income streams

Fundamental Principles

If you are a resident in one country, and receive income in another, you cannot choose where this income is taxed; it is determined by the DTA. It is either taxable in Spain, in the UK or in both countries. Where it is taxable in both countries, then you will be allowed a credit for any tax paid, upto the amount of tax payable in the other country.

This is a really important point as the DTA is quite specific about how relief for tax paid in one country can be claimed in another. It says that relief can be claimed as follows:

"Where a resident of Spain derives income or owns elements of capital which, in accordance with the provisions of this Convention, **may** be taxed in the United Kingdom, Spain shall allow as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in the United Kingdom"

The key word in this clause is **may**. This means the relief is allowed for income which is taxable in both countries, not for income which is taxable only in one country e.g. private pensions, capital gains

Unfortunately, knowledge of the DTA is very poor. When times were good, Spain didn't bother about this, and all the professional advice was to just offset any tax already paid. However, now they are looking to increase the tax revenue, it is possible if they review your return that they may require you to pay the full tax due, and reclaim it from the UK, which they are entitled to do. It's quite easy to reclaim, and you reclaim it on the same form as you apply for an NT (No tax) code (Form Spain Individual). It takes about 6 weeks to obtain a refund from the UK

The key point here is that they can go back 4 years, so if they pick your return, you could be asked to pay the tax for 4 years (plus fines and interest) and then claim it back from the UK.

Examples of Application

On the basis that the main audience for this note are resident in Spain (living here more than 183 days a year) with income streams in another country, these examples are based upon income received in the UK by a resident of Spain.

Pensions

State and /or private pensions are taxable only in Spain. You should apply for these to be paid gross in the UK (using Form Spain Individual) as under the DTA the tax is payable in full, and should not be offset, although many gestors operate it this way.

Government Pensions (GP) are taxable only in the UK; they may not be taxed in Spain under the DTA. At present they don't even need to be declared. However, when the new DTA is introduced, Spain will be able to take the income into account when working out your marginal rate of tax in Spain. This is a standard clause in the OECD DTA. What this means in practice is that if you have no other income which is taxable in Spain (e.g. state pension, interest, rental income etc.) then it will have no impact (until you start drawing your state pension). If you do have any other income, then the way it works is that they take your GP into account when working out your total income. They then work out the amount of tax you WOULD pay if it was taxable in Spain. This amount is then divided into your total income, and the resulting percentage is your marginal tax rate. This rate is then applied to any income that is taxable in Spain.

My estimate is that if your income taxable in Spain is more than €7,000 (basic UK state pension) and your GP is around €2,200 (under 65) or €3,000 (over 65) then you will pay more tax. This is based upon individual tax submissions.

Employment Income

If you are employed by a UK company, but carry out your work in Spain, then your income is taxable only in Spain, unless you also carry out work in the UK, in which case, some of your income may also be taxed in the UK, relative to the amount of time you work there. In this situation it is important to read the Statutory Residence Test, to determine your residency as far as HMRC are concerned. In addition, if you work in Spain, you should pay Spanish Social security (not UK national insurance).

Rental Income

Rental income earned in the UK is always taxable in both countries. The allowances by Spain are very generous, with the same types of expense deductions as the UK, and then only 40% of the net income liable to tax. Whether you will pay any more tax in Spain will depend upon your income streams, and where they taxed. For example, if you have a state and/or private pension, which is taxable in Spain, and rental income in the UK, then because of the tax allowance you may not pay much tax, if any. However, even though the allowances are more generous in Spain, if your personal allowances have been used up by your personal income, the net rental income may be taxable.

Interest Income

Interest earned in the UK is taxable only in Spain. However, under the current DTA, if you receive interest net of tax, you can only reclaim the excess over 12% from the UK, so this is the amount can be offset. Having said, this will change in the new DTA, and you will be able to reclaim the full amount from HMRC.

Form Spain Individual

As mentioned above, the Form Spain Individual is the correct form to complete, to apply for a refund of any tax paid that is subject to the DTA plus it also requests future income to be paid gross. You are supposed to complete the form and then hand it into your local Hacienda to sign and return to the HMRC.

However, HMRC will also accept the form if it accompanied by a Certificate of Fiscal Residency, which you can apply for online.

Useful Links Below

Double Taxation agreement

Statutory Residence Test – NB Reading this will give you a headache.

Online Tool for SRT (beta)

Apply for Certificate of Fiscal Residence NB – you will have to enter the amount of income you declared on your return, so you will need a copy to hand, for the year in question

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